



Highlights of [GAO-06-361](#), a report to the Committee on Small Business and Entrepreneurship, U.S. Senate

Why GAO Did This Study

Congress passed the Sarbanes-Oxley Act to help protect investors and restore investor confidence. While the act has generally been recognized as important and necessary, some concerns have been expressed about the cost for small businesses. In this report, GAO (1) analyzes the impact of the Sarbanes-Oxley Act on smaller public companies, particularly in terms of compliance costs; (2) describes responses of the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) to concerns raised by smaller public companies; and (3) analyzes smaller public companies' access to auditing services and the extent to which the share of public companies audited by mid-sized and small accounting firms has changed since the act was passed.

What GAO Recommends

SEC should (1) assess sufficiency of internal control guidance for smaller public companies, (2) coordinate with PCAOB to ensure consistency of section 404 auditing standards with any additional internal control guidance for public companies, and (3) if further relief is deemed appropriate, analyze the unique characteristics of smaller public companies and their investors to ensure that the objectives of investor protection are met and any relief provided is targeted and limited.

www.gao.gov/cgi-bin/getrpt?GAO-06-361.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear, (202) 512-8678 or shearw@gao.gov, or Jeanette M. Franzel, (202) 512-9471 or franzel@gao.gov.

SARBANES-OXLEY ACT

Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies

What GAO Found

Regulators, public companies, audit firms, and investors generally agree that the Sarbanes-Oxley Act of 2002 has had a positive and significant impact on investor protection and confidence. However, for smaller public companies (defined in this report as \$700 million or less in market capitalization), the cost of compliance has been disproportionately higher (as a percentage of revenues) than for large public companies, particularly with respect to the internal control reporting provisions in section 404 and related audit fees. Smaller public companies noted that resource limitations and questions regarding the application of existing internal control over financial reporting guidance to smaller public companies contributed to challenges they face in implementing section 404. The costs associated with complying with the act, along with other market factors, may be encouraging some companies to become private. The companies going private were small by any measure and represented 2 percent of public companies in 2004. The full impact of the act on smaller public companies remains unclear because the majority of smaller public companies have not fully implemented section 404.

To address concerns from smaller public companies, SEC extended the section 404 deadline for smaller companies with less than \$75 million in market capitalization, with the latest extension to 2007. Additionally, SEC and PCAOB issued guidance intended to make the section 404 compliance process more economical, efficient, and effective. SEC also encouraged the Committee of Sponsoring Organizations of the Treadway Commission (COSO), to develop guidance for smaller public companies in implementing internal control over financial reporting in a cost-effective manner. COSO's guidance had not been finalized as of March 2006. SEC also formed an advisory committee to examine, among other things, the impact of the act on smaller public companies. The committee plans to issue a report in April 2006 that will recommend, in effect, a tiered approach with certain smaller public companies partially or fully exempt from section 404, "unless and until" a framework for assessing internal control over financial reporting is developed that recognizes the characteristics and needs of smaller public companies. As SEC considers these recommendations, it is essential that the overriding purpose of the Sarbanes-Oxley Act—investor protection—is preserved and that SEC assess available guidance to determine if additional supplemental or clarifying guidance for smaller public companies is needed.

Smaller public companies have been able to obtain access to needed audit services and many moved from the largest accounting firms to mid-sized and small firms. The reasons for these changes range from audit cost and service concerns cited by companies to client profitability and risk concerns cited by accounting firms, including capacity constraints and assessments of client risk. Overall, mid-sized and small accounting firms conducted 30 percent of total public company audits in 2004—up from 22 percent in 2002. However, large accounting firms continue to dominate the overall market, auditing 98 percent of U.S. publicly traded company sales or revenues.