

Thomas M. Sullivan: Give small business a break from Sarbanes-Oxley

Thomas M. Sullivan, The Examiner
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The microprocessor, air conditioning, the pacemaker and the safety razor. All of these inventions were made by small firms that grew large due to their success, transforming their industries because of their superiority — and the existence of readily available capital markets. However, those markets could be closed to the next generation of small, innovative firms if regulators succeed in imposing costly reporting requirements that discourage a private firm's decision to go public.

This is the situation the U.S. Securities and Exchange Commission (SEC) is confronted with as it considers how to implement section 404 of the Sarbanes-Oxley Act of 2002, which would require small companies to obtain expensive outside audits for reports on internal controls. The Office of Advocacy of the U.S. Small Business Administration strongly recommends that the SEC provide some flexibility for small companies to comply with the Sarbanes-Oxley Act without incurring costs that could inadvertently shut the door to capital markets.

Since 2002, my office has worked with the representatives of small entrepreneurial companies that have consistently informed us that these new requirements will effectively close the capital markets to all but the largest companies. Their concern is backed up by the results of industry surveys that have shown the new audit requirements are prohibitively expensive for small business. In fact, a survey of actual compliance costs conducted by Financial Executives International recently found that for the smallest of public companies surveyed, the first-year compliance costs alone exceeded \$1 million.

The question small private firms have to ask is whether or not it makes sense to raise capital by going public, given the new costs of complying with section 404 of the Sarbanes-Oxley Act. Moreover, in a global marketplace the competitors of small private firms can be innovative companies from other countries. These firms may not be saddled with the costs of complying with Sarbanes-Oxley when they go public elsewhere, thus putting them at a competitive advantage over similar firms here in the United States.

These new costs could prevent the next firm with an idea like the microprocessor from using capital markets to grow. We must act now to ensure that this country does not forever shut its capital markets to small, growing, private firms.

So far, the SEC has taken an active role in ensuring that its rules under the Sarbanes-Oxley Act do not unduly harm small business. Hopefully, the SEC will continue its efforts to choose responsible public policy that encourages small business growth.

In 2005, the SEC created the Advisory Committee on Smaller Public Companies, which includes more than a dozen representatives of investors, public companies, securities professionals and academics. The committee's charge was to review the statute's requirements and make

recommendations to minimize its harmful impact on small business. The advisory committee met publicly across the country over the course of 11 months, solicited testimony from members of the public, investors and a wide range of industry participants, and kept a public record of its activities on an SEC Web site.

Now, the advisory committee has completed its assigned task, and voted on April 20 to recommend that the SEC defer the implementation of the new section 404 internal control audit requirement for small companies until there is an adequate framework in place to account for differences in size between smaller and larger companies. The recommendation would still allow companies to “opt-in” by providing audited reports of their internal controls to investors; meaning that if after a few compliance cycles it becomes apparent that the internal control reports are valuable enough to investors to boost share values, those small companies may perform them. However, the recommendation allows small companies to continue to participate in public capital markets without expending more than a million dollars to comply with the new Sarbanes-Oxley reporting requirements.

The Office of Advocacy of the U.S. Small Business Administration supports the Advisory Committee’s recommendation. I hope the SEC acts to keep our capital markets competitive and open to small companies.

*Thomas M. Sullivan is the chief counsel for advocacy, Office of Advocacy, U.S. Small Business Administration.
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