RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE

on

SMALLER PUBLIC COMPANIES

Second Day of Meeting

June 17, 2005
9:00 a.m.

Columbia Law School
435 West 116th Street
New York, N.Y.
The following individuals were present in person:

Committee Members:

Patrick C. Barry
Steven E. Bochner
Richard D. Brounstein
C.R. "Rusty" Cloutier
James A. "Drew" Connolly III
E. David Coolidge, III
Alex Davern
Joseph "Leroy" Dennis
Janet Dolan
Richard M. Jaffee
Mark Jensen
Robert E. Robotti
Scott R. Royster
Kurt Schacht
Ted Schlein
James C. Thyen
Herbert S. Wander

Committee Observers:

George J. Batavick
Daniel L. Goelzer
Jack E. Herstein
SEC Staff:

Cindy Alexander
Anthony G. Barone
Gerald J. Laporte
Kevin M. O'Neill

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Wayne A. Kolins, National Director of Assurance and Chairman to the Board, BDO Seidman, LLP; Executive Committee Member, Center for Public Company Audit Firms, American Institute of Certified Public Accountants  Page 41

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PROCEEDINGS

HERB WANDER, Presiding:

1     MR. WANDER: Good morning, everyone. I
2     am Herb Wander, Co-Chair of the Advisory Committee.
3     I would like to welcome all of you. We have a much
4     bigger audience than we did yesterday, although
5     from hearing comments from a number of you, many of
6     you did listen in to the webcast of our session
7     yesterday, either while we had it or later in the
The purpose of this morning's session is to have our invited guests and some who have asked us to speak to provide us with information, facts, and their analysis of how our Advisory Committee can stick-handle our way through all of the various regulations and try and streamline them and make them more user friendly for smaller companies without jeopardizing the benefits of the various laws that have been put in place to protect investors.

We thank all of you for coming. We are going to start off this morning and I'll give you a few housekeeping rules.

If you speak, you are supposed to touch the button and you will see this little red light go on. When you are finished, please turn the light off because I understand only three of the mikes can be alive at one time.

What we are going to do is have a short presentation by our first panel, each of the panel members, and then we will open up the questioning by members of the Advisory Committee. I will try
and -- if members of the Advisory Committee would raise your hands, I will try and mark down who is next to ask questions and please feel free to ask each other questions, our guests.

If there are any questions before we begin? If not, why don't we start, and I'll start with Ed Knight because he is the first on my list.

Briefly introduce yourself, Ed, to those of us here and in webcast land.

That's another thing. Because we are being webcast, please state your name so that people will know who is speaking.

MR. KNIGHT: Thank you, Mr. Chairman.

This is Ed Knight, I'm executive vice president and general counsel of Nasdaq. Thank you members of the committee for allowing us to appear today and for your service on this committee.

Nasdaq believes this is a very important committee. It deals with a critical issue for our economy, but also for Nasdaq. We are the home of many large companies, but we're also the home of many early stage, growing, smaller companies. And the issues that you discussed
yesterday and that are on your agenda are critical
to us and I am going to comment on them briefly
today. I have a formal statement which I ask be
made part of the record and I will summarize that.
I will try to limit my remarks to a few minutes,
but if you could allow me, there are a number of
things that I want to touch upon.
Nasdaq does have, like the American
Stock Exchange and other stock exchanges, a unique
perspective in terms of the seat it has on the U.S.
economy to observe what goes on with smaller
companies and to see on the front lines what they
are experiencing with corporate governance with
Sarbanes-Oxley, with many of the critical issues
you are dealing with today.
A little bit of history: As you would
expect, in 2002, with the crisis in corporate
governance, we reviewed all our listing standards.
We did this with the help of a standing committee
that advises our board, the Nasdaq Listing Hearing
and Review Council, of which Steve Bochner we are
honored to have as a member of the committee and
made many contributions and had input from the
public on that.

We tried to reshape our listing standards with a few goals in mind that I will just briefly touch upon. One, we felt it was important to have mandatory listing standards, not just recommended best practices.

Two -- this is particularly, I think, important for smaller companies. We strive to have clear listing standards, unambiguous listing standards. We did not think if you were a small company and wanted to list with Nasdaq that you automatically needed to go out and incur a major legal bill to understand our listing rules. As much as we love the legal profession, we feel our rules ought to be as clear as possible on their face and we sought to do that.

Third is, it was very important for us to work into our rules that one size does not fit all. And this is a topic I know you are discussing in other areas. We worked particularly in the independent director definitions, how independent directors populate committees to deal with the issue of one size does not fit all.
Fourth, we felt it was very important to underscore the importance of timely and adequate disclosure. That is at the heart of our compliance systems. It is at the heart of getting investors' confidence around the market, so we have reemphasized in our rules the importance of timely and complete disclosure.

Lastly, it was do no harm. If we did not know what the likely result of a new rule was, we waited until we had the evidence. We did not want to harm the capital formation process in the United States.

We applied these principles, we adopted rules that gave smaller companies more flexibility, particularly in the independent director area. For instance, you can deal with the requirement of having all independent compensation or nominations committee in a couple of ways which small companies have found very effective. You can use the directors on the full board and not populate separate committees. Smaller companies with only seven directors found that particularly useful, that they didn't have to rush out and recruit new
directors. They could use the independent directors on their board for these functions.

We have since then worked very hard to streamline our listing rules wherever we can and to make clear the process of delisting, make it as transparent as possible and, as I said, reinforce the time limits that apply to companies who file late 10-K and 10-Q filings.

Emerging issues. What are the issues we see today, particularly since the beginning of the year, that are affecting small companies? Not surprisingly at the top of the list is 404, I know a topic that is receiving a lot of attention here today.

I want to underscore, this is not an issue of lack of support amongst our companies for Sarbanes-Oxley. We have done a survey of those companies and we found that 74 percent of them feel Sarbanes-Oxley is necessary. But it does appear that what we have in place right now is a fairly inflexible framework to deal with 404 obligations that is putting excessive compliance and control requirements on smaller companies. That is having
a cost impact that is disparate in terms of smaller companies as a percent of revenue. Smaller issuers, meaning issuers in our survey that had less than $100 million in revenue, appear to have spent eleven times more than companies who are on the larger side as a percentage of revenue.

The average cost for a Nasdaq company, as best we can tell from our survey result, is a million dollars, but some companies have spent as much as 15 million; and the total cost of 404 implementation, extrapolating some of these numbers and making some estimates, we conservatively estimate at $3.5 billion. On average, companies are spending two and a half times more than their fully loaded audit costs on 404.

There is new guidance out there, as you know, and I know you discussed over yesterday and in the past. To this point we are not seeing that that guidance is changing auditor behavior. We are still seeing a very conservative approach by the major auditing firms and firms helping companies with 404. That is 404. I want to come back to that with some suggestions of how some of these
issues can be dealt with, but in addition to that, we are finding companies are -- and in a related way are having trouble making timely filings, quarterly filings and annual filings because the Big Four auditors are dropping them as clients generally because they fall below the Big Four's risk profile. Since auditor resources are stretched very thin in these firms, the set of smaller companies that do retain national auditors often receive, frankly, less attention is what we are hearing, and they are put on a lower priority than the larger companies. This makes it more difficult for smaller companies to get back on track within a reasonable period of time and, therefore, we are seeing some results in our delisting process. So far this year we had to issue 60 delisting letters to issuers who failed to file forms 10-K. Last year only 14 were in that similar position at this point. What is contributing to this trend of late filing? One, auditors, as I alluded to earlier, are very risk averse, particularly when it
comes to smaller companies. Therefore, less well
established firms are often retained. These firms
do not have the national office structure and the
SEC relationships and, consequently, underwriters
are reluctant, we are finding, at times to
participate in transactions with these firms,
impacting smaller companies' ability to raise
capital.

I would also mention, thirdly, the
issue of smaller companies retaining and recruiting
CFOs, finance staff and internal auditors. That is
another frequent issue that we hear when people are
late with their filings. They are losing people,
they can't keep people in this area. It is a very
competitive market for talent. The larger firms,
of course, are spending to compensate individuals
at a higher rate and, frankly, individuals are less
willing to take these positions that have some
reputational risk associated with them, especially
if they are going to be paid less than a larger
company would pay.

Fourthly, I underscore that what we are
hearing from companies is some degree of being
overwhelmed with the disclosure obligations, particularly 8-K. We think perhaps additional time in that area to allow them to deal with their various disclosure obligations might be called for and ease some of the burden on them.

Getting back to 404, a couple of suggestions I would briefly recite. One, incenting the CPA firms away from overauditing. Understandably, many CPA firms are extremely sensitive that they will be judged as too lenient by the PCAOB. They feel they are getting squeezed on both sides and therefore are taking a very conservative approach. How those firms are evaluated I think is going to be critical in terms of how they provide their services to smaller companies.

Second, raising the level of materiality used for planning the scope of 404 and what must be reported as material. I know that was discussed yesterday. I think that is an important area and I know this committee is focusing on it, looking at, for instance, several measures that a company could choose from and clear measures as to
what is material for these purposes, such as gross
revenues, market caps or assets should be
considered.

Thirdly, permitting different forms of
evidence, particularly internal reports that are
used to monitor certain controls as opposed to
going out and creating new reports that entail
additional cost, and alternating the frequency of
control testing. Staggering internal control
assessments to mid-year to alleviate the year end
rush to evaluate internal control deficiencies and
allowing more flexibility for issuers to implement
mediation and premediation plans.

Lastly, in the 404 area, I mentioned
the good work of the COSO task force that I
understand is focusing extensively on smaller
business and trying to tailor a framework that
would be clear for smaller businesses in applying
the COSO model.

I want to emphasize that in terms of
Nasdaq's own experience, we are a public company.
We like to say we eat our own cooking. We apply
our listing standards to ourself, with SEC oversight, to ensure it is done in an arm's length manner, but we also comply with 404. From our experience we have urged our companies to look at this as an opportunity to continue to improve their financial reporting and, frankly, to urge them to embrace it as part of their culture and looking generally at minimizing compliance risk. But we are finding, given all that and given the efforts the SEC is making, that we are making to ensure that we can still have a place for small companies to enter the public capital markets, some companies are choosing not to do that.

This year in the first quarter 22 Nasdaq issuers voluntarily delisted compared to only 7 for the same period in 2004. This includes domestic issuers that elected to deregister and also foreign issuers who suspended and terminated their ADR programs. In each of these cases the companies explained their decisions by citing the increasing regulatory cost associated with being a public company.

We are also hearing from venture
capital firms that smaller issuers may be filing to become a public company, but they are doing it in part to attract interest in acquisitions, as an acquisition candidate, and not solely because they want to be a public company. Of course, if small businesses forego the lower cost capital raising opportunities afforded by public markets, in the long term I think that will adversely affect the economy.

Lastly -- I appreciate you indulging me with a few extra minutes here. I just want to mention the number one issue after 404 that we hear from our companies is a lack of research coverage. We have approximately 1,200 Nasdaq companies out of 3,200 that have no research coverage and 35 percent of all public companies have no research coverage. We think we have a partial solution for that supplied by the market that won't require regulatory action. We announced last week that in partnership with Reuters we are forming a new company to help public companies obtain independent analyst coverage. The independent research network will aggregate multiple independent research
providers and distribute that in an independent way
to investors and to the public. We hope that will
help deal with the lack of research coverage by
providing a distribution and function for those
companies.

Again, in closing, I want to thank the
SEC for establishing this committee and for
allowing Nasdaq to appear, and thank the members of
this committee for their service.

MR. WANDER: Thank you very much, Ed.

Why don't we go on to the rest of our
guests and then we will open it up for questions.
So, please, write down your questions for Ed and we
will follow up.

Next, Neil Wolkoff, we'd like to have
you introduce yourself and provide us with your
thoughts.

MR. WOLKOFF: Thank you, Mr. Chairman
and thank you, members of the committee, for the
invitation to be here. My name is Neil Wolkoff. I
am the chairman and chief executive officer of the
American Stock Exchange. As most if not all of you
know, the AMEX is a national exchange; it's part of
the national market system. While some of our
approximately 700 listed companies are large cap
stocks, companies like Imperial Oil, IVAX
Pharmaceuticals and Nabors Energy, the large
majority of our listed companies are small and
mid-cap stocks with market capitalization between
$50 million and $500 million.

Any regulatory system that has the
potential to disincentivize such companies from
listing is of course of vital importance to our
exchange and of vital importance to our listed
companies.

In preparing for my testimony today, I
want it to be noted, I am not an accountant. I
have never led a public company. I thought it
would be useful, however, since so many of our
listed companies are really the living, breathing
examples of the concerns of this committee, that I
would reach out to those companies and ask for
their opinions, both complaints and
recommendations. And as I proceed through my brief
statement, I will report on some of those ideas. I
think you will find them most useful.
Before doing that, however, I would like to follow through on my colleague's description of the listing process because I think it can be of great importance, particularly since so many of the concerns about Section 404 deal with the fact that it is a one-size-fits-all box that companies find themselves in. And to the extent that some of the recommendations and some of the thoughts concern either differentiating or layering of Section 404 compliance, I thought it might be helpful to explain a bit more about what the listing process really means as far as the regulatory scheme because, after all, this is a regulation that fits together with other regulations; it doesn't sit on its own.

With regard to the role of AMEX, which is a role that is shared by my Nasdaq colleague, we perform a thorough review of all applicants for listing on the exchange. The review consists of confirming objective information. The listing requirements are firm listing requirements. We look at financial condition and size of the applicant, but we also look at non-public sources
of information. We look closely at the background of the principals.

The review is conducted by a branch of the regulatory department, which does not report to me or other management and is, therefore, independent and not subject to the business pressures to approve companies for listing.

Based on the prelisting review and the ongoing monitoring of listed companies as well as given the threat of delisting, listed companies are exempt from Blue Sky requirements of individual states.

With that as background, many companies have complained about one size fits all and, in contemplating a layered or differentiated approach to applying Sarbox to small cap companies, I recommend you consider exchange listing as a mitigating factor in requiring full scale uniform 404 compliance.

With that, I would like to get into some of the comments. Without being repetitive, I think in the words of our own listed companies -- I would prefer, of course, not to be giving names.
Starting with some of the complaints dealing with the issue of segregation of duties in small companies. Over and over again people talk about how in a small company you are basically required, in order to be profitable, to have people wearing many different hats. One commentator says auditors expect to see segregation of duties, such as individual IT departments, et cetera. In small companies, head count alone does not allow for this segregation. In many cases the small companies, individuals act in multiple capacities.

Another comment on the same subject. Someone says, "We are not a large company. Therefore, we are limited in segregation of duties. Most of our employees perform a number of functions which make us efficient and profitable as shown by our past history."

Of course, a number of companies have talked about the cost of 404 compliance and the difference that this cost can make literally in
profitability or not. Just a couple of comments on
the cost implications. One commentator says "SOX
404 is a problem. Cost is very significant. This
includes both money paid to outside consultants and
auditors as well as time management we will spend.
We are estimating 400,000 to 500,000 dollars in the
first year. In good years, this is 30 to 50
percent of our earnings."

There are other examples not said quite
as dramatically or perhaps as melodramatically, but
the point is that the costs of compliance are
deemed to be quite a serious concern. Just as the
report -- I believe the Foley Group came out with a
report on the issue of relationships with auditors.
Several people commented on the impact that this
has had on the relationship that they have had with
their auditors, including one commented about a Big
Four firm -- if, indeed, there are four big firms
left. "After being with us for 35 years, they told
us they did not want to do our audit anymore. They
do not have the staff and are concentrating on
larger corporations."

Another one said, "External auditors
are now regulators and unable or unwilling to
provide technical expertise."

Another comment that made, I thought,
quite a bit a sense and would like to report came
from a couple of banks that are listed companies,
talking about the impact of multiple and separate
regulators, including Sarbanes-Oxley. So it is not
simply a complaint about the impact of
Sarbanes-Oxley, but the lack of coordination and
the inability to use the compliance with one set of
regulations to satisfy another. Just a couple of
comments. "The non-differentiation of SEC
requirements for regulated versus non-regulated
companies is frustrating, as a company such as ours
already has internal audits, external audits and
regulatory exams."

Another says, "I would like to believe
the opportunity exists to merge the information
acquired in all oversight to a combination of
Federal Reserve, FDIC and SEC reporting."

So, in addition to a complaint, you
might consider that as a recommendation.

Some other recommendations I would like
to get to that came in from our listed companies.

One generally says, "I suggest that requirements for smaller companies should be tailored to their size and should be discussed with their auditors for improvement, but should not result in extra cost to the company."

"Company size," another one says, "should be measured by revenues and not market capitalization. A small company with a large market cap must still rely on its revenues in order to maintain efficient operation."

As an aside, we find a number of applicants have market capitalizations in the pharmaceutical or biotech industries that are 100 or $200 million, yet no revenue because the market values the prospect of what the company is going to do. So you have a substantial market cap, substantial audit requirements, no revenue really to audit. So you might take revenue into account.

One commentator has a helpful recommendation and asks for additional guidance. It says, "While the cost of compliance with Sarbanes can be overwhelming, the recent guidance
provided by the SEC and PCAOB are helping us to manage and minimize these costs. Additional guidance which further addresses uniformity of testing will be helpful in the areas of cost control and program efficiencies."

Lastly, one commentator recommended that without necessarily changing the requirements of Section 404, simply extend the period of time over which full 404 audits are conducted. If SOX 404 applies to all companies, instead of an annual control review and auditor attestation starting in year one, the work could be phased in over several years, one or two areas could be picked each year for management to document and test internal controls followed by auditor review and attestation.

I hope my comments have been helpful to the committee. I hope I have been able to give voice to many of the concerns of the listed companies of the American Stock Exchange and I thank you very much for your time.

MR. WANDER: Thank you, Neil.

Next, Alan Patricof, co-founder of Apax
MR. PATRICOF: Thank you, Mr. Chairman and members of the committee for inviting me to appear here. I would like to preface my remarks by saying I strongly urge you and hope that you will take action, in whatever form it is, sooner rather than later in connection with this issue because it is becoming, has become a very, very important issue for young companies and the longer you delay implementation of revised rules, the more companies are going to be injured by the current regulations.

My name is Alan Patricof, and I am the co-founder of Apax Partners, a leading private equity firm operating both in this country, Europe and Japan. Our firm's range of activities run from early to later stage investments and we currently manage in excess of $20 billion dedicated solely to private equity investments. During the course of the past 35 years, I personally served on the board and committees of more than 15 public companies, most of which have been listed on Nasdaq, but several of which have also been listed on New York
Stock Exchange. In addition to that, I have been on many, many more private companies and members of my firm have been members of boards of a multiple of that number.

In preparation for this appearance, I have spoken in the last several weeks with at least ten of the companies with whom I am personally associated at the present time, each of whom has operated at different levels of market capitalization, revenue and profitability and most of whom are currently listed on Nasdaq, Small Cap board, Bulletin Board or Pink Sheets. It is a compilation of their concerns as well as my own inputs and personal experiences that I will communicate today with the hope that the committee will take these comments to heart when considering revisions to SOX compliance for small companies.

It goes without saying that the requirements under Sarbanes-Oxley are not only frustrating to the companies with whom I deal, but without exception have caused them considerable expense, diverted significant number of personnel to paperwork which they can ill afford to do and
changed the overall nature of their business
process to living in constant fear of violation of
some aspect of the regulations.

These problems have compounded the
already existing problems facing a small company in
meeting the requirements for Nasdaq listing and
complying with normal SEC reporting. While I
admittedly heard positive comments from several of
these companies on certain aspects of SOX, which in
no way as the law should be discredited, the
overwhelming majority of the comments I received
were of a constructive nature on how to improve
what these companies hope are evolving compliance
guidelines.

An area that came up in nearly every
one is the mechanisms that trigger Sarbanes-Oxley
compliance for small companies. The law, as
currently written, mandates SOX compliance for
those companies with market capitalization equal to
or greater than $75 million. The primary intention
of my appearance here today is to point out to you
that this is a totally arbitrary measurement by
which to mandate compliance and in the end will
unnecessarily cause small companies to suffer the 
burdens of being public which they can ill afford 
to incur.

In some cases it will cause them to 
delist and go private. In other cases, they will 
find ways of getting marketability for their 
companies on alternative markets such as the AIM 
Market in London where, based on my personal 
knowledge, many Israeli companies formerly listed 
on Nasdaq are now focusing their listing attention.

I will agree with the previous speaker that many 
companies are going through the formality of 
putting out offering memorandums with the real 
intention of advertising for merger and obtaining 
premature -- as a premature means of liquidity, 
rather than facing the burdens of being a public 
company in the United States.

Let me move on and recite to you some 
of the specific complaints repeatedly made 
regarding SOX legislation.

Market cap has no correlation to a 
company's resources or complexity. In today's 
world, virtually no company -- I emphasize. No
company can go public at less than a $75 million
market capitalization with a reputable underwriter.
Therefore, the only companies who will be excluded
under the current rules from compliance with SOX
are companies whose stocks have performed poorly in
the market and have fallen below their initial
market capitalization. They then face the problem
that if, for example -- I just took an arbitrary
example. They have a hundred million shares
trading at 60 cents a share or $60 million market
capitalization and are excluded from SOX, they may
have a run up in their price by a very modest
amount, say 25 cents a share, from 60 to 75 cents a
share, and they will now be in a position where
they will have to comply.

The result is that even those who are
under that level have to live with the possibility
that minor fluctuations can put them in a
regulatory position, so they really have to think
about being regulated under SOX even before the
event happens.

More to the point, I ask you a question
to which I do not have the answer. How does market
cap accurately reflect upon the size, stage and
operations of a company and resulting internal
controls that should be placed?

Number two, companies are being forced
to add employees or hire independent contractors in
addition to literally thousands of hours on the
part of their own employees, and I repeat,
thousands of hours, at significant cost to assist
them in the SOX implementation process and ongoing
SOX compliance. In addition to these incremental
costs, they are diverting attention of existing
employees from critical day-to-day functions.
Ironically, this is, unfortunately, caused in some
cases internal personnel to temporarily divert
themselves from their own internal audit functions
which had been in process in order to comply with
SOX.

Number three, as a result of the change
in the accounting industry and consequent pressure
from institutional investors and retail investors,
increasing importance has been placed on using a,
quote, Big Four accounting firm. As a result,
small companies, who are the least prepared to
negotiate, are increasingly facing oligopolies, causing a disruption in a normally balanced relationship between a company and its accounting firm. Young, small companies are now in constant fear that their auditor will either abandon them because of the pressure of business from more profitable, larger companies to do work that makes no business sense or increase their auditing fees. That is the alternative.

At the same time, an unnatural relationship is developed between the companies and their auditors as accountants have become more gun shy about taking a risk-focused approach to their audit. Rather, accountants are frequently defaulting into a position of letting process take over from substance. In this regard, the auditors themselves are constantly referring to their own concerns with the pressures from PCAOB compliance. Over all it is this dynamic that has caused the relationship between auditor and company to go from cooperation and consultation-focused to adversarial.

Number four, directors themselves have
become overly concerned by SOX, in particular 404,

making it more difficult to get directors for any

board, much less a small company board. In

addition, directors, in order to attract them to

serve, are receiving higher fees and are requiring

higher levels of directors and officers liability

insurance as they are increasingly concerned with

their own personal liability.

Five, lastly, another consideration is

that under SOX small companies are being painted

with the same brush that large companies face and

they are disproportionately less able to meet those

challenges.

As a result of the foregoing, I would

like to specifically recommend some or all of the

following elements be incorporated into

legislation.

Number one, change the mechanism for

mandating SOX compliance to $75 million of annual

revenues, not including revenues from research and

development fees as referred to a minute ago from

biotech companies, rather than a $75 million market

capitalization. This would be a much more
appropriate measurement that would preclude a great
many more companies who are at the early stage of
development from mandatory SOX compliance. In
today's world, a $75 million revenue company is not
a large company. It is a small company. If one
takes into consideration the potential
profitability from a company at that size -- and I
hope you can follow my math here -- and assumes the
incremental cost from Sarbanes-Oxley are at least a
million dollars, as I constantly hear, and have
heard much larger numbers and been cited much
larger numbers, I have found -- as I have found
through my conversation, and even if you apply a
high profit margin to a $75 million company you
will find that in general terms you are talking
about ten to twenty percent of pretax profits being
applied to SOX compliance if they do have profits
which is far beyond what a business can tolerate
for process.

But in addition to that, you have to
add all the costs of requirements from Nasdaq and
SEC requirements. Under the circumstances, I would
consider this a reasonable compromise, namely a $75
million figure since a company has more foresight into its projected revenues and, thus, more ability to plan for meeting this threshold than it does for planning to be at a $75 million market cap.

Two, even if a company is slightly below the $75 million level, say 50 to $75 million in revenues, I would suggest you develop a form of Sarbanes-Oxley Light, which would include certain elements that are essential to you as the committee and to the SEC and with which no one could disagree that should be continued. This would help to gradually prepare these companies for full SOX compliance. This would include procedures such as the CEO and CFO signing off on the financial statements, the requirement for the establishment of certain committees, the need and composition for independent directors, et cetera. You can add whichever ones you, as the committee, think are the right, key elements to be include in this Sarbanes-Oxley Light approach. But, most importantly, this would include a dramatic reduction in Section 404 controls, which is the major stumbling block and the major cost item in
relation to SOX.

Number three, I would suggest an adjustment in how companies account for the initial cost of SOX compliance, which is undoubtedly more than the ongoing cost. More specifically, I believe this initial cost should be treated, perhaps, as a stock issuance cost by charging in the same manner and by charging the equity account directly rather than treating it as an expense item on the income statement.

The impact of this proposed change is, perhaps, best captured by one public company with $15 million in annual sales whose CEO told me he would be instantaneously profitable if it were not for the expenses attributable to Sarbanes-Oxley compliance.

Number four, I would strongly urge that emphasis be placed on the acceptability -- I want to emphasize this particular recommendation -- that emphasis be placed on the acceptability of more regional accounting firms for use by small companies, so that there is a more competitive element introduced into the current accounting
system. Also, the establishment or encouragement or in any way possible of a fifth or sixth big -- four, five, six or seven or eight, as we used to have, should be encouraged to restore a more appropriate balance between accounting firms and the client company to contain costs currently being incurred by these small companies and at the same time to give them an alternative that is generally accepted by the investment community.

Five, if there is any reluctance to using the measurement of revenues, which I again believe is the most appropriate metric, I would urge other factors be taken into consideration, such as stage of development, how many years in business, its geographic dispersion, does it have one plant or many plants, and whether it is profitable or loss making, but I still feel the $75 million level is the best one.

Six, the overall issue of material deficiencies, significant deficiency and deficiency. I am sure you are familiar with those definitions under SOX 404 is one that needs to be reviewed particularly, since a company, as I
understand, can have a material deficiency and yet
get a clean opinion from its auditor something to
me seems to be inconsistent since both are covered
by the same auditing firm and significant
deficiencies in particular can be created by very,
very minor difficulties.
Perhaps there is a better way to
categorize what is in the material category and in
the significant category and redefine all those
categories for small companies. Perhaps public
notification can be eliminated for a period of time
until a certain amount of time is passed so
companies have an opportunity in a private basis to
correct material or significant deficiencies
without having public disclosure.
In summary, I believe Sarbanes-Oxley
has been a constructive force in the securities
market and I am not in favor of eliminating it,
merely modifying its provisions as they relate to
small companies. Process cannot be allowed to take
over from the substance in building companies. I
have been involved with the creation of literally
hundreds of companies during my career. The engine
of growth in our economy comes from smaller
companies and we do not want to overwhelm them at
their early stages of development with unnecessary
paperwork and compliance with process which will
discourage risk-taking at a time when they should
be focused on building dynamic, successful
companies which have an employment multiplier and
ultimately add to the strength of our country.
Thank you very much.
MR. WANDER: Thank you.
MR. PATRICOF: One last thing. I will
submit a letter written by a woman by the name of
Susan Strausberg, with whom I am in contact, CEO of
EDGAR Online, which deals entirely with the issue
of filing for small companies and I think her
comments-- it is not a portfolio company of mine,
but I think it has great bearing on the subject, so
I will include that, if you will, in the written
record.
MR. WANDER: Thank you very much and we
would be delighted to have her comments.
I will now move to this table, to Wayne
Kolins.
MR. KOLINS: Thank you, Mr. Chairman.

I am Wayne Kolins and I'm national director of Assurance and chairman of the board of BDO Seidman, a national accounting firm. I am also on the executive committee of the AICPA Center for Public Company Audit Firms.

My prepared remarks here today are on behalf of the Center members. The Center was established by the AICPA basically to provide a focal point of commitment to the quality of public company audits and provide the SEC and PCOAB with comments on their proposals. There are approximately 900 Center member firms in the U.S. that collectively audit 97 percent of all SEC registrants. There are approximately 97 firms that recently audited companies that filed Section 404 reports, and 93 of those are Center members.

Members of the Center are appreciative of the SEC's efforts in acknowledging that while benefits of compliance with Sarbanes-Oxley are significant, careful consideration of the associated costs are necessary to achieve those benefits most efficiently. The Center's most
significant charge is to enhance audit quality which will contribute to the overall restoration and maintenance of investor confidence and trust in the capital markets. In that regard, we believe in open dialogue with the regulators to assist them in carrying out their public interest responsibilities. Given the depth and breadth of our membership, many firms view the Commission's actions in establishing the Advisory Committee as acknowledgement of the burden smaller public companies bear in complying with the complexities of the Act. We appreciate the opportunity to assist the committee in considering methods that may scale securities regulations for smaller public companies to ensure that the costs and burdens of regulation are commensurate with the benefits to the investing public.

Since passage of the Act, behaviors and requirements have changed. To name a few, there is an increased focus on internal controls by company management, audit committees are more engaged and appropriately focused on effectiveness of internal controls of financial reporting, companies are
becoming more focused on providing reliable and
more transparent financial information, enabling
investors to become more involved, and external
auditors are more engaged with audit committees,
all of which contribute to more effective audits.
These changes and others collectively contribute to
the overall restoration of investor confidence in
the capital markets. However, these benefits don't
come without an associated cost of compliance.
The cost benefit analysis of the
Sarbanes-Oxley Act has been a topic of many surveys
and articles. First year implementation costs are
easier to quantify and articulate compared to the
related, less transparent but potentially very
significant benefits. These benefits include the
thousands of control deficiencies remediated in the
process of compliance with 404. Benefits also
include transparent disclosure of material
weaknesses to investors. The events that led to
the creation of the Act and the PCAOB didn't happen
overnight, though. Accordingly, the process to
improve investor confidence in the financial
reporting process will take time.
This past year, thousands of auditors devoted an enormous effort in implementing Section 404 of the Act during audits of accelerated filers. We believe the PCOAB will have the opportunity, through its inspection process, to provide firms insight and clarity in the application of the internal control auditing standard. We also believe that efficiencies will be developed through this experience as auditors refine the process of the integrated audit and can use this information on the 404 audits of smaller public companies that are required to comply in the future.

While we don't believe that any revision to the Sarbanes-Oxley Act are needed, we do believe there may be ways for efficient and effective implementation with regard to smaller public companies. To that end, we recommend the following. First, the market value definition of accelerated filer should be increased to $700 million to ease the reporting burden on smaller public companies. In connection with the Commission securities offering reform proposal, its Office of Economic Analysis performed a study
identifying issuers with a wide market following
and seasoned offerings. This study indicates the
market capitalization level at which issuers widely
followed by investors, whose interest in
accelerated filers is likely to be the highest, is
$700 million, not the $75 million reflected in the
current accelerated filer definition. In that
regard, the study shows that companies with market
caps of $700 million or more account for about 95
percent of the U.S. equity market capitalization.
Therefore, we believe the Advisory Committee should
consider recommending an increase of the current
$75 million threshold to 700 million. If an issuer
is not widely followed, we believe the cost of
meeting the accelerating filing deadlines is overly
burdensome and exceeds the benefits.
Next, the Center suggests that the
Advisory Committee consider whether the accelerated
filer deadlines for smaller public companies should
be permanently extended. These due dates are
scheduled to be reduced to 60 days after year end
for annual reports for years ending on or after
December 15, 2005, and 35 days after quarter end
for subsequent quarterly reports. Extending the 
accelerated filer deadlines would alleviate time 
pressures that smaller public companies face. The 
Center believes additional time would be an 
important factor in a smaller company's ability to 
produce reliable financial and internal control 
reports given their human resource and other 
constraints.

If the SEC does not raise the threshold 
to the $700 million level as we suggest, we believe 
that the results of the SEC's office of economic 
analysis study of market following, which I just 
referred to, at least warrants retaining the 
current due dates for periodic reports of these 
issuers. That is, 75 days after year end and 40 
days after the quarter, and not accelerating them 
进一步 to 60 and 35 days respective.

Thank you for giving me the opportunity 
to share with you the Center's recommendations for 
assisting the committee in this very important 
endeavor. This concludes my prepared remarks as a 
representative of the AICPA Center for Public 
Company Audit Firms and I would be pleased to
answer specific questions the committee may have on behalf of myself and my firm, BDO Seidman.

MR. WANDER: Thank you very much. Our last two speakers now, the money people, the bankers. The first is Bill Loving, chief executive officer of the Pendleton County Bank in West Virginia.

MR. LOVING: Thank you, Mr. Chairman and members of the Committee. Good morning. My name is Bill Loving and I am executive vice president and CEO of Pendleton County Bank in Franklin, West Virginia. I am representing the Independent Community Bankers of America, or ICBA, trade association with approximately 5,000 community banks and bank holding companies, many of which are publicly held companies. Pendleton County Bank, chartered in 1925, presently has assets of $165 million and is a wholly owned subsidiary of Allegheny Bank Shares, whose stock is not listed on any exchange, thinly traded and has few institutional investors. Like many publicly held community banks, Allegheny Bank Shares is a good example of a publicly held company
that should not be subject to reporting

requirements of Section 12 of the Securities and
Exchange Act and to all the regulatory burdens of
the Sarbanes-Oxley Act of 2002, or Sarbox.

Allegheny has 653 registered
shareholders, the majority residing in or related
to residents of Pendleton County. Our shareholder
base has grown to over 500 not because of mergers
or public offerings; rather, our original
shareholders have distributed their holdings among
their descendents. With 53 employees and three
branches, it is a severe strain for a bank and
holding company to comply with all the reporting
and disclosure requirements of the Exchange Act and
internal control attestations of Section 404. To
date, we have spent approximately 50,000 and 160
staff hours to comply. Next year an additional
1600 staff hours and 50,000 relating to control
testing, increased internal staffing and escalated
audit cost, which could increase 50 percent due to
Sarbox requirements.

Finally, due to the law's complexity,
we found it necessary to add one senior management
employee to coordinate and oversee the project. While our estimates for compliance are below those reflected in ICBA's recent Section 404 survey of community banks, the costs are certainly substantial. We have considered going private to avoid the significant increase in cost. However, considering our small community -- Franklin's population is less than 1,000 and Pendleton County's population is approximately 8,000 -- it would be a significant loss to our community and to the bank's reputation if we were to go private and repurchase most of our stock or participate in reverse stock split. Many of the local residents who have proudly supported the bank would cease to have ownership in one of the two publicly held companies in the county, both of which are small community banks.

I appreciate the opportunity to testify today and will summarize my thoughts in written testimony on regulatory relief and the recommendations of ICBA. I believe that each of these points reflect appropriate ways to scale the securities regulations in a way that costs and
burdens are commensurate with the benefits to the 
investors and public alike.

First, in my opinion, the registration 
threshold in Section 12 of the Exchange Act should 
be increased. The current threshold of 500 
shareholders has not changed since 1964. The 
Commission, however, did note in 1996 that it 
intended to update the 500-shareholder requirement 
at a later date. I believe the later date should 
be now.

Pendleton County Bank, with assets of 
165 million was considered a medium size bank in 
1964. Today we are in the small bank category and 
significantly below the average U.S. bank size of 
1.1 billion. Using 1964 as our base, the 
collective market value of 500 shareholders 
holdings and adjusted for inflation would be 
equivalent to what 3,000 shareholders would hold 
today. Consequently, we recommend that the 
500-shareholder requirement under Section 12 of the 
Exchange Act be increased to 3,000.

We also recommend that Sections 
12(g)(4) and 15(d) of the Exchange Act be updated
so that the threshold for deregistration is increased from 300 to 1,800 shareholders.

The second recommendation would be to exempt community banks and bank holding companies with less than 1 billion in assets from Section 404 requirements. Banks have been subject to the internal control attestation requirements of the Federal Deposit Insurance Corporation Improvement Act, or FDICIA, since 1991. Those requirements exempt banks like Pendleton County Bank with assets of less than 500 million in assets because the federal banking regulators recognized the burden these requirements would have on smaller companies in light of the other regulatory requirements.

The FDIC is currently considering raising the FDICIA threshold to one billion and new rules may be issued as early as this summer.

We encourage the Advisory Committee to consider recommending a similar exemption from Section 404 for community banks.

ICBA's final recommendations are adjust Auditing Standard Number 2, or AS2. While the recent guidance concerning AS2 was a good step in
reducing unnecessary cost, ICBA recommends that application of AS2 be tiered to a company's size and complexity. AS2 is still complex and a one-size-fits-all standard. Consequently, smaller companies are subject to higher audit costs and are unable to find qualified firms to fulfill AS2 requirements. For many of ICBA's members that qualify as accelerated filers, filing on an accelerated basis presents an undue burden.

The complexity of today's accounting standards in the new Section 404 requirements create an immense amount of work for community banks. ICBA recommends that the SEC significantly raise the $75 million public float threshold in the Exchange Act 12(b)(2) to an amount closer to 700 million, which was suggested by the SEC's Office of Economic Analysis, and that the SEC not proceed further with acceleration of filing deadlines.

Finally, ICBA's recommendation would be to revise the current definition of Small Business Issuer under regulation S-B by increasing the $25 million public float and revenue test. Given the
explosive growth of the stock market and inflation
that has occurred, it would be appropriate for the
SEC to raise this threshold.

We would also like the regulation to be
revised so there is more streamlined disclosure
process for smaller companies like Pendleton County
Bank.

As CEO of a community bank subject to
the disclosure requirements of the Exchange Act and
Sarbox, I am concerned with the regulatory burden
facing community banking. The time and the effort
taken by regulatory compliance diverts resources
away from customer service. Even more significant,
the crushing weight of regulatory burden is causing
many community bankers to seriously consider
selling or merging with larger institutions, taking
the community bank out of the community.

I urge the Advisory Committee to
recommend to the SEC ways to relieve community
banks like Pendleton County Bank from the
regulatory burden of Sarbox and other security laws
and regulations.

In closing, I thank you for this
opportunity to testify and the efforts that you are
taking in this regard.

MR. WANDER: Thanks very much, Bill.

We will now turn to Dan Blanton, Chief
Executive Officer and President of the Georgia Bank
Financial Corporation.

MR. BLANTON: Thank you, Mr. Chairman
and good morning. Thank you for allowing me to be
here.

Before I go to my prepared comments, I
want to say how much I appreciate the opportunity
to be here. I am deeply concerned with the future
viability of community banks. These are your banks
that lend to the small businesses in all the
communities. Like my colleague, I am deeply
concerned with where their future viability will go
if they cannot get some relief under this Act.

I am here representing the Georgia
Bankers Association. As their written statement
set out fully, ABA is the larger banking trade
association representing community, regional, money
center banks and holding companies. I am the CEO
of a $770 million bank. We have 5.3 million shares
outstanding and 700 shareholders. I am one of the
members of approximately 100 bankers on ABA
Community Bank Council and this represents over 90
percent of the banks and savings institutions in
the country.

The ABA is on record in support of many
of the important measures adopted under the
Sarbanes-Oxley Act. However, we have long
maintained that banks are different from the rest
of corporate America and that they are already
subject to extensive regulation and that the
business of banking is unique, producing assets
that do not accurately reflect bank size relative
to the assets of other types of businesses. For
these reasons, ABA was instrumental in urging
Congress to craft an exemption for banks from the
insider lending prohibition of Section 402 of SOX
as these are already subject to strict regulatory
oversight.

The ABA strongly supported the New York
Stock Exchange and Nasdaq requirement that list
companies having a majority of independent
directors seated on their boards. In this
connection, we worked extensively with Nasdaq and the New York Stock Exchange to ensure that a listed company's directors will continue to be considered independent, despite having an arm's length lending or deposit relationship with a bank or holding company of which it is a director.

In connection with considering methods to reduce regulatory burden for small public companies, the ABA would urge the committee to consider our proposal made earlier this year to Chairman Donaldson to update the 500 shareholder threshold under the Section 12(g) of the Exchange Act. As explained more thoroughly in our written statement, the 10 million asset test has little relevance to the banking community as only 1 percent of all banks, 105, have assets less than $10 million. We would urge the committee consider raising shareholder level to a number somewhere in range of 1,500 to 3,000.

It is well documented that the cost of compliance is relatively great for small companies that are large issuers. This increase in cost has caused Georgia Bank Financial Corporation's
directors to consider delisting as it would save
our company at least $250,000. Deregistering would
force this company to buy back its stock from more
than 400 current shareholders. We are reluctant to
do this because the bank was founded on the belief
that the Augusta area needed a locally owned and
operated relationship bank. Most of our
shareholders live in our market and all but few do
business with our bank. This localized ownership
is quite common in community banks across the
country. Oftentimes, investing in local banks is
the only remaining investment opportunity someone
has within their community. As he said, he has two
publicly traded companies in his market. I have
three. They are all banks. This is the way
corporate America is now. If the 500 shareholders
threshold would be raised, therefore easing the
burden associated with the Exchange Act reporting,
we would not have to reduce community investment in
our banks.

Investor protection should not suffer
under our proposal. Most community bank stock is
held by members of the local community who are
users of the bank's services and tend to buy and hold their investments in their local financial institutions. Like many community banks, Georgia Bank Financial stock is traded very thinly over the OTC Bulletin Board.

Moreover, banks and their holding companies are also subject to strict regulatory oversight. Georgia Bank Financial is supervised and examined under the Federal Reserve System. Its subsidiary, Georgia Bank and Trust is examined and supervised under the FDIC and Georgia State Banking Department. In addition to raising the shareholder threshold, we also urge the definition of Small Business Issuer eligible to use the short form 10-KSB and 10-QSB under Regulation S-B be revised. One of the criteria for using these abbreviated forms is the small business issuer must have revenues less than 25 million and a public float of less than 25 million. My company can no longer use this form because our market capitalization is roughly $176 million even though we had net income of 8.7 million last year.

96 percent of all deposit institutions
have net income less than $25 million. Adjusting
these numbers upward would reduce the regulatory
burden for those publicly traded community banks
that have a public float greater than 25 million.

Finally, we would urge that the 75 and
40-day time period for filing Forms 10-K and 10-Q,
respectively, not be reduced further to 60 and 35
days as currently contemplated for those publicly
traded companies that have in excess of 75 million
public float.

In conclusion, many of my peers
expressed concerns that significant costs
associated with complying with the Commission's
periodic reporting requirements may cause them to
expend significant resources to deregister or,
alternatively, put their institutions on the
selling block. Either way, local communities
suffer because less cash is available to lend or
the larger, acquiring bank is not equipped to bank
local small businesses. Making target adjustments
to the definitions laid out in the Exchange Act
can, the ABA believes, alleviate some of the
significant regulatory burdens for community banks
and allow these companies to continue to serve
their local communities.

Thank you for giving me the opportunity
to present my remarks.

MR. WANDER: Thank you very much, all
of you, for your very helpful observations and
information.

We are now open for questioning by
members of the Advisory Committee.

Why don't I start up top there, Mark?

MR. JENSEN: Mark Jensen. This is a
question for -- I am sorry, I am struggling with
everybody's names here. I guess, Mr. Knight and
Mr. Wolkoff and Alan Patricof.

I would like to switch the discussion
for a minute to quality of compliance with 404. I
think all of you in your remarks cited difficulties
in obtaining auditors of quality in smaller
companies and smaller companies being constrained
by their own resources in their ability to comply.

I guess the question, to be somewhat
provocative to solicit your thoughts on it, do we
have a law in 404 that effectively is impossible
for small companies to comply with quality and,
therefore, they basically are going through a check
the box kind of exercise and, in fact, we are not
achieving anything with the law because of lack of
resources and focus? Mr. Knight?

MR. KNIGHT: That is a tough question.

I don't know that we have enough information at
this point to reach a conclusion. I think the
small companies, one, are taking it very seriously.
Where the quality issue I think is affected is in
terms of the advice that is available to them.
What we are finding is, they are having a hard time
retaining one of the national firms that has access
to a national office and resources to help them in
that regard. In particular, the capital raising
function is tied to, often, underwriters wanting
one of those national firms.

So I think quality is affected by the
advice available and there is a lack of
competition, if you will, in this area. There are
few accepted firms, and that is constraining the
ability of small companies to perform in this area.
They need more time, they are telling us. They are
getting dropped by auditors. They are losing employees, so they are not able to deliver in that respect.

The question of quality is the one that is defined by the PCAOB in terms of the standards they are establishing. It is a fairly high standard and I don't think anyone has a problem with that per se, but there is a question of the benefits that you get from that. Is it worth the costs associated with that? The COSO task force, as I understand, is trying to come up with a practical framework that small companies can use in applying their model and, hopefully, some relief will come through that.

MR. PATRICOF: I am not sure exactly the thrust of your question. And I don't think people are just going through the check the box. I think they are taking it very seriously. That is the problem. They are taking it so seriously that it occupies virtually all their time. As I said, internal audit functions which should normally be going on have to be put aside in order to focus on this. I think it is also becoming increasingly
difficult to keep internal people and accountants,
I think, are finding difficulty keeping people who
deal with these issues because it is just -- it is
process and no one likes to just deal with process
all the time.
And I will reemphasize the fact that
the way the world is going, we used to deal with a
Big Eight and that was a very competitive, open
negotiation. If you didn't like one auditor, you
had a chance to go to someone else. Today the
relationship between auditors and companies has
changed dramatically. It is a oligopoly. You
can't negotiate fees. For a small company, it is
virtually impossible. You take what is told is the
price. You don't have the opportunity to go to
someone else. First, the other person isn't
interested because they are going through the same
process and they know the drill. And the second
thing, it would look poorly on the company to be
changing auditors. What we really need is a lot
more auditors -- that there is moral suasion to
accept a Big Eight, Big Ten -- as many as you can
get or to accept more regional auditing.
How that comes about is dependent on how the regulatory bodies talk about this and encourage it. I think the bully pulpit and moral suasion and letting people know there are a lot of accounting firms out there who have good quality people beyond the Big Four.

MR. WANDER: Rusty and then we'll take Janet next, and Dan after Janet.

MR. CLOUTIER: I wanted to ask the two bankers a question. I wanted to go a little further in the comments you made because I think it is very important that the committee understands and the SEC understands that community bank something a little bit different.

Correct me if I say anything you disagree with because I think I can speak for all trade organizations on this question.

Community bankers, both of the gentlemen here I am sure sign call reports every 90 days with the FDIC, file Y9's with Federal Reserve Bank. That information is made very public. You can get it on FDIC.gov and it is verified every year when you are examined by the FDIC who comes in
your bank and does a very thorough examination of
the statements you have filed to make sure they are
adequate and correct versus any other organization
of checking that.

The other thing is, if there is any
problems within the organization, there are
memorandums of understanding, cease and desist
orders which are also filed, which are also a
public record and made very available to the public
and very easy to get.

It certainly seems like we as a
committee should encourage the SEC to take all this
into consideration when we talk about public
disclosure. And the other factor you mentioned is
that most community banks are owned pretty much
within the community, which they pretty much know
what is going on in Georgia and West Virginia with
that bank better than any research firm does, and I
would assume that neither one of you all have any
research. Most community banks do not. As the
gentleman spoke of very clearly, most banks under a
billion dollars just can't pick up research.

I just think that we need to ask the
SEC to take all this into consideration. I know it is tough to ask for carveouts for different companies, but certainly in this instance there should be a consideration of a carve-out because of the amount of regulation and verification -- remember, verification. Not only regulation but verification. As I tell people, I worry much more about signing a call report than I do about the SEC attestation. Nothing against the SEC, but the OCC has all the power in the world to come after me. They don't need any additional rules or regulations. I would like it if any of you would comment on that.

MR. BLANTON: I completely agree. Our industry has for many years been held to a much higher standard and we are very proud of that. We go through an extensive amount of regulation and review and examination all the time. I wouldn't even say -- it is a regular process that we have examiners of some group within our institution examining us.

The burden this year -- this past year to comply with SOX 404 was unbelievable, in the
pain and anguish it bestowed on our staff. Our
staff is a bunch of A-plus people who really want
to exceed everything they are given and it was all
we could do to try and hold them back enough. They
were working 20 hours a day in cases complying with
SOX.

We think SOX is very worthwhile. There
is a lot of good, important things in it. But we
do really urge to be given some relief and some
consideration for the already heavy regulations and
examination burden that we currently bear.

MR. LOVING: And I, too, agree with my
colleague, Dan, that the banking industry has been
held to a much higher standard for many years and a
standard we are very much proud of. We are
regulated by, in our case, a state banking
association regulator, the FDIC, our holding
company is regulated by Federal Reserve. As Rusty
indicated, a cease and desist order is something no
one wants to have filed upon them, so we are
cconcerned about the controls that are in place
today.

We would ask that there be some
consideration given because of that, because, as
was mentioned, the call report that's filed
quarterly, it is signed, it is attested to by the
directors and executives of the bank. With the
Call Report Modernization Act, it will soon be
available immediately to the public once it is
filed, so there is a form in which the public can
get that information instantaneously, if you will,
as well as most community banks being owned by
community residents in small communities. They
know very well what is going on within the bank.
So I agree wholeheartedly with your comments and
statements.

MR. WANDER: Janet?

MS. DOLAN: Thank you, Mr. Chairman.

First of all, on behalf of all the members of the
404 subcommittee, I want to thank all of you for
your comments and particularly your suggestions.
If you heard our summary yesterday. We are already
considering many of the suggestions you have made.
I do have a question for Mr. Kolins, though.

One area we are very interested in
going input on is the area of how do we achieve
what everybody is trying to achieve, which is to
turn this from a one-size-fits-all to tailoring 404
for small companies, if we can, especially in the
area of risk profile. That is, can we do anything
to help PCAOB or the SEC to help get us to the
point where rather than just saying either you are
on one side of the line or the other -- in other
words, either you comply with everything or we
exempt you -- can we identify which are the A
controls and which are the D's? Which should be
done every year and which, perhaps are not as
significant or could be done on a staggered basis?
Some way to try to actually bring a rational look
to what should be required to provide and create
confidence in the 404 process and what is just
being done that doesn't provide that much value
especially for small companies?
So, you represent the people that are
doing the auditing. Has your association done any
reflecting on that knowledge you have been through
the first year or do you have a mechanism to do
that? Do you have some way where you could give us
some substantial foundation and input and
professional judgment on, if you ran the world, how
you would be able to tailor this so we don't have a
situation where, as I said, it is all or nothing,
but we can tailor something that helps get to what
that I think the PCAOB was urging your industry to
get to in their pronouncement in May, which is
let's not over-audit, let's use a risk-based
assessment and find a way to tailor audits to the
companies involved. Can you give us input? We are
really interested in feedback in that area.

MR. KOLINS: I hope so. Before I get
into the response to the question more deeply, you
have got to look at the perspective and the
environment in which the auditors were first
looking to comply with 404, as well as the
companies looking to comply with 404, because they
are both basically were doing it almost the same
time. It was a real-time audit environment that
was being created over a period of a year or so
versus the 90-some-odd years that auditing
standards and financial statement audits were
developed. So, you had some people on the shore of
the beach looking at the tsunami coming in, not
knowing quite what to do until it was a little late.

So, right now you are into the retrospective part, which I think has become very useful. People are sharing experiences. There was the meeting of a standing advisory group of the PCAOB last week devoting two full days to analysis of 404 and what can be done about that. Certainly a big focus there was on the risk-based approach, which I think the Q and A's that came out in May from both SEC and PCAOB were very helpful in pointing the auditors and companies because they are both looking from the same perspective, to more of a risk-based approach in both assessing their own controls and reporting on those controls.

There are groups within the AICPA task force dealing just with 404. They get together on a regular basis and they will certainly be focusing on this effort.

One of the big concerns that was raised and I think a potential large deficiency would be to what extent can the audits of internal controls be integrated within the financial statement audit,
so you can at least take credit for more that has
been done in the financial statement audit for the
comfort that you get out of doing a 404 engagement.
I think firms did not have sufficient time to get
those integration mechanisms into place last year.
Things were happening too quickly. I think now
those things are happening.

One idea I could bounce around that I
think has some merit is looking at what are the A
controls and the B controls, as you mentioned. I
think if I recall Moody's had done a report some
months ago indicating what it would consider as to
something that might affect credit rating, looking
at the controls affecting the control environment,
the entity level controls, that if those were
considered to be material weaknesses, that would
have a significant effect, whereas application
controls, the more detailed controls that are more
easily correctable wouldn't give them as much
concern.

I think that was probably borne out by
and large in the marketplace when material
weaknesses were reported as to what kind of
material weaknesses there were. It might be
appropriate for these smaller companies, however
defined, to, perhaps, have a mechanism in place
where every year their controlled environment,
their entity level controls are reported on, then
every two years, whatever time period it would be,
perhaps more detailed application controls could be
reported on because at the end of the day I think
what probably has been the underpinning of many of
the financial statement frauds is not a detailed
application control as to whether John or Mary did
on an invoice, but what the tone at the top was and
what the potential for management override was.

MR. WANDER: Dan and then Scott.

MR. GOELZER: Thank you, Mr. Chairman.

Let me say, I thought there was a terrific amount
of food for thought in everyone's statement and I
appreciate you coming here today and making them.

I wanted to ask the same kind of
question Janet did, but from a little different
perspective. Ed Knight, I think the first
suggestion concerning 404 in your statement was
that steps be taken to, as you say, incent the CPA
firms away from overauditing. I wonder if you had
any specific thoughts in mind as to how that might
be done? Certainly the sort of thing, at least
from my perspective that the PCOAB grappled with in
its May 16th statement and also that we are
grappling with as we try to structure and operate
an inspection program in a way that won't drive
people to dysfunctional behavior, but will, in
fact, focus on serious quality issues.

I was wondering if you had anything
more specific in mind there. And kind of a
corollary to that, at the end of that section of
your statement you say this, meaning, I guess,
overauditing continues to be the case even after
the most recent PCAOB guidance, which I think
raises another question that has come up at this
meeting. Everyone seems to like the May 16th
guidance, but opinion seems to vary considerably on
whether it will really have any impact on the audit
process. I was wondering if any panelist -- Wayne,
I am afraid to overwork you, because you work on
our SAG also, but maybe you would be the best
person to comment on whether what the regulators
said on May 16th will have a significant affect on
the year two reviews or the first year reviews for
new companies that come into the system.

MR. KOLINS: I think it will. There
was a lot of discussion last week at the SAG
meeting focusing on the risk-based approach and top
down approach and focusing on a really important
area within the framework of AS2, which is what is
a significant account, and whether something is
scoped in or scoped out. I think there was clear
consensus about what that really means. It is the
same for audit of financial statements as for
internal control audit.

What came out of the meeting loudly and
clearly, which wasn't so clear before that I think
in practice, even if you consider an account as
significant, it doesn't mean you have to beat it to
death. You don't have to do everything with it in
terms of nature, extent and timing, and the less
risk there is of material misstatement within that
account, the less audit work you can apply to it,
rather than looking at every significant control
relating to it, you can reduce, again, the nature,
timing and extent, and I think that will drive
practice during this next season.

MR. KNIGHT: I don't know that I have
any magic bullet here. What we are hearing is that
accounting firms, when they in turn are audited by
the PCAOB and particular audits are being examined,
the PCAOB is identifying rather, for lack of a
better description, minor issues as troublesome in
that accounting firm's overall quality control
approach. And so then the firm is extrapolating
from that to their work on 404 and saying, "I want
to avoid any of those issues." And despite being
told to take a risk-based approach, I have got this
real world experience in my last examination that
they are extrapolating to how they deal with
clients going forward. That is one issue.

The other is just taking the concept of
404 and applying it to an economy like ours with
its complexity is a daunting task. And to do it
with any ability for people to be able to be
confident around what are huge risks for an
institution is very hard without, I think, creating
clear, safe harbors. And that is what people want
to know I think both in the accounting area and in
the public company area. People want to do the
right thing. They want to be told what is a safe
harbor, but then you say, "Well, what is material?"
And you have to fill a room with lawyers and have a
debate.

I know the government -- I've served my
years in the government. They need to retain some
flexibility and some discretion and they are
cconcerned that if they establish that safe harbor
and the economy evolves in a certain direction,
that somehow they will be condoning behavior they
will later feel is troublesome. I just think it is
necessary in this area to have some safe harbors
for people that are practical in the world.

MR. WANDER: Scott?

MR. ROYSTER: As one of the guys who
has spent the last twelve or eighteen months
writing a lot of checks to outside auditors and
consultants to pay for all this, I want to explore
the issue Mr. Patricof has raised, look a little at
the oligopolistic structure that exists with regard
to public companies relative to their outside
auditors and then come back to you, Mr. Kolins, and
ask you a little about your business, the business
of being not one of the Big Four, but, perhaps, one
of those Big Ten that Mr. Patricof would like to
see.

I have been mystified by how this
structure can continue to exist given that 97
percent of all public companies and thousands of
public companies beyond the large ones are
basically requiring four firms, through some sort
of funnel mechanism, to process all this work.

How do we go about addressing this
issue of the oligopoly that exists in the
accounting industry and have you at BDO Seidman
seen some progress with regard to taking on more
public company clients, seeing, perhaps, a bit more
of a willingness in the marketplace for your firm
to expand its market share? Hopefully, the answer
is yes, and what can we do to hopefully see other
firms increase their shares over time?

MR. KOLINS: I am not sure I can help
you in terms of what to do about an oligopoly.

That is a very macroeconomic question. In terms of
the response to the second part of the question may help with the first.

We have seen more inroads into the larger, at least from our perspective, larger public company clients over the past year, year and a half. And I think it comes down to very much of a supply and demand situation. Clients want service, they want service today. They don't want to hear about resource constraints if they can't get that service. So we are seeing clients that are larger than some we have seen before. I believe that when the client discusses with us what the tools are we bring to bear in focusing on what the tone at the top is at the firm, who is on the board at the firm, what is your governance at the firm, what technical resources do you have, what industry expertise do you have? Those are the things that really matter to the company when it gets right down to it.

All of the companies have audit committees. Some of the audit committee members are on other audit committees. People start to talk. Jawboning could be part, morale suasion
could be part of it. I don't know what mandates can be brought to bear, but we have seen more opening up in the marketplace for companies in maybe the bottom part of the Fortune 500. You are not going to get the Fortune 100. There are logistical issues in terms of doing an audit that certain firms just can't handle because of size. You can't be in a hundred different countries with a hundred people on staff at every one. There are certain constraints. But beyond that, I think there are possibilities for openings, and some of it has to do with bias against the firm that perhaps an investment banker says, "No, you can't go to that particular firm." And in many cases the smaller firms have the technical ability and the resources to perform those engagements. MR. ROYSTER: Just a quick follow-up, because one of my issues also has been the investment banks and the law firms who either take these companies public or represent these companies after they are public, perhaps otherwise being resistant to listed companies or soon to be listed
companies doing business with firms outside of the
Big Four. So you obviously have seen that
resistance, that bias. Are you doing anything to
try to address that and are you seeing some
loosening of that?

MR. KOLINS: We actually, about six
months ago, got a call from one of the major
investment banking houses wanting to speak with us
to find out what more we could do with them because
they were having problems getting service with the
normal channels that they were dealing with.

Again, I think it is a question of supply and
demand. Oftentimes the clients themselves are
saying, "No, I don't want to change firms. I want
to stay with the firm I have. Maybe I will change
investment bankers." In that case you have a
reputation established with that particular
investment banker. Problem is they don't
necessarily talk to the one down the hall or across
the country.

MR. DENNIS: Sorry, Drew. I just have
a follow-up to Scott's question to Wayne. Really,
also to Alan and Ed. I am wondering if there are
things this committee can do or the SEC can do, the
exchanges can do, to promote what Alan had talked
about of trying to broaden the number of firms that
are viable options for smaller public companies.

MR. PATRICOF: Let me answer that one.

We all saw in the paper today that the Justice
Department is concerned about, it looks like,
bringing, perhaps, an appropriate action against
one of the Big Four because of their concerns of
going down to the Big Three. They weren't
concerned when they did that with Arthur Andersen
or, perhaps, they would have done that differently.
If they can be concerned at this stage and express
it in some fashion of going down to three, there
should be a way of expressing attitudes that
encourage the formation of acceptable accounting
firms.

For example, this Commission, when it
reports, could have a section which devotes itself
to this subject and says it is the committee,
Commission's attitude that there should be
encouraged by the investment bankers -- and it's
the investment bankers that count -- that regional
firms should be considered, that other firms that
have a national presence that are not of major
proportion should be considered. I think that mere
statement can be referred to and will be referred
to frequently, I am sure, by young companies who
resist changing their auditors in order to go
public and by investment bankers who feel they are
in a comfort zone of using companies that are not
necessarily household words.

I am speaking from intimate knowledge
of the circumstance and I assume Scott knows
exactly what I am saying. I am sure everybody else
does. We have all faced this every day of this
problem of if we don't have one of the Big Four,
investment banking firms are concerned and they
will encourage you strongly to change accounting
firms, particularly if it is a local or regional
firm.

So I think you need at some level
somebody that makes it acceptable without making
regulations, but just an attitude.

MR. KOLINS: I think it is a question
of getting the right audience to listen to this
because it is probably a very narrow -- you are
dealing with the money people, basically, that
would have that concern, and maybe want to go the
course of least resistance in picking a firm with a
certain name.

Short of regulation, jawboning could be
a difficult mechanism to get something done.
Perhaps pointing out in cases where a large firm, a
large company has a non, call it Big Four firm
doing the audit and looking at that particular
experience and having symposiums where the
management of that company talks with management of
other companies about that particular experience.
You are talking CEO to CEO about relevant
experience, which may be helpful.

MR. WANDER: Drew and then Dick and
then Steve.

MR. CONNOLLY: Mr. Chairman, thank you.
I am very mindful of the time. I will do my level
best to be brief. I would like to thank
Mr. Laporte and Office of Small Business Policy
within the SEC and your good self, sir, for
providing us the resources of these witnesses and a
panel that I am truly in awe of and grateful to for
the overall information they provided.

Where to begin? Mr. Knight, I am
mindful, having reviewed your career, sir, of your
government service under the Clinton Administration
and the Treasury Department and for that I am
grateful.

I am, however, concerned. Currently my
subcommittee is Capital Formation within this
overall Committee. And there are a host of issues.
I am going to be brief about the most current ones
depthly concerning to me and, perhaps, as a matter
of full disclosure, I should tell you, you did
regulate me, actually the NASD did regulate me for
17 years, so I am, perhaps, aware of what I speak.

I am deeply concerned about the current
proposed eligibility rule. I have read and I did
hear your remarks and I am concerned that perhaps
we are saying one thing and, from a public policy
perspective, doing another. Transparency, good
governance, investor protection, and information
disclosure are all objects to be pursued in the
public marketplace but the eligibility rule, which
perhaps many of us are not familiar with, is a proposed rule by the NASD at the moment, or Nasdaq, considerably, to essentially punish a late filer on a couple of occasions. Whether it is Sarbanes-Oxley late or whether it is late because they can't find auditors or for whatever reason it is late, a public company would be late in its filings of Ks and Qs on a sequential basis or two or three time basis and essentially be punished, delisted, thrown into perdition as we often call the Pink Sheets.

My concern with that is that, thinking as a potential public company executive, I have no incentive whatsoever to come current or comply with those disclosure rules for that entire period of a year. I am wondering if public policy and disclosure would not be better served with some other form of sanction, without essentially putting someone in a penalty box for a year because I think that is kind of a negative assertion or way to do things.

The other comment, very quickly, is
that Chairman Donaldson, upon appointing us, was kind enough to take under advisement a comment I had and I know Mr. Coulson will propose as a rule, and that is if you are listed on the New York Stock Exchange, the American Stock Exchanges or the National Market System, there is a mechanism for both collecting and reporting monthly short interest. There is no such method or requirement to provide that disclosure and that visibility on either the Bulletin Board or the Pink Sheets. And since it is regularly reported that Nasdaq would like to get out of the Bulletin Board business, I would like your comment, sir, on whether or not that is in fact true, whether the regulatory costs of the Bulletin Board are sufficient that Nasdaq as a for-profit company -- I don't own any stock; I guess that is additional disclosure -- would like to basically get out of the Bulletin Board business and how do we do that and maintain a small company marketplace?

MR. KNIGHT: It is a very good question and I appreciate it. Let me back up here a little bit in history and describe a period. January
2003, the year after the Enron/WorldCom issues, there were no IPOs in this country. None on the American Stock Exchange, none on the Nasdaq, none on the New York Stock Exchange, for the first time in 20 years. Basically, the capital markets in terms of creating new ventures, public capital markets had shut down. We had a real crisis of confidence in this country.

Last year, we had 140 IPOs on Nasdaq. It is coming back. But part of the reason is, I believe, that the public, again, has confidence in the public disclosures and in the enforcement of the rules of the stock markets and certainly the SEC.

That is a very fragile matter and it is something we have to work on every day. And we believe passionately at Nasdaq in the importance of public disclosure. Our board, in looking at the Bulletin Board, found that there was a troubling phenomenon and that was that hundreds of companies were what I would call serial offenders of the obligation to make public disclosures. In a period
of a year or so, they were not reporting on time
three or four times a year. We felt that we needed
to get tougher in this area, and so did, frankly,
the SEC.

Now, the rule we propose is three
strikes and you're out. That is, if you
continually are late with these filings, that you
are given a time out. We think it is fair. It is
the subject of public comment right now.

Obviously, there is comment on that and we will
take that and act accordingly. But it is something
our board felt very strongly about and we feel very
strongly about in Nasdaq in terms of the importance
of our enforcement of the obligation of public
companies to disclose and on a timely basis.

In terms of the Bulletin Board, we are
committed to the Bulletin Board. We and the NASD
are vigorous in our oversight of it. We are
approaching exchange status at Nasdaq and that
status requires us to change the legal structure of
the Bulletin Board. I do not expect there will be
any pause in the provision of that service to the
investing public. It may be under a different
legal structure. It has nothing to do with the
profitability of Bulletin Board whatsoever. It has
to do with Section 6 of the Exchange Act and
whether we can operate the Bulletin Board as an
exchange.

MR. CONNOLLY: Mr. Knight, just so you
are aware, our committee has some sympathy to the
overwhelming regulatory cost to maintain a Bulletin
Board and we have had some discussion. I am not
sure where it will end up in terms of
recommendation, but listing fees, initial and
potentially ongoing, are not out of the question.
But for that consideration, I suspect we may ask
for some other Nasdaq-oriented negotiation or,
perhaps, discussion as to how that offsets one
another and becomes fair.

MR. KNIGHT: We have a listing venue
for small companies. It is called a SmallCap. We
were not -- again, this was the board's decision --
to not create a lower standard in terms of listing
standards in Nasdaq for the Bulletin Board, which
was the direction some were urging us to follow.
We feel, in terms of public companies, one who
lists with us, we are vouching for those companies
to the public. We have a set of well thought out
corporate governance standards. They should apply
to all companies. We are not interested in
lowering them.

MR. CONNOLLY: Thank you, Mr. Knight.

Finally, Mr. Patricof, firstly, I am
honored to be in your presence. Again, I have
attended over the years the New York Venture Group
breakfasts at the Rainbow Room if we can go back
that far. I would just like to point out to the
room that Mr. Patricof, perhaps unlike some of the
others here as witnesses, has actually testified on
behalf of, taking his testimony into account, the
lessening and the right-sizing of some of these
regulations while simultaneously running a $20
billion private equity fund, putting that money
deployed into the marketplace.

Quite frankly, if that that kind of
money says -- and our mandate is investor
protection and the investors are saying, "Hey,
let's look at some of these regulations from the
standard of the benefits of those regulations," I
think that kind of, for me, outweighs a number of
the potential regulators, banking trade association
individuals, who I am very sympathetic to your
duplicative regulation and I think this
administration is probably very sympathetic as
well.

Mr. Patricof, thank you very much for
being here. Would you consider taking a portion of
that equity fund and dedicating it to microcaps and
can you persuade my friend Susan Strausberg to
consider appearing before us in Chicago, as I
believe that EDGAR OnLine has materially benefited
public disclosure in this country?

MR. PATRICOF: I can't specifically
speak for Susan Strausberg, who is out of the
country at this particular moment, but I am sure
she would be very happy to speak before the
Commission. I can't speak for her, but I am pretty
sure she would, in Chicago or any other place,
because I think she believes in this issue.

As to us -- we don't trade in stocks.

I would tell you, we have microcap stocks. We
didn't necessarily intend to get there. As I said,
I think it is very important to understand my numbers may be wrong, but research can be done. You cannot go to an underwriter today and bring your company public at $75 million in value because the underwriters want a certain percentage of the float to be trading after they take an underwriting and they want, in order to make sufficient money and to create a sufficient market. As a result, the initial offerings today -- not what they used to be. I remember you used to have public offerings a million or $2 million on a full Nasdaq listed stock. It wasn't that many years ago. Today you have to do a public offering -- I am not just making a number. I am saying a million or $2 million would have been a public offering back in the seventies and as late as the early eighties. Today you have to have a public offering of 20, 30, $40 million to get anyone interested. So the only ones who fall in the category of small caps under market cap are people who, after they got traded, not necessarily because they did badly -- it may be they did badly but because of lack of coverage, as has been
discussed, or other exogenous reasons -- the market cap has gone under there.

So I think market cap has absolutely no
applicability to size of company. We have several
companies in our portfolio with market values of a
billion dollars that don't have a revenue level
because they are in the biotech or research area
that have great promise for the future and have
very few employees. They are spending all their
time on research and complying with the regulations
of being public.

MR. CONNOLLY: We take that very much
seriously within our subcommittee and looking at
the revenue test versus potential market cap.

MR. WANDER: Drew, we are going over
our time and we have got two more speakers.

MR. CONNOLLY: Certainly, Mr. Chairman.

I ask that these witnesses conceivably make
themselves available throughout the course of this
committee to help shape the recommendations and not
be a one-off.

MR. WANDER: I am sure they will.

Dick and then we'll finish with Steve.
We will run a few minutes over, but I did want to let everybody have their opportunity to ask questions.

Mr. JAFFEE: In the interest of time, because the question I was going to ask really has been discussed, I will pass for the moment.

Mr. BOCHNER: Thank you. This is really directed at the whole panel, but maybe Mr. Wolkoff and Mr. Knight in particular.

Delisting -- as kind of a follow-up to Drew's question -- it has to do with de-listing--that is a powerful remedy, so I know that is not done lightly. I think one of the situations it is appropriate for is when somebody is not getting information in the market because a market can't function ultimately if there is not good information flowing, but we have heard a lot about the problems of 404 compliance, that resources aren't available, that the costs have increased.

I am noticing in Ed Knight's testimony that delistings are way up. Sixty delisting letters due to failure to file Form 10-K, 14 last year. I think there is some uncertainty out there.
Maybe I will ask it more in question form. Is there uncertainty out there and would it be helpful to get guidance, get a recommendation from this committee and maybe guidance from the SEC on the relationship between 404 failure to comply with 404 in various forms, whether it is a disclaimer, an adverse opinion and so on, and being timely?

So in other words, continuing that line of thinking, would you think that a decoupling of 404, at least until we figure out where things are going to land from a cost and compliance point of view, a decoupling of 404 from the idea of whether or not one is timely filed if there is various 404 problems. Is that a good idea or from a self-regulatory organization point of view do you think we have that covered and understood?

MR. KNIGHT: No. It is a good idea. It is something we are having ongoing discussions with the SEC about. We are looking at interpretive room in our rules to give company more time, and we are given companies more time because of these issues.

It is not clear whether this is solely a 2005 issue or something we are going to face
regularly. You are right; the delisting remedy is
a severe one. It is one that is characterized with
a lot of due process at Nasdaq in terms of the
opportunity for companies to make a case before an
independent panel and to the listing council, then
to our board, then to the SEC, all in a very
transparent way. But those adjudicative bodies
have to date shown a lot of flexibility dealing
with these issues. As I said, we are talking to
the SEC about how we can put more flexibility in
the system.

MR. WANDER: Thank you. Any other
questions before we take a short recess?
If not, I want to thank each of the
panelists for the excellent presentations. All of
you were extremely well prepared and we value your
comments. As Drew said, we may call upon you in
the future and you should feel free to provide us
with comments at any point during our
deliberations.

We will come back about, let's say,
five minutes after eleven.

(Recess.)
MR. WANDER: Why don't we reconvene?
We will begin our second group of guests.
A couple members of the Advisory Committee have come up to me and said because of the information we were provided earlier and I am sure as a result of the information we will hear from our next group of panelists, that it might be useful for all of us to stay around for an extra ten or fifteen minutes just to make sure we highlight those things we want to follow up on.
For our future meetings, I have already had a couple of suggestions, which are excellent suggestions, that we actually hold our meeting after we hear from the various panelists so we have an opportunity, while it is fresh in our minds, to dissect it.
With that remark, if everybody could, please, stay just for a few minutes afterwards?
We will begin the second set of panelists and we will start with Bill Carney, who is a professor at Emory University Law School. I pointed out to everybody that in his article which he so kindly sent me a few months ago, his closing
line is "and we will say good-bye to the community
banks, if all this takes place." Right?

MR. CARNEY: Something like that. I
think it was community ownership of community
banks.

Thank you, Mr. Chairman and members of
the Committee, for inviting me. I apologize for
the darkness of the presentation there. I guess as
a competitor I might say this shows up much better
at Emory Law School than at Columbia Law School.

What I have done is a study on the cost
of securities regulation generally, with
particularly emphasis on the increased cost imposed
by Sarbanes-Oxley from filing of Schedule 13E-3 for
calendar year 2004. As I indicate, as a chance for
free advertising this will be forthcoming in the
Emory Law Journal 2005 later this year.

In order to be consistent with the
methodology of earlier studies, I focused on
companies that filed their initial 13E-3, not
amendments, during calendar year 2004.

Let me begin by mentioning something
the other witnesses already mentioned. Not all the
cost increases have been related to Sarbanes-Oxley. SEC has continued to add to the regulatory burdens by accelerating timetables for traditional filings, including 10-Ks. Accelerated 10-Ks, 10-Qs, 8-Ks and expanding the contents in particular of the 8-Ks are among increased costs imposed on registered companies.

But that is only part of the cost. More executive time is spent on these matters than was formerly the case. We also have increases in D&O insurance premiums, increases in auditing fees. The last study I saw indicated a 58 percent increase in auditing fees. A company with which I am familiar is looking at trebling of auditing fees right now. Those are the hidden costs I suppose of Sarbanes-Oxley that you don't get out of the 13E-3 filings I have looked at.

The number of 13-E filings has gone up steadily since 1998, from a low of 25 to a high of 114 in 2004. This has been accompanied by a steady increase in number of leveraged buy-outs. These are the numbers here from 115 in 2001 to 521 in calendar 2004. I don't have data for 2003 but I do
have dollar amounts for those years. If you look
at that you can see the dollar volume of LBOs has
had a very steady rise, roughly 400 percent from
2002 to 2005 projected numbers. I used the first
quarter numbers for LBO's for this year and simply
projected from that.

I have no way to separate those LBO's
that may be partly explained by avoidance of
regulatory cost from those that are driven by other
motivations. But given the evidence I provide
below, it seems likely avoiding these costs
explains at least part of the LBO trend. The
average size of the LBO in 2004 was $261 million.

A striking figure on 13E-3 filers is
their very small size. The median gross revenues
of these companies were only $25 million. There
are some larger companies in the set but not very
many. I have got a distribution of those companies
and you can see that out of the 114, actually,
111 -- I didn't have dollar amounts on three of the
companies -- 66 of them, over half, had gross
revenues of less than $50 million. On the other
end of the scale, there were ten companies that
were in the 500 million revenues and up. At least one of them, Cox Communications, I think, was in the 7 or $8 million range. It is a big company and even it mentioned -- I shouldn't say the cost of compliance. I should say the regulatory cost imposed by securities regulation generally.

One has to assume that of these firms, 114, 44 of them, or 39 percent, not only listed compliance costs generally but specified the compliance costs as a reason for terminating registration. Those companies provided cost estimates. One has to assume these firms were facing further cost increase as they proceeded with their implementation of Section 404. Some of the other firms -- well I think I said that. Excuse me. I am getting ahead of myself.

I think the numbers in the filings understate the cost of compliance and include only out of pocket cost such as increases in auditing and legal fees, as well as cost of hiring additional employees in a few cases, but they do not include increase of executive time and other employee time devoted to these tasks. In some
cases it appears that firms seriously underestimated the anticipated cost of compliance.

One firm estimated cost of compliance with SOX at $25,000 while two others put the cost at $34,000 and $36,000 and I have to believe they were getting out so early that they hadn't looked very hard at what they were really going to incur.

I excluded one very large 13E-3 filer from my numbers because it seriously distorted the numbers. The number I have now is 43 reporting companies that indicated average compliance costs with securities laws of $291,000, of which 174,000 was added by Sarbanes-Oxley compliance, at least that was their estimate. These are very small companies, average net profits of just over half a million dollars, and the compliance cost as percentage of net profit was over 50 percent.

These companies are clearly rational in deciding to exit public markets. Sarbanes-Oxley raised their compliance costs by 148 percent.

Next, I would like to address the identity of these companies. I don't know how well this will show up. There are 44 companies on that
list. Obviously, they are relatively small. I have highlighted those companies that appear to be community financial institutions in blue. Fifteen, or over one-third appear to fit that category. This means community banks and thrifts will no longer be owned by the community in many cases. This bears out that this is having a significant impact on institutions such as that.

In some cases, stock that declined after the bubble burst in 2000 may have found being public was no longer attractive regardless of the increase in compliance costs imposed by SOX. I have attempted to compare the rising number of going private transactions, shown in the bar graph in yellow, and Nasdaq composite in the blue line. What is interesting there, the number of filings began to rise before the market collapsed and it was already on its way up. As the market began a recovery in 2003 -- hard to say 2004 was a recovery, but at least it was up from the bottom -- the number of filings on 13E-3 continued to go up. This suggests to me that compliance costs rather than stock prices or stock levels generally were
the stronger driver in this recent trend.

This isn't the first time we have had a going private movement. It's happened before. I am old enough to remember one in the early 70's. I think others in this room may also remember there was a flurry of IPO's and then a disappointment in the market and then again in the eighties we saw the LBO movement. All that suggests caution, that there may be other forces that create going private movements from time to time. I don't think we have ever seen one where the 13E-3 filers were specifying the compliance costs with the securities laws generally and Sarbanes-Oxley in particular as a reason for doing that.

I should point out as, has been pointed out by others -- this is the website where you can find the paper if you wish to. Terminated registration of the securities laws has an odd set of consequences. It only requires that shareholders drop below 300. It doesn't require that trading stop. We have Pink Sheets. We have broker-dealers who are at least in theory supposed to maintain comparable information on these
companies. There is some testimony that maybe they don't do that as well as they ought to.

What we are doing by driving the companies out of this system is driving them into an inferior disclosure system where they may still be trading. I think this may very well be a perverse result. I am not sure investors are better off with a one size fits all regulation that imposes such costs that companies are forced in effect to exit the public markets.

It has already been mentioned that financial institutions are already regulated heavily on their controls and in that sense Sarbanes-Oxley just duplicates what's already happened. I want to second what the other witnesses have said about that. It seems that it truly is duplicative and adds a layer of cost that really doesn't benefit anybody.

Thank you.

MR. WANDER: Thank you very much, Bill.

We will now go on to Cromwell Coulson and we can probably turn the lights up again.

MR. COULSON: Thank you, Mr. Chairman
and members of the committee for having me here. I am not really going to talk about the implementation of fixing the nuts and bolts of Sarbanes-Oxley. Instead, really what is happening is, with Sarbanes-Oxley having imposed a cost or tax upon issuers, many issuers are voting with their feet and coming to the Pink Sheets. I look at this as an opportunity for two things. One, the historic viewpoint of issuer disclosure has always been through the SEC, through the reporting mechanism. And the position of companies which are exempt from SEC reporting, there has never really been guidance to truly say you need to disclose into the market. It is this gray area. Quite often you heard Pink Sheets companies don't have to disclose, we can't make them disclose. But actually that is wrong.

Hopefully members of the committee will all read the written statements we submitted because they go much more into depth and build what we would like to see come out of this, which is taking a dark part of the market or a splotchy part of the market more transparent through existing
securities laws. That is going to be a great improvement for this space of the market if the committee can get some recommendations to be made by the Commission.

Now, a lot of people don't know what's happened to the Pink Sheets because they remember it was this paper-based phone process. It was not very technologically advanced. But that has changed today. The Pink Sheets is a fully electronic marketplace. We have electronic firm quotes from market makers, we've got depth of liquidity. All the market maker quotes are electronically linked. We have the largest market makers. UBS Securities, CitiBank, Knight Securities, TD Waterhouse, Jeffries and Company, RBC Dain Rauscher, Hill Thompson, large financial services firms. They are automated, they have capital, and they are completely interested in making this market transparent and efficient and providing their customers with best execution.

We brought out two years ago PinkLink, which was electronic linkage of the market makers. This was private. The marketplace decided they
needed it. At PinkLink, we now do the bulk of interdealer trading in Pink Sheet stocks but also Bulletin Board stocks. Of orders sent on PinkLink the average execution response time between broker-dealers is 14 seconds. The average fill rate is 90 percent for orders. This is a good market with good, transparent pricing, and I think I have done a lot to fix the process.

Now market makers and broker-dealers are in discussion about limit order display. This market is moving forward. The problem is the product that is trading on the market. Because we are the farm leagues and we provide a marketplace for shares, the only real thing that defines them and links them all together is they don't want to be or can't be or are too small to be listed on an exchange. That includes emerging growth companies which are too tiny or too new and where the opportunity is, but also most of the regulatory problems. Closely held companies, who have minority investors -- and as you have heard from so much of the going dark debate -- some of these closely held companies are looking to treat their
minority investors fairly and some are not. Some are wanting to cut off the information flow and squeeze out the minority investors.

We also have the economically distressed. We provide a place for securities to trade when they have fallen off an exchange. And some of those securities fall off the exchange and don't come back. Others, like HealthSouth, fell off an exchange, was delisted from the exchange at 20 cents and they fixed, and is now a $5 stock. And investors have been better for having access to a transparent, efficient market for those shares. And exchanges are better because they have the ability to delist securities but not totally shut down the market for the minority investors.

Now, the effects of Sarbanes-Oxley is, we have got more companies come to the Pink Sheets. It is a good thing for me, for my business, and I can't say it is not. We have been picking up a lot of high quality listings. And we have really been picking up two types. One type says this is a cost and we are making a case to our shareholders that this money is better spent on the business or in
dividends or buying back stock. And these guys have wanted to continue disclosing information to the marketplace.

We have another group that has said, "We are delisting and we are not going to tell you anything." You can tell that they are just looking to prey on the minority shareholders to buy out those shares and by going dark they are going to manipulate the secondary market price, and they have been very successful that if you look at those stocks, they have gone down.

Now, we have created what I call a third path for disclosure. The SEC has EDGAR. Of being a reporting company, there is two tiers, the large and small companies. We have created a service called Pink Sheets News Service where issuers can supply their financial information to the marketplace in a low cost basis, and it is displayed for free for investors on our website. We have had great interest in companies that are delisting for Sarbanes-Oxley and wanting to keep transparency of information.

Now, we have also had great success
with the SEC has been using information displayed in the Pink Sheets News Service for enforcement actions and it cut short potential fraudulent activities. We have made statements in court cases they have done. So, it is very good to know that even if you are disclosing outside the SEC EDGAR system, there are still consequences if you lie to investors.

But it is not all so bleak. We have heard all day about nobody on earth would become a reporting company, and that is completely wrong. Companies are becoming reporting all the time. And that is because of another dynamic that's happened in the market: the changes in the financing environment. As Mr. Patricof said earlier, small issuer offerings are not being done anymore. The demise of the underwriter for small companies is well known. Part of that is that there are problematic underwriters, otherwise known as boiler rooms, that the NASD has done a very good job of running out of business. The other side is, the profitability of that space of business has been removed and the small underwriter does not sell to
However, the small broker-dealer and others are providing financing for issuers and that is being done via the PIPES market, Private Investments in Public Equity Securities. PIPES are based, though, on secondary market liquidity. The funds buying PIPES are only going to buy a PIPE if they think they can eventually access the secondary market.

Also there is the demise of research. Demand is now being created by IR firms, paid research and promotion. And this is not a bad thing if done well, but also there is the problem that promotion can be done to spread lies, and that is an enforcement issue.

The secondary market liquidity comes from a self-directed investor. There are not brokers pushing these securities to individual investors but instead investors are finding these investments. It is good for companies that need the capital. It is a complete shame if they are buying an investment thinking it offers potential
for growth and instead the money is being routed
into some fraudster's pocket instead of some
company that needs capital and can use it to grow
and hire people.

Now, the world has changed with demand
and distribution coming from different sources but
the base problems are still out there. There is
still fraud and deceit by insiders upon outside
investors. The games are still the same and the
underlying premises of securities laws are still
applicable. But we do need to adjust securities
laws and interpret them to fit the different
players because much of the demand and distribution
of securities is coming from unregulated entities
outside the system.

Promotion and distribution of
securities is occurring via the secondary market
without adequate current information being made
available to investors and conversely companies are
going dark to squeeze out minority investors.

Legitimate issuers are given no
guidelines by the Commission on how to disclose
information if you are not a reporting issuer.
10 Historically under 144, issuers would -- 144 has a
11 requirement that there be adequate current
12 information publicly available. Issuers are
13 turning and saying, "My issuer has distributed
14 their annual report to their shareholders, to any
15 broker-dealers who requested it, to the market
16 makers in any statistical services. Under those
17 facts and circumstances is the issuer making the
18 information publicly available?" And the SEC would
19 write back and say yes.
20 Well, in the early eighties the SEC
21 replied to one of those letters and said, "We are
22 not able to make a determination on this issue and
23 any of our previous communications cannot be relied
24 on." So people are left in this darkness. How do
25 I make my information available? And that was a
1 trend which was saying everybody should become SEC
2 reporting. If you are not SEC reporting, become
3 voluntarily SEC reporting. That was an interesting
4 trend because it didn't cost that much.
5 Sarbanes-Oxley changed that. It cost a
6 lot to be SEC reporting. There is a value quotient
7 but there is a certain size that value becomes a
tax that makes you want to move to a lower tax
venue.

Also, with changes in the way financing
is done means the disclosure needs to be more
marketplace governed by the Exchange Act and it is
more relevant than disclosure in an offering
document because the truth is that offering
document is the stock is going elsewhere after that
security is becoming freely traded. Disclosure
rules, therefore, need to focus on the needs of
small cap investors when companies are publicly
traded rather than when the stock is initially
issued.

I look at this Committee as an
opportunity to fix two problems. One, you have the
ability to put forward regulatory clarity for
nonreporting issuers so this section of the small
company marketplace becomes more transparent and
more efficient when issuers are interacting with
the secondary market
Two, you have an ability to protect
investors when companies go dark with a malicious
intent to squeeze out their minority investors.
I am going to go through it at 30,000 feet of various areas I think general principles that should be put toward in securities laws to clean the system up, and we can move forward. A few of the examples are going to come from the AIM Market, which has been I think the most successful small cap market. I would very much ask the committee to take a look at the AIM Market and how it works because more and more companies worldwide, including American companies, are going to the AIM for access to capital.

I have done a very good job of improving the Pink Sheets trading and if you have got a stock and you are disclosing to investors and you are not looking to raise capital, the Pink Sheets is a great system to have your securities traded on. There is lots of market makers. Anybody can buy it through a broker-dealer. They are best execution, there is great compliance in the trading process. This is a good thing but we need to work on the issuer disclosure.

We have two problems because we -- three problems. One, we can't force issuers to
disclose all the time. But on the flip side, we can force them to disclose if they are interacting with the market. Two, we have a problem that some issuers can use not disclosing to try and kill the secondary market so they buy people back. That is just as bad as selling someone an overpriced security is stealing something they have. Three, we have a bunch of unregulated entities who are interacting in the market and we don't know what they are doing.

So what I look for is, one, disclosure. Investors need to be protected with disclosure by nonreporting issuers when the issuers or its insiders and affiliates are interacting with the secondary market. That is a principle 10b-5, antifraud. The belief is the uninformed may trade with the uninformed; those that are informed may trade with each other; but the informed may not trade with the uninformed.

After they fall out of the SEC reporting regime there is no guidance for non-SEC reporting disclosure. There needs to be a correspondent to Reg A, which is an offering you
can do without being SEC reporting and get free
trading stock; and there is the Rule 15c2-11
has information disclosure standards, but it is
wrongly written because it should be the issuer,
not the broker-dealer.

The AIM model really looks for
disclosure of annual and quarterly financials,
market activity by insiders, holdings, and they
have a broad idea of any interim information that
could affect the stock price.

That is the general -- and I lay out in
my written statements more of the meat of the
details how to get there. I would really love to
have all you read it instead of going into detail
and pushing it forward.

Another question. The size of the
reporting company. Based on the number of record
holders in this day of electronic book entry is
ludicrous. The committee should look at market
cap, public float, round lock beneficial holders,
but 300 for beneficial holders is way too low and
the committee should really look at for what size
of company the tax of Sarbanes-Oxley compliance is
worth it. That is being a reporting company, but
don't say you don't have to disclose if you check
out.

I also believe -- everybody is throwing
numbers at you left and right. Really the SEC
needs to implement that numbers need to get
adjusted over time. There needs to be a process.
Markets change and there needs to be every five
years or ten years the SEC goes through and decides
what are the rational numbers. We have been very
lucky that our economy has expanded, the amount of
equity on the exchange has expanded. To stick
these things up is the same debate we had with the
alternative minimum tax. The numbers need to move
forward with the prosperity of America.

Another area, which is broker-dealer
relationships with issuers. The secondary market
and the Pink Sheets and the Bulletin Board has
changed to firms that are doing the supermarket
approach where they trade every security. They are
much more interested in providing best execution
for their clients and they do not have a
relationship with the issuers. In fact, the NASD
has a rule which says broker-dealers cannot be paid
by a issuer to make a market, file a 15c2-11 form
or other actions or engage in due diligence of that
issuer, which is incredible. That is a leftover of
the time when a fraud was done by a boiler room
that made a market in it, that had a relationship
with the issuer.

Today it is different and I think it is
a good thing that we have lots of big financial
services firms trading these securities. But on
the other side is, we don't want to drive away the
regulated broker-dealer from providing advice to
small issuers because in England, on the AIM, they
have the NomAd example. To be on the AIM really
all you need is a Nominated Advisor, who is a
broker dealer or in some places an accounting firm
who vouches for you, and that guy has a business of
understanding his clients and he is not going to
blow up his business for one client. Of course,
there should be protections that a market-maker --
if a NomAd has a question, they cease being a
NomAd --

MR. WANDER: Cromwell, since we have
three more witnesses, can you sort of wrap up?

MR. COULSON: Real quick wrap up.

The other one is 15c2-11. Its history is it has been reproposed three times. It is an awful rule. I write about why it is. The short reason, you are asking a broker-dealer to do a pro bono merit review with the idea that if they see something bad they will stop trading it. That is the idea of turning the water off in your house if your pipes leak. It is also bad because it is in the Market Reg part of the SEC. It needs to be in Corporate Finance. It needs to be in Gerry's office.

The other areas, the small ones are finders. I think we need to fit them into the broker-dealer area, which are you are going to hear a lot on. Promotion. Promotion needs disclosure of when it is happening because it is happening outside of the system. And also securities received for promotion need to be made restricted. We also need regulation of broker-dealer transactions. The point to regulate broker-dealer transactions with issuers is not at the
market-maker point but at the transactions with
insiders and affiliates because that is the point
under Know Your Customer, you are going to be able
to tell someone is accessing the market and doing
something bad.

That is my quick wrap up.

MR. WANDER: Thank you so much. Next we will go to Michael Taglich. Welcome.

MR. TAGLICH: Thank you very much.

That was some speech there.

My name is Michael Taglich, President and founder of Taglich Brothers, which is a broker-dealer focused on microcap and small public companies. We invented paid-for research. We are the only NASD member firm I know of that conducts that business. We were ranked number in United States according to Investars for research performance for 2004 and number 2 in the country for the four years ending December 31, 2004 by Investars.com, as well as number one in the United States in research performance for the 24 months ended March 31, most recent quarter.

We are engaged in leveraged buyouts.
We also are engaged in public offerings of small public companies and we assist institutional investors, generally hedge funds, and individual investors in investing in small public companies. I also am the chairman and have been from time to time of different small public companies.

We invented paid-for research as a solution for a market anomaly which is effectively small public companies that under the old model didn't offer the opportunities of a corporate finance transaction in the near term to finance their research report or generate enough in the way of trading volume to get a research report out there; just didn't get research.

We thought it was a very inefficient way to allocate research. When you are a small public issuer, what you really want is everybody in the world to have an understanding of what your future looks like, your risks and rewards, and have a best guess of what the next 18 months looks like. And if everybody in the world had that understanding, they would be able to price your stock appropriately and your securities would be --
you could do more with your stock than just buy it back.

It has been a very effective program.

There are people skeptical with regard to conflict of interest. They are involved in that. We think we managed that very, very well. It is an area of the marketplace we think will grow. I've also argued it is much less conflicted than the larger firms in a typical research model.

That being said, one of the main reasons I am here is to bitch and moan about Sarbanes-Oxley which may not come as a shock to you folks. Frankly, I think it is a really silly regulation. 404 expenses provide dubious value, which I have yet to see anybody really put a number on, academic or otherwise. It is terribly frustrating for management teams to be wasting, especially at small companies where assets are limited and capital is difficult to access, to be wasting what would be the cost of one, two, three or four engineers or otherwise a material dividend to shareholders on regulating, effectively, the honest.
I would argue, and anybody in the accounting business or law business will attest to it, if someone is dishonest they can find a way to fool their auditor. You can put all the controls in the planet on them. This is effectively a tax on the good.

If the shareholders had an opportunity to vote on it, or the board, whose fiduciary responsibility to make sure things are correct in the first place anyway had its say, none of these expensive controls would be laid in the way they are. There is really no productive reason to do that.

That being said, it is a terrible handicap which pains me as a patriot because the access to capital is a great strategic advantage for small American companies versus the rest of the world. And the reason why our markets work as well as they do is not because of the SEC or any law body. It is because we generally have a populace that is generally honest and we have got directors of public companies who are generally exercising a fiduciary responsibility and investors that will to
take a bet thereof.

I would support and I think it is something the commission should consider, eliminating Sarbanes-Oxley for Bulletin Board companies. Pushing companies to the Pink Sheets -- which there is nothing wrong with per se, and will become a better market -- it doesn't really matter where a stock trades at the end of the day. It is going to trade based on what people's perceptions are of what the future is. You want a better market if you can. The Bulletin Board is a better market than what the Nasdaq was six years ago. If you are looking for a way to cover yourselves, make the Bulletin Board SOX-exempt and anybody who buys a stock there and loses money based on what the existing fraud statutes were, it is a caveat emptor market.

Let the good money find out where they want stocks listed and get yourself out of the business of doing it. Worst case scenario, let the Commission say, "Look, you are a sucker. You bought a Bulletin Board stock," which I don't think will be the case. The Bulletin Board is a
very efficient market, getting better every day and
shouldn't have the stigma that it has.

You tend to think, from a Commission
standpoint, about stocks exchanges as buildings. I
don't think the investors care. I don't think you
get a premium valuation if you are more SOX
compliant than otherwise. I would like to see
opportunity for issuers to vote themselves out of
SOX and disclose it. If the board decided to
recommend to shareholder they voluntarily exempt
themselves out of SOX I think it would be a
terrific thing.

I think the SEC does a lousy job and
can never do a good job of rooting out fraud in the
marketplace. I think the marketplace would do a
much better job, specifically if restrictions
placed on short selling were lifted. Short
sellers, for all the supposed abuses -- and by the
way, I am not in the short selling business. I do
nothing on the short side. I don't believe in it
as a great long-term strategy but there is plenty
of money out there that plays the short side of
stock. They perform a great public service, far
more efficient in rooting out fraud and keeping

fraud from happening. If there weren't certain

regulations in place, many of the excesses that

happened, the so called boiler rooms, would have

been wiped out by the marketplace without a finger

being lifted in Washington.

I think those are all things to

consider. I think it is okay to have a CFO sign in

blood on the numbers. That is well and good. But

these additional regulations don't make anybody

richer. They make the country poorer. And since

we are all patriots here, we should look for a

vibrant market with as many companies as possible

being public. And it shouldn't be based on all the

regulations the SEC drops but on it but should be

what the board and shareholders agree is

appropriate regulation. Again, if you lifted

regulatory burdens on Bulletin Board companies and

let these marketplaces compete side by side, you

would find, I believe, that there would be more

and more interest and net-net, I think the

marketplace would be happier.

We are very close to reaching a tipping
point where the marketplace for small company equity is going to be moved off shore. I'd consider making a major effort creating an off shore marketplace for American public companies. If SOX gets implemented like the timetable says it will be, I think there will be a great move off shore for markets. Lastly, the least you could do if you keep the regulations in place is certainly extend beyond '06 and the size limit should be raised too, say $150 million.

MR. WANDER: Thank you. Did you submit a written statement?

MR. TAGLICH: No.

MR. WANDER: Could you provide us with some of your recent public offerings and some of your research?

MR. TAGLICH: I would be happy to.

MR. WANDER: So that we can circulate it. Just get it to Gerry.

We thank you very much.

Next, Gayle Essary, Chief Executive. I appreciate the opportunity. I am not here to talk about Sarbanes-Oxley. I am waiting for the
applause.

I am here really to talk about research. I know that that is something that is significantly interesting to many members of this committee. Appreciate the fact that Mr. Schacht is here and he represents, I guess, the largest contingent of credible professional analysts in the world. I hope it is self evident that the proposals that we have been advocating for standards of transparency and credentialing, conflict resolution, equal distribution and research conduct are the antithesis to our purely business interests. We are surrounded in our industry -- picking up a little bit where Cromwell left off -- by promoters and so called research providers that are producing substantial revenue and profits for their owners and shareholders by shunning ethical practices. Therefore I hope you realize our advocacy rather than being self serving is quite the opposite and predicated on long term opportunities that might exist if there were an ethical playing field and if the public continues to respect the shareholder empowerment platforms
that we and others like us produce.
I am also Executive Director of the
First Research Consortium, which promulgated a
couple years ago the standards for independent
research providers and I submitted that as part of
our written statements for you all to look at.
We agree that the road to liquidity and
capital raising ability for smaller public
companies rests on analyst coverage, which after
all is simply an informed proxy for individual and
institutional investors. However, that coverage
must be believable, it must be free of conflict, it
must be transparent and it must be professional.
Ten years ago Investrend Research --
seems like only yesterday -- established a model
which remains the standard today. Investrend
Research does not produce research. Investrend has
no clients. We provide no services to a company.
A company enrolls in our program on behalf of its
shareholders-- and that is understood with the
company when that occurs -- and pays Investrend an
enrollment fee. Investrend then facilitates
assignment of an analyst from a pool of around 70
that are prequalified, most of them have gone through the exacting CFAI programs.

The analysts and the company then work through the research product after which the analyst signs off on the report and submits it to the Investrend research syndicate, which then is obligated to publish it to the largest possible distribution base to ensure equal and full access to all classes of investor. The analyst is paid in advance for his or her initial report by Investrend and not the company, to eliminate any connection between the fees and the analyst. The analyst may not own or trade in the shares of a company under coverage and neither may officers of Investrend nor our company itself.

Investrend has adopted the CFAI analyst guidelines and, more importantly, the standards for independent research providers promulgated by the First Research Consortium. We held public hearings and received public comments over our procedures and each of some 7800 reports all had a statement inviting submissions from the public for any better ideas or better procedures.
In the period between our May 24 comments which we submitted in writing and today's testimony -- you can see how fast this industry is moving -- two new enterprises have emerged with some hoopla. Both have been invited to adopt the standards for independent research providers. One did not respond. We are engaging in discussions with the other. However neither have proposed anything new or superior to the practices now in effect or have been in effect for the past ten years and neither have put forth any proposal that has as its basis anything other than the company pays for the research.

We remain poised and ready to work with any group or entity, including your committee, to develop a different or more creative model to pay for the cost of coverage, including some ideas which we submitted in writing to you. We have not clearly formulated our attitude towards an exchange engaging in a for profit enterprise to provide investment recommendations on its own listees or whether that is a conflict. But the book should not be fully closed until that is evaluated by the
If there were going to be a serious effort to provide alternative funding for research coverage for companies listed on a particular exchange, we would have gravitated to all or part of that paid out the listing fees with such an exchange to ensure investors have negative research as well as positive research from those who voluntarily -- which primarily are those who believe that they can meet the test of an independent professional analysis. But it appears that at least one exchange sees this as a revenue generator rather than as an investor service.

However paid for, distribution is key to investor attention. If smaller companies as well as institutional investors cannot have timely and equal access to published research, then the system is flawed. Today, although having our own financial wire distribution channels to reach the disclosure points, the Investrend research syndicate also uses paid press release distributions. However, some press release services do not allow tickerization unless sourced.
by the company due to what appears to be a rather
overriding policy instituted by Yahoo! To keep
third party promotions and pump-and-dump campaigns
off its site. At least one press release service
will not even discuss or disclose its policies,
which appears to us to be sort of all over the
place.

Sourcing by the company does not suit
the standards since it provides a covered company
with a veto over a negative report or update. We
would work with any group to help Yahoo! and
legitimate press release services establish a
policy that achieves the distribution standard.
Distribution of one class of investor and passing
along a headline regarding a recommendation or
rating to the public without disclosure and access
to the full report is really a form of
institutionalized pump-and-dump and should not be
tolerated.

A word about our standards. We've long
advocated to CFA Institute and National Investor
Relations Institute that it is a fatal conflict to
allow analysts to hold a stake in their ratings, so
far without a great deal of success. New York Attorney General Elliott Spitzer does not see this as a problem, he recently told me in a private conversation, because many institutions ban their analysts from holding stock in the companies they cover, to which I responded, "Doesn't that make the case why it should be banned altogether?" He then had some other thing he needed to attend to.

The standards for independent research providers prohibit this practice but to completely engender confidence in the analyst profession this needs to be addressed on an industry-wide basis.

Finally, we need to discuss the proliferation of questionable research profiles, reports, analysts comments that confuse investors in the marketplace. At one of the CFAI-NIRI events one of the co chairs of the committee that worked out the program talked about the faxes received. We are a part of Junkfax.org and these are faxes we received over the past four or five months submitted to us by the public and that we exposed over 125 companies that have either used these or some unnamed third party has used these to
apparently sell out of their stock.

Even some otherwise legitimate research providers take stock for their coverages, making substantive amounts if their coverages results in price appreciation. They fail to provide any information about analyst credentials, take advantage of the SEC loophole that seems not to require the real person payers behind promotions to be absolutely identified under regulation 17(b), take advantage of 17(b) loopholes that let companies issue reports without any disclosure as to payments, use spam emails and junk faxes.

Stock should not be used to pay for promotions, directly or indirectly, since that is essentially using shareholder resources in a way that is at odds with shareholder interest.

However, stock pooled in a central repository or sold prior to the institution of coverage should actually be explored as an alternative means by which shareholders might pay for a service for which shareholder value is the objective.

Again, I thank you for the opportunity
and that completes my comments.

MR. WANDER: Thank you very much.

Could you also supply us with some examples of the research product? Your letters have been very interesting and I have read them, but it would be useful to see those.

MR. ESSARY: I would be glad to do that.

MR. WANDER: Next, David Feldman.

MR. FELDMAN: Thank you very much, Mr. Chairman and good morning, ladies and gentlemen. Our law firm represents issuers, investment banks, investors and deal makers, primarily in combination financing transaction, including reverse mergers and PIPE transactions. Among other things, we have the unique distinction of having completed more PIPES representing investors than any other law firmin both 2003 and 2004.

We also represent a number of publicly held entities that have periodic and other reporting obligations and I am honored to be here today to express our views on the direction and
agenda of the Advisory Committee to our experiences in the private bar.

In general I believe the committee is setting the right tone and seeks to focus on the main areas that are ripe for attention. My hope is simply to ensure the committee looks especially closely at the smallest public companies, those under one hundred million in market cap or less than a hundred million in revenues and not adopt too broad a definition of smaller public company so as to dilute the interest of those most in need of assistance, namely the smallest of the small.

Some argue these smallest companies probably should not be public in the first place since they wouldn't qualify for a traditional IPO. I strongly disagree. I believe other measures of going public are legitimate and acceptable methods of obtaining a public market for an issuer's securities. In fact, to some extent contrary to Mr. Patricof's comments, we are seeing the increase in popularity of what I have been calling the new small cap IPO, which is a reverse merger together with a contemporaneous PIPE transaction. I think
even greater confidence in the reverse merger market is coming soon with pending rule-making activity through Mr. Laporte's office. 

In the end, any company of any size seeking to grow by acquisition using publicly traded stock as currency, reward executives with valuable stock options, seek greater and easier access to capital or simply provide liquidity to founders and investors can benefit from being publicly held as part of a long term strategy. 

Congress, the Commission and the Committee will, I hope, will seek ways to ameliorate the more draconian burdens on these smallest companies, to improve opportunities for growth through publicly traded stock rather than simply write them off as not needing protection from those who believe they were premature in going public in any event.

Many of the foci of the committee, including reviewing the challenges, internal controls, corporate governance and so on, are strongly applicable to these smallest companies as well and I am not here also to talk about Sarbanes, but the burden on a $50 million company that is
growing and profitable of developing and testing
internal controls is much more significant in terms
of its relative impact on and cost to the
organization than the burden on a $200 million
company in the same situation.

In addition, some of the challenges
faced by all smaller public companies in the area
of capital formation apply also to the smallest.
Thus, while the topics chosen are generally of
significance or importance to all public companies,
I am hopeful the committee will seek to distinguish
even within the smaller group to analyze the effect
on the smallest.

I believe you are hearing from many
commentators as to the potential changes in
Sarbanes. I would focus on five areas I would
respectfully propose you include in your focus
beyond or within what you proposed in your agenda.

First, form 8-K reporting. In many
cases it is difficult for a smaller or smallest
public company to bear the cost of constantly
monitoring its compliance with the new four day 8-K
reporting requirements. I believe the Committee
should review whether they should be provided the opportunity for additional time or the right to extend time in certain situations, comparable to current Rule 12b-25 so as to avoid inadvertent noncompliance or particularly burdensome costs such as overnight, speedy or EDGAR filing services.

Second, Regulation S-B. With due respect to the authors and their intentions I do not believe there are valuable or significant differences between Reg S-B or Reg S-K other than the one additional year of reporting under S-K, which is really only a burden in the year a company goes public. I believe the Committee should review the possibility of a major overhaul of Reg S-B with a view to more clearly streamlining disclosure problems for smaller companies. And I believe you should focus more on materiality of disclosure much as we do with Reg D offerings to non-accredited investors, and less on rote disclosure of categories of information that may have no absolutely no significance to a particular company.

Third, short form registration. I believe the committee should look at streamlining
the concept of "seasoned issuer" for eligibility for short form registration. A strong company that has been public a year or two and just happens not to have significant market capitalization but which which has been following all applicable rules and making all necessary disclosures should be able to avail itself of short form registration to improve its ability to raise capital and grow.

Fourth, the Pink Sheets. As Cromwell mentioned, in my view there remains significant fraud on the Pink Sheets, though lots of great opportunity. I would propose, in order to improve confidence of investors that you seek some rule changes in this area. These rule changes could in my view begin the process of requiring minimal public filings by these issuers. For example, I think most Pink Sheet traders don't provide the 15c2-11 information to their market makers. One change could be to require the issuers to file that information either with the SEC or with the Pink Sheets controlled website so any investor can obtain the information and so that compliance can be better monitored by the Pink Sheets or
Commission staff.

In addition, I suggest requiring the reporting of insider trading and stock accumulation by making Section 16(a) and Section 13(d) applicable to Pink Sheet traded companies even if not registered under the Securities and Exchange Act.

Fifth and last, Capital formation. A key area is treatment of brokers and finders as discussed. I am hopeful the Committee can assist in providing stronger guidance to practitioners and issuers as to treatment of these critical intermediaries especially for smaller companies. For example, staff guidance has not always been consistent from the SEC with regard to the definition of a finder. I also believe that broadening exemptions from registration will significantly aid in the growth of these smaller companies.

For example, Regulation D should be broadened to permit larger numbers of nonaccredited investors so long as disclosure and non-general solicitation requirements are met which would
protect these investors.

I also believe the Committee should examine the effective prohibition on conducting private offerings while public offering registration is pending. Technically private offerings may continue through financial institutions, but as a practical matter this does little to help a small company seeking to bridge its operations through a public offering. These private offerings should be permitted so long as the investors are accredited and general solicitation is avoided other than through the filing of public offering registration statements.

In conclusion, I believe the proposed agenda does represent a very positive step in analyzing the dizzying array of burdens, requirements and brick walls which are making it more and more difficult for the smallest public companies to see benefit in remaining public or going public in the first place for that matter, despite the benefits to be gained by these companies in many cases. If the goal of the committee is to make going public more attractive,
I think the proposed agenda represents an excellent place to start and I thank you very much for your time.

MR. WANDER: Thank you, David.

Now our last witness, John O'Shea.

MR. O'SHEA: I would first like to express my appreciation for being invited here to testify in front of the Securities and Exchange Commission Advisory Committee on Small Public Companies. I speak from a dual perspective: First, as President of the New York Stock Exchange, an NASD member firm that has small business issuers, SBIs, as clients. Secondly, as an individual who acted as officer and director of and invested personally in many SBI's.

I have been working with SBIs over 20 years now and witnessed numerous changes in regulations aimed at smaller issuers that have successfully improved market transparency. By contrast, the Sarbanes-Oxley Act, SOX, has placed a broad based burden on public companies issuers of all sizes. While there are many positive aspects to the act, the audit review standards are
particularly onerous. In the case of larger
companies, I believe the burden can be absorbed
with minimal impact, with the benefit realized by a
majority of investors. In the case of smaller
public companies, I believe the cost, both
financial and by use of management resources, has a
disproportionately large effect and these expenses
are not commensurate with the benefit received by
the smaller number of investors.

In response to this I note two negative
trends. First, many issuers are choosing to
terminate their registration or go dark. Second,
an increased number of issuers are choosing to go
public in markets outside of the United States.
Both of these fall under the law of unintended
consequences, having an effect the exact opposite
of what SOX attempts to accomplish. Rather than
increasing disclosure and providing stronger
controls, many issuers are terminating previously
available disclosures or, by going public
elsewhere, not providing them at all.

Approximately 200 companies petitioned to delist
their stock in each of '03 and '04. This compares
to just 67 companies in '02 prior to the implementation of SOX. This has resulted in an estimated loss of 4 percent of smaller companies from the public arena per year. Short of taking costly legal action against the issuer and further burdening our courts, investors in such companies have little recourse. The securities are either moved to the Pink Sheets or stop trading all together, often reducing share prices to fractions of prior value and leaving investors in the dark regarding the company's operations.

The second trend is the growth of competing, non-U.S. marketplaces catering to small cap companies, particularly the Alternative Investment Market, the AIM, in London. In 2004 the number of international companies listed on AIM was 116, nearly double the 60 from '03. By contrast, over approximately the same period, the number of issuers across the Nasdaq, Small Cap index and OTC BB has remained even. Among the listed companies AIM includes 17 U.S. companies and 28 Canadian companies. Some abandoned their U.S. trading status in order to join the AIM, and some never
pursue trading at all. Coming to its tenth anniversary this Sunday has been praised in international press for its continued growth beyond expectations with limited scandals. Our own investment banking clients, including Chinese, European and even U.S. issuers have requested that we consider the AIM as an option for them, an alternative to U.S. markets. Additionally, our customers who invest in small cap stocks are expressing an interest in purchasing securities in non-U.S. markets.

Further emphasizing this attraction is the fact that newer markets are being formed that are emulating the AIM rather than Nasdaq. In the past two months alone two markets were launched, the Irish Enterprise Exchange and European Alternate Market. Each focused on small cap companies. As these alternatives become increasingly available and credible, issuers both U.S. and international will have less incentive to face the complexities and cost of comparable U.S. markets.
In light of these two trends I offer the following specific recommendations which are further detailed in my written statement:

Definition of smaller public company.

I find the $700 million threshold discussed in other comments to be appropriate with respect determining whether accelerated filings should be required. An alternative would be a market capitalization of 500 million, the average of the companies on the Amex and also the competing AIM.

Companies falling short of these thresholds already face difficulty meeting their current deadlines as auditors routinely push them to the back of their queue as they service larger, higher profile and higher paying clients.

I further recommend the definition of SBI to be expanded to include companies with market capitalization beneath 100 million and standards be customized for them. SBI's are the companies with the greatest potential for growth, that create the most jobs and fuel our economy. These often grow into larger cap companies or become acquired by larger cap companies, thereby fueling additional
growth. If we do not nurture our SBI during their incubation we will continue to lose that innovation to markets outside our borders.

Disclosure requirements. I believe the current periodic reporting requirements for SBIs are appropriate and beneficial to the marketplace. In addition to giving SBIs more time than accelerated filers to file their reports, thus giving them greater attention from their auditors, I would suggest the SEC work with the PCAOB to encourage non-December 31st year end fiscal years.

I do believe the four day 8-K reporting period can be burdensome for most SBIs particularly in two situations. For major corporate events such as mergers and acquisition Form 8-K should have a complete description of the transaction and related financial statements. Due to limited resources of SBIs, the four day limit may cause an incomplete filing which provides uncertain information to the marketplace and then needs to be amended. Additional time would help that ensure all pertinent information is released simultaneously.
The second situation would be for sales of unregistered securities. In private placements or PIPES securities are often sold at discount to market. Upon announcement of a closing of a PIPE frequently the stock price has a negative reaction. If multiple closings are held many announcements within four days while the offering is still open may hamper ongoing selling efforts in the event market price declines in response to the announcement. This could cause the result of not raising the additional funds that the company may have needed to continue growth. I would propose instead that an 8-K not be filed until after the offering has been completed or terminated.

Modification of Rule 15c2-11. Our firm has filed numerous applications on behalf of issuers since inception of Rule 15c2-11. I agree with the idea that more information needs to be placed in the hands of the investors, not in our filing cabinets. The Pink Sheets implementation of a form in which companies can post information has been a very important step. I would suggest that the SEC or NASD support them in creating rule
changes requiring companies to post this
information and/or creating a separate public
depository.

Regarding approval process of 15c2-11, I recommend that a revised list of standards and requirements be published. As the current application items do not encompass the qualitative standards that examiners review in the course of most applications. I further support the position, subject to disclosure, broker-dealers be allowed compensation in connection with assisting companies to become traded. As scrutiny of companies attempting to become quoted has increased, the number of firms filing these applications has declined. Allowing compensation for broker-dealers would create incentive for firms to reenter this space and devote resources to support them. Perhaps then, like the AIM, which has a paid Nominated Advisor service, the OTC can break free from its current stagnation and begin to grow.

I thank you again for the opportunity to express these views.

MR. WANDER: Thank you very much, John.
We have probably 15 or 20 minutes, so the floor is open for questions from members of the advisory committee.

MR. DENNIS: One question. Very interested in Michael's comments about the investors and your thoughts about their willingness to not comply with SOX if given a choice of a vote. I guess I want to clarify that. What you were saying is that, I assume, a company that is listed on Nasdaq, faced with that stockholder vote, would elect to go to Bulletin Board and not comply with SOX, or would you propose that they remain listed on Nasdaq? Does the Bulletin Board become the AIM of the U.S.?

Then I would like also John's comments around those same kind of thoughts as to how he sees that concept working on his clients.

MR. TAGLICH: The Sarbanes-Oxley before it was Sarbanes-Oxley. The board always had the opportunity to make their internal controls as strong as they would like to. Audit committee of a public company always had the power, if they wanted to, to hire all the controllers they wanted.
Historically they hadn't chosen to lay on all these additional costs, beyond where they are right now. Then Sarbanes-Oxley comes along. I believe the individual investors would much prefer the marginal dollars that are dropped in Sarbanes-Oxley to otherwise be spent in the business or paid out as dividends. And if we made the Bulletin Board our AIM so to speak, where it was back to the pre-SOX regulations, pre-SOX costs, I think you would see a flowering. It would be much easier -- first, it would be -- we'd have a direct comparison. You would see some companies move from the Nasdaq to Bulletin Board. Ultimately what makes a market work well is the demand and the supply of stock and the ability of people to trade, and the Bulletin Board is a very efficient market at this point. I would argue sometimes it is at least as good a market as say the American Stock Exchange, for example. I think you'd see a drive toward that lower cost. The marketplace would vote with its feet to a significant extent, and then it would be caveat emptor.
MR. O’SHEA: I would express my answer from the standpoint of dealing with institutional investors as opposed to retail investors because that is we do. The institutional investor has been able to make an intelligent decision prior to SOX and after SOX and they are simply following the money. The issuers are finding the burdens of going public so onerous they go elsewhere and so the institutional investors are following them.

MR. WANDER: Rusty?

MR. CLOUTIER: Thank you all for your testimony. I thought it was very, very good. A lot of great, great comments this morning.

Michael, we have known each other fifteen years. I will do just that for public disclosure. I always appreciate your honesty. I know you have been down there -- I will use a word, on Wall Street, the belly of the beast, so you kind of know what is going on day to day.

My question is, I have heard a couple of comments about following the money. I heard it from Seidman, that auditors follow the money. Obviously, on Enron and WorldCom -- I made these
comments yesterday -- you can follow the money.

My question is, on research, have

things changed much since Sarbanes-Oxley?

Supposedly there are still the Chinese walls in the

investment firms, but I think really if you do

business with somebody, if they take you public, if

you do some investment banking, the Chinese walls

most probably aren't any stronger than they were

before.

I guess my fear is that with the large

investment companies, we still have the fear of

another WorldCom or Enron out there. As a friend

of mine says, the big gets the gain and we get the

pain. It is the smaller getting all the pain.

My question to you, Mike, you have

always been honest and blunt, you got your ear to

the ground on Wall Street. Have things really

changed that much since Sarbanes-Oxley was

implemented, particularly on the large companies,

the Enrons, and the large investment banking firms,

or just changed in our part of the world?

MR. TAGLICH: There has been a change.

WorldCom and Enron were frauds. That had nothing
to do with analyst or research reports. Every
market cycle there will be some frauds. There is X
amount of dishonest people and every once in a
while somebody gets away with it.

Getting to research, paid for research
and such, I don't think that there really was a
problem with the way if was beforehand. When a
firm did an investment banking underwriting and
fifteen minutes after they did the deal, a few
weeks after they came out with a buy recommendation
on the stock, I think the marketplace at the time
took that into account.

I think there is in general an
underestimation of how efficient the marketplace
is. Research is only credible based on whether it
is right or not at the end of the day. Markets put
out of business people that aren't credible. If
you get a fax -- you showed a sheaf of faxes
before. Some over the counter heaters or whatever.
If you get something on your fax machine that tells
you to guy some moonglow stock or whatever, it
can't have any credibility, it can't have much
effect in the marketplace. The marketplace will --
the marketplace shut the Reg. S business down long
before the SEC did anything about it.
I think at the end of the day
research's credibility, the firms have a proclivity
to be right. At the end of the day, if there is
one thing you want people to understand is how
right is analyst X. Our analysts don't get paid in
stock, we don't take stock as a payment, our
analysts can't own the stock, although I think all
three of those are dumb policies. I think it is a
terrific when an analyst owns a stock. I don't
allow it because everybody else doesn't. At the
end of the day it doesn't really matter. It is is
the analyst right or not that is important. The
bucket shops and the brokerage firms that have egg
on their face, they have egg on their face because
they were wrong. If people understand where the
market is going around and everything is disclosed
and they can make their bets and take their
chances. They are all grown up people.

MR. SCHACHT: Another question for the
two research guys. I think one of the issues we
wanted to explore with you two is, is there a
solution to this reduced and reducing coverage of
small issuers that is sort of going on in the
marketplace? Is there a private market solution to
that through the sort of services you provide and
others are coming to market, or is there something
this committee should consider from a regulatory
standpoint to try to address the reduced coverage?

MR. TAGLICH: I think we offer a
private market solution that is cheap and a viable
issuer can afford at this point. I do think that
the ability to pay for research out of investment
banking revenues as opposed to effectively
disguising that fact, if you will, would be a
recognition of a potential reality. Specifically,
if you do investment banking for an issuer, you
should be able to throw in research coverage. You
should have to disclose that you did investment
deal X and earned a fee off it, but issuers still
expect when you do an investment banking deal for
them for you to provide some sort of research
coverage.

At the end of the day if the money is
disclosed and people know who it is coming from,
the buyers are going to decide whether the research
is good or not based on whether the analyst has got
any credibility and where the story is. A lot of
people that complained about the conflicts in
research coverage, I thought it was fairly amusing
because none of those people ever paid for that
research. There were people at discount firms
complaining about Merrill Lynch's research. I
don't see why Merrill Lynch owed them any fiduciary
responsibility.
MR. ESSARY: Within the industry we have divergences of views. One of the things we look to is that we don't let our analysts, for example, be price predictors. One of the reasons for that is that if you were to judge -- again, I go back to Mr. Spitzer because he once suggested that analysts should be paid according to how accurate they are. If that was the case Mr. Grubman should have been the highest paid analyst on the Street.

We look at it really from the standpoint of the analyst deciding what the fair value of a company is, dividing that by the number of shares they expect to be outstanding twelve months hence, and if that is more than what the company is currently trading for, so be it. If it is less, so be it. If it is three times as much or half as much, it is insignificant. Whether or not the market ever trades to that is really not our business. Our business is simply to give them the valuation.

As far as how to expand that, that is really difficult. We have done our best to try to
create -- actually, it is a six tier but it winds up being a 17 tier price point opportunity because our belief is that even though we covered NYSE companies and we have covered penny stocks -- I mean less than a penny stock -- we believe that every company should be covered. One of the problems is shareholder education. If shareholders went to their companies and said, look, you can be covered. You can pay $5,000, you can pay $50,000 if you are a larger company, and you can have coverage and you can have something that we can rely on that is an objective, professional opinion and a benchmark -- some benchmarks are set and then a company has to arrive at those benchmarks or not. Those are the kind of things that could happen.

And also, investment bankers could, instead of doing it internally, they could allocate monies to the various independent research houses that would allow there to be a broadening of coverage. Also, I think there are some new rules that prevent in house analysts from going on road trips, and so forth. There is nothing wrong as far as we can see -- we don't do it but we are thinking
about it -- having independent analysts be able to
be available to be able to go on road trips and
give their true opinion. Something that they've
already issued to the public, of course, but
expound on that when necessary.

There are other opportunities to create
some funds where actually public stock could be
perhaps even attributed to that so that the cost is
zero to the company. Why not do that? As long as
it is not held and used as price appreciation but
is sold in advance of coverage, why not do that and
allow those companies that are standards-based to
participate in some sort of a round robin type of
coverages? Because it is, after all, in our view,
it is the shareholders that we report to, not the
company. So, those are perhaps some solutions. We
have suggested some of those in the papers and are
willing to help work on some others.

MR. WANDER: Mark?

MR. JENSEN: Hopefully I am going to
keep this really short because I am hoping I can
get two questions in. I have one for David on

PIPES.
Specifically the practice of short
sellers, the arbitrage situation, what I like to
refer to as death spiral preferreds.

What do you feel about that practice?

You must see it a lot. Is there something that
could or should be done about it?

MR. FELDMAN: I think the good news it
has pretty much gone by the wayside. The death
spiral deals are a thing of the past for the most
part. The SEC is looking into, I think, practices
from two or three years ago. But for the most part
now, the deals are fixed price, they're not
adjusted when the stocks price adjusts. They may
adjust for future financings. So we are pretty
lucky in that the PIPEs we're seeing now, we're
actually seeing PIPE investors become investors,
not arbitrageurs as much, which is one of the
reasons we are seeing a greater trend being done
along with reverse mergers because there is not as
much immediate liquidity in a reverse merger. Yet
the PIPE investors are saying, "That's okay. We're
willing to do due diligence, be careful, meet with
management and not just ask the one single
question, which they used to, which is, "how much
does your stock trade?"

Now it has changed. It really has and
we are happy about it. We told our clients, if you
short the stock going into the deal, you are going
to jail. We think it is important to make sure
every one does their business on the up and up and
I am glad to say in the last few years -- hopefully
John will agree -- that trend has pretty much gone
away.

MR. JENSEN: I would hope so too. If
not, it should be something that's addressed
somewhere.

This is a question for the entire
panel, whoever wants to comment on it. A number of
you mentioned a lot of small business issuers are
moving off shore. I guess the question I would
like to get some clarity on, do you see that as a
factor of Sarbanes requirements, and specifically
404, or the entire regulatory requirements and
overlay of the entire regulatory system causing
that? I am just curious whether it is one thing or
all of it?
MR. COULSON: Since I was visiting the AIM two weeks ago, they were quite gleeful about Sarbanes-Oxley in general. That is their biggest selling point now. Actually, as you look at businesses, the fourth leg of Pink Sheets quotations is ADRs of large foreign companies like Nestle, Heineken and could easily be companies on the AIM. One of the big reasons -- there is two big reasons they have been successful. They are very much geared towards the capital raising process and they look at issuers, new issuers coming in as getting them access to capital.

Two, I believe the Nominated Advisor, of having these issuers who are raising capital have a disclosed relationship with a broker-dealer is a good thing and it has been highly successful. That is something which we don't have in the U.S, is almost illegal on the market making side in the Bulletin Board /Pink Sheets space.

MR. WANDER: Drew?

MR. CONNOLLY: Thank you, Mr. Chairman.

Once again as full disclosure, I have had a 25 year relationship with Mr. O'Shea, I've worked for him
twice, we are better friends than I am an employee.

I have had a long and continuing business relationship with Mr. Essary.

The concern I have is that this committee absolutely has heard this testimony. We have an awareness that these issues are being responded to by significant professionals. The Pink Sheets, for example, Mr. Coulson and I have had multiple conversations and I have to take my hat off. I was a stockbroker when those Pink Sheets were pink sheets and they were stapled together and in order to get a trade done you literally had to make three phone calls to get three different quotes and prices. Had I been approached to be a member of his LLC and be privileged to be an investor side by side in Pink Sheets LLC, any day. If in fact he follows the lead of New York Stock Exchange and Nasdaq and chooses to go public, I certainly want to know about it. His performance in creating a truly transparent marketplace, his continuing testimony both to Congress, the Small Business Foundation Forum annually, his support and help to the CEO
Council and his continuing awareness of his both privilege to be in the space and his public duty therefore to clean up the space.

I think we are both very much committed to removing the term fraud from the phrase penny stock fraud. For that I am truly grateful. I hope we pursue this marketplace and its potentials in the capital formation process.

I was unaware until this morning that there is an Irish Enterprise Exchange. With a last name like Connolly, god am I glad that is happening. Maybe I need to do a tax deductible trip to check it out.

Mr. Taglich, the only thing I am concerned about, and I certainly am aware of your research, sir, and I consider it first rate. I follow a lot of it and I am moved by it.

My big concern is the comments you made about short selling. The recent removal of an up-tick rule is deeply concerning to me because I have been on the other side as both an investor and capital formation specialist for public companies who are up against sometimes unlimited, often off
shore and virtually opaque investors who have more money than they do patriotic support of some of these issuers. By virtue of their outsized economic impact they have the ability both to legally and illegally short these issues into the ground.

I don't think it is free and unfettered and I'd be more concerned about that, I think, than we may be.

MR. TAGLICH: I appreciate that and I can see how short sellers could be seen to be abusive. Again, I have no revenue on the short side. But most of the companies I have seen complaining about short sales are of speculative value -- short sellers of speculative value and the short sellers may very well be right. In my opinion they do an inordinate amount of homework versus longs, and in my opinion they are the far more efficient as far as policing the markets than the regulatory agencies, and no offense to the regulatory agencies.

One thing I would stress to the Commission, the endeavor, especially with small
companies, is something you guys really need to
work on. We need to have the lowest cost of
capital for small companies in the world. If it is
not done here it will be done offshore. The cost
of capital, net net the return that one has to
offer an investor to raise money is terribly
important, and if American companies have a cheaper
cost of capital than their competitors and better
access to the public marketplace, you have created
a lot of wealth for society.

Part of that cost of capital is the
fact that the numbers that investors are buying are
the numbers that the investors are buying.

Specifically, enforcing five or ten years ago's
fraud statutes and also minimizing regulatory
costs. The cheaper you make it to go public and
stay public, the more public companies there are
going to be. And public companies today have a
much lower cost of capital than private companies.

You can look at the multiples of small companies
that are public versus private. There is a much
higher valuation thereof and therefore there is a
lower cost of capital.
MR. CONNOLLY: Thank you, Mr. Taglich.

To finalize my comments, Gayle Essary, as you know, I have been persuaded, albeit reluctantly, that the methodology of valuation actually is a superior one to a price prediction. But I would like to salute you and make folks aware that First Research Consortium and the principals, in my judgment, differentiate Investrend's research in the marketplace and hopefully the investor community will look at that.

Finally I want to say in terms of AIM and the offshore venue, the venture capital trust propounded over in the England and the AIM marketplace are often tax driven in some regards. There are substantial tax incentives for British companies to be listed and for long term investment in those companies and I know that is not our mandate. We are very clear to act within the realm of what we can do. But in terms of small company capital formation the tax policies of this country perhaps would have an impact as well. Thank you.

MR. WANDER: Any other questions before we adjourn?
If not, I want to thank everyone for spending time with us, for your excellent presentations and the thought that went into them and your preparation time. We will stand adjourned. However, those who are still here from the Advisory Committee, if we could just talk for a few minutes I would appreciate it.

Thank you all very much.

*** These minutes reflect the last 25 minutes of the public meeting of the SEC Advisory Committee on Smaller Public Companies held at Columbia Law School in New York City on June 17, 2005.

This portion of the meeting began at approximately 12:45 p.m. after a temporary adjournment of approximately 15 minutes.

Mr. Wander presided at this session.

Mr. Jensen stated that the Committee needed to elevate Section 404 to the top of its agenda because delay and indecision will cost small business significant amounts of money. He urged the Advisory Committee to be bold in its thinking and recommendations. He also suggested that the Committee hear from accountants experienced in working with smaller companies as witnesses at the next hearings of the full Committee in Chicago in August. He stated that such witnesses could authoritatively discuss where the burdens in Accounting Standard No. 2 can be reduced and applying the COSO framework to smaller companies.
Mr. Wander said that Mr. Royster, before leaving for the day, had told him he wanted to hear from more reporting company witnesses in Chicago.

Mr. Coolidge suggested that the Committee consider reducing the length of time between meetings and wrapping up its work sooner rather than later.

Mr. Brounstein said that people are really interested in entity level controls, rather than application level controls, and that the Committee should urge regulators to focus on this level. He said the Committee should try to find ways to prevent companies from going dark and moving their trading abroad. He also said the Committee should look into what it takes to move to a risk-oriented approach to regulation.

Mr. Connolly suggested that the Committee needs to be assertive and should consider recommending changes to SEC Rule 15c2-11 to provide more transparency. He also suggested that the Committee consider inviting Chairman-Designate Christopher Cox to meet with the Committee as soon as appropriate.

Mr. Dennis suggested carving out the smallest of the small and reporting out some recommendations applicable to this group for adoption at the Committee’s August meeting.

Mr. Wander directed the SEC staff to circulate these minutes right away and get the reaction of the Committee members.

Mr. Connolly asked whether it was possible to put one item on the agenda and have it implemented. Mr. Wander stated that Chairman Donaldson had encouraged the Committee Co-Chairs to consider adopting interim recommendations.
Mr. Broustein suggested that the Committee consider recommending that regulators work on refining materiality standards. He said that there is something inherently wrong when you can get a clean audit opinion with a material deficiency in internal control over financial reporting.

Mr. Cloutier encouraged the Committee to consider recommending that the SEC staff to meet with banking regulators from the OCC and FDIC in an attempt to decrease duplicative regulatory burdens. Mr. Broustein asked whether there are other areas of overlapping regulation.

Final adjournment occurred at approximately 1:10 p.m.

CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the SEC Advisory Committee on Smaller Public Companies.

[Signature]
Herbert S. Wander
Committee Co-Chair

Exhibit A: List of Members of the Public Who Provided Written Statements and Presentations

Jun. 17, 2005  Professor William J. Carney; see also slide presentation
Jun. 17, 2005  Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, Inc.
Jun. 16, 2005  Murray S. Cohen, CEO, Epolin
Jun. 16, 2005  David L. Cox, Chairman, President and CEO, Emclaire Financial Corp., Farmers National Bank

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Jun. 14, 2005  Gayle Essary, Managing Director, Investrend Research and CEO, Investrend Communications, Inc.

Jun. 13, 2005  Andrea Psoras, Principal, Strategic Advisory; Member, New York Society of Security Analysts

Jun. 12, 2005  Samuel J. Yake, Paoli, Pennsylvania

Jun. 10, 2005  R. Cromwell Coulson, Chief Executive Officer, Pink Sheets

Jun. 08, 2005  William (Bill) A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank on behalf of the Independent Community Bankers of America


Jun. 08, 2005  Philip V. Oppenheimer, Oppenheimer & Close, Inc.

Jun. 08, 2005  Steve Nagel, President, Kolorfusion International, Inc.

Jun. 08, 2005  Karl Kirwan

Jun. 08, 2005  Victoria Duff, CEO, Bold Ventures Group

Jun. 07, 2005  Michael Ramos, CPA

Jun. 07, 2005  Karl R. Barnickol, Barbara Blackford, Linda K. Wackwitz, Subcommittee on Smaller Public Companies, Securities Law Committee, Society of Corporate Secretaries & Governance Professionals

Jun. 06, 2005  Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial Executives International and Member of the SEC Advisory Committee on Smaller Public Companies


Jun. 01, 2005  Deloitte & Touche LLP


May 31, 2005  Robert J. Kueppers, Chair, Center for Public Company Audit Firms

May 31, 2005  Ernst & Young LLP

May 31, 2005  Charles W. Barkley, Attorney at Law, Charlotte, North Carolina

May 31, 2005  Ronald J. Simpson, Chief Financial Officer, Minefinders Corporation Ltd.

May 31, 2005  Debra Fiakas, CFA, Managing Director, Crystal Equity Research, New York, New York


May 31, 2005  Joel Jameson, President, Silicon Economics, Inc., Cupertino, California

May 31, 2005  BDO Seidman, LLP

May 31, 2005  KPMG LLP

May 30, 2005  Michael T. Williams, Esq., Williams Law Group, P.A., Tampa, FL

May 30, 2005  David N. Feldman, Managing Partner, Feldman Weinstein LLP

May 26, 2005  Peter Chepucavage
May 26, 2005  Steven J. Sharp

May 26, 2005  Phillips W. Smith, Ph.D., Paradise Valley, Arizona

May 24, 2005  Kathryn Burns, Vice President and Director of Finance, Monroe Bank

May 24, 2005  John B. Williamson, III, Chairman, President and CEO of RGC Resources, Inc.: RGC; Director and Audit Committee Chairman of Optical Cable Corporation: OCCF; Director and Audit Committee Chairman of Botetourt Bankshares Inc.: BORT.OB


May 24, 2005  Brad Smith, President, WBS&A, Ltd.

May 23, 2005  Scott Shaw

May 17, 2005  James A. Brodie, Managing Director, Carr Securities

May 11, 2005  Frederick D. Lipman, Blank Rome LLP, Philadelphia, Pennsylvania