RECORD OF PROCEEDINGS

MEETING OF
SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE
ON SMALLER PUBLIC COMPANIES

Wednesday, December 14, 2005
9:00 a.m. - 4:00 p.m.

SEC Headquarters
100 F Street, N.E., Room L-006
Washington, D.C.
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The following Members were present in person:

HERBERT S. WANDER, Co-Chair
JAMES C. THYEN, Co-Chair
PATRICK D. BARRY
STEVEN E. BOCHNER
RICHARD D. BROUNSTEIN
PASTORA S.J. CAPPERTY
JAMES A. "DREW" CONNOLLY, III
E. DAVID COOLIDGE
ALEX DAVERN
LEROY DENNIS
JANET DOLAN
RICHARD M. JAFFEE
MARK JENSEN
DEBORAH D. LAMBERT
RICHARD M. LEISNER
ROBERT E. ROBOTTI
KURT SCHACHT
TED SCHLEIN
JOHN VEIHMEYER

The following Members were absent:
C.R. "RUSTY" CLOUTIER
SCOTT ROYSTER
The following Official Observers were present in person:

- DANIEL L. GOELZER
- JACK E. HERSTEIN

The following Official Observer was absent:

- GEORGE BATAVICK

The following SEC staff were present in person:

- GERALD J. LAPORTE
- KEVIN M. O'NEILL
CHAIRMAN WANDER: Why don't we begin the meeting. It's a little bit after 9:00 and I would like to personally welcome all of the members of the Advisory Committee and our observers. As you can see from the recommendations from our subcommittees, everybody has been quite busy since our last meeting, and we look forward to a very lively discussion today and hopefully to vote on the preliminary recommendations and then begin the task of formalizing our recommendations in a report to the Commission.

To begin the meeting I would like to call on my Co-Chair, Jim Thyen.

CHAIRMAN THYEN: Thanks, Herb. Thanks, everybody, for coming today, and welcome. Dan, thank you last night for the excellent evening and the fine dinner. As Herb mentioned, we are approaching our convergence phase on our journey. Maybe to give a little context for everyone listening as well as here, we were formed in March. That's when we were given our charters and our goals. Clearly we focused on four areas, and we are to recommend to the SEC four aspects of the federal security laws that should change, specifically to ensure that the cost of regulation is commensurate with the benefits for smaller public companies.

We were given our four over-arching principles to kind of guide our work. We added in August a clear, concise
For the past 10 months we spent a lot of time on fact-finding, on listening, on research. We have heard from the "best and the brightest" in the fields. We have sought their advice and counsel, and we have heard a diversity of viewpoints and diversity of experience and diversity of background.

So our work now in these five subcommittees, it's been pretty intense the last 10 months. It's been heavy on collaboration and it's brought us here to this point. So what we are trying to do here today is, first of all, seek to understand each other and each other's work -- the recommendations we bring, understand the context of the subcommittee work in the perspective of the whole advisory committee and also in context of our charter, and then we want to gain a solid perspective on that collective work, and finally vote on these preliminary recommendations so it can take us to the next phases -- the preparing of the preliminary drafts, the submission for public comment, finally leading to our final report and our presentation in April of all recommendations.

Hopefully those kind of contextual thoughts help for our next step. Herb?

CHAIRMAN WANDER: Before going into our agenda, just let me give everyone an idea of our schedule for today.
This morning each of our subcommittees will make a short presentation of their recommendations and then the full committee will have an opportunity to ask questions, make suggestions, and we can go through a very thorough discussion of each of the recommendations.

Hopefully we will get done sometime around noon or 12:30 with that phase of our meeting today. We then plan, as soon as that is over, to break for lunch, have an hour lunch break, and then come back and vote on these preliminary recommendations.

The way we would like to vote is if there's something that is not controversial or a series of recommendations from a subcommittee are not controversial, we could sort of bring them all on the table and have a hands-up or hands-down vote on those. Ones that may need further debate we would probably save for a little further debate but pass the ones that are not controversial.

I think one other comment. Jim and I are both very pleased with the work so far, and my only suggestion to the whole Advisory Committee to keep in mind is that we are not going to be as successful if we have 60, 70 recommendations to make to the SEC, and so we should try and make sure we prioritize those that are really important and those that are less important, it doesn't mean that they get dropped off the table, but they get put in for further work by the SEC and
further study and perhaps even attacking the issues involved.

Before we begin, I did bring with me an Advisory Committee report from 1977, which is around the table, so people can have a look-see what that looks like.

It is actually two volumes. It was too heavy to bring, but there were some "heavyweights" on that committee -- Al Summer and Warren Buffett and Marty Lipton and Homer Kripke. There's even a dissent, and it's very interesting the dissent says, well, the committee didn't consider cost benefit analysis, so since 1977 I'm not so sure how far we have gone.

In any event, with that brief introduction, I would like to call on Janet to provide us a report from the Internal Controls subcommittee.

MS. DOLAN: Thank you very much, Herb, and thank you very much, Jim.

I am pleased to lead off today's hearing, and to put before the committee the recommendations of our subcommittee on internal controls. Before I do, I want to welcome those who are attending in person as well as those who are attending by webcast. We appreciate your interest in the work of our subcommittee as well as that of our entire Advisory Committee.

To my fellow members of the Advisory Committee, I am leading the presentation and discussion of our
subcommittee's recommendations but I am speaking for our subcommittee. As we get into the discussion phase, I will call on individual subcommittee members to assist in the questioning. This is to ensure you benefit from our collective know-how and experience in developing these recommendations.

In beginning our presentation I want to reiterate that although we are recommending changes in the application of certain parts of the Sarbanes-Oxley Act to small companies, we believe that a number of the requirements of the Sarbanes-Oxley Act and the listing requirements of the various exchanges are very effective. More importantly, they can be implemented by all companies at a reasonable cost.

These include whistleblower programs, independent directors on boards and especially on audit committees, Section 302 certifications by management, and the greater focus of companies on the importance of internal controls to provide greater confidence in the integrity of public companies.

While we support all of these reforms, we are concerned that the way that the auditor attestation requirement of Section 404 has been implemented has resulted in the deployment of company resources, both time and money, that exceeds the intended benefits of the law. While this is a concern for all companies, it is particularly for small
companies, on which this burden falls so disproportionately.

We are not alone in this concern. Corporate leaders, business trade associations, SEC members, and even members of Congress have raised similar concerns. This has led to not only this committee’s work but to an effort by the GAO to do a cost/value analysis of how this section of the Act has been implemented.

Before I review our conclusions and recommendations, I want to address an important issue head-on. That is, whenever you have the audacity to suggest that a law as implemented does not have an acceptable cost to value relationship, you are attacked by some as undermining the intent of the law or, even worse, going soft on would-be violators.

This is a very simplistic response to a very challenging burden borne by the SEC and other regulatory agencies. The natural tension between our capitalistic economic system and our democratic political system is what makes this country work. Striking the right balance is critical to maintaining our vibrant economy. Underregulating can leave us vulnerable to the excesses of unchecked capitalism. Overregulation discourages the innovation and risk-taking needed for strong economic growth. Striking the right balance is not easy and no regulatory agency knows that better than the SEC.
I believe that is the spirit in which this Advisory Committee was formed. I can assure you that is the spirit in which our subcommittee approached its work and the spirit in which we are making our recommendations today -- that is, how to strike the right cost/value relationship for SEC regulatory oversight.

To begin, I want to succinctly lay out how we arrived at our conclusions and recommendations.

First, in an effort to quickly respond to the loss of public trust created by corporate scandals such as Enron, WorldCom and Global Crossings, the Sarbanes-Oxley law was enacted very quickly. Next, AS2 was developed and implemented without field testing or other steps to realistically assess whether the legislation could be implemented in cost effective manner. Had it been, the issues facing us might be significantly less, however, we are where we are.

Therefore, although we strongly recommend that the SEC review AS2 to ensure there is adequate clarity as to the level of granularity in the external audit of internal controls needed to provide quality assurance without prompting overauditing, we had to assume that AS2 will be the standard to which all companies -- large, small, and micro -- will be held.

Recognizing this, we had to look at the cost/value
relationship of expecting all companies regardless of size to expend the resources and effort needed to obtain the external auditors' attestation of compliance with AS2, as it is currently being applied by auditors.

We conclude that whatever value micro and small companies would get out of that level of auditor involvement, it is not proportional to the costs and burdens such involvement puts on those companies.

Therefore, we are recommending exempting those companies from external audit requirements of AS2.

As you know from our previous meetings, we looked for a way to implement the external auditor involvement in a way that would right size it for micro and small companies. This is because in these companies, unlike large companies, the external auditor relies much less heavily on internal process controls to audit the financial statements.

Therefore, the value of requiring the micros and the small companies to build the same kind of control environment as a large company simply to meet the external auditor attestation requirements of AS2 is far outweighed by the expense and time commitment to do so.

There is no readily apparent way to right size AS2 for micro and small companies short of developing a new auditing standard or developing a COSO framework for micro and small companies.
While both of these might ultimately occur, we had to consider what relief could be provided now.

Considering the extensive time it takes to do a good job of developing, adopting, and field testing something as significant as a new auditing standard, we decided that the most effective relief to be granted is to exempt those companies for which the application of the external auditor requirement of AS2 seems least valuable.

With that as background, let me present our conclusions and recommendations, and then answer any questions that you.

You have our report, so I will not go through our conclusions individually. Rather, let me pull them together to paint a picture of the foundation upon which we built our recommendations.

The overarching conclusion is that micro and small companies are very different from large companies and they are being greatly disadvantaged by the attempt to apply a one-size-fits-all approach to all companies.

This one-size-fits-all approach is really that part of AS2 that requires the external auditor to annually test and attest to the operations of the internal process controls. Because there is no clear standard for management or the auditors as to what constitutes adequate internal process controls, the COSO framework has become the default
standard relied on by all comers. We are all well aware of the unanticipated cost to business for management to document, test, and affirm the breadth of controls required by COSO only to then have the external auditors repeat the same process.

Not only do auditors not rely on the work done by management but then the entire process must be repeated annually, rather than testing only that which has changed. This level of activity and cost may not have been anticipated by Congress but that is how Section 404 has been implemented.

While businesses of all size are questioning the value of this level of regulatory oversight, the burden is hitting small companies particularly hard. As our slides 20 and 21 show, whether you look at the external audit fee only, or the total costs of compliance, the largest companies may pay a negligible percentage of revenues while micros pay significant percentages of revenue just to comply with 404. This puts small companies at a significant disadvantage when trying to compete with those larger companies or, worse, with the foreign and private companies who do not have to bear these same costs at all.

If we are going to try to justify this huge disparity in financial impact on the micros and small companies, we should have a very good reason for doing so.
Although it is not always easy to get a straight answer as to what risks 404 will actually prevent, what you generally hear is that it will increase the integrity of the financial statements and/or it will help to prevent fraud.

While many are now questioning whether 404 will actually do either of those, in the case of micros and small companies, auditing the internal controls is a much less effective tool for doing either than it is in large companies.

As to improving the integrity of the financial audit, it has already been said, that in micros and small companies the auditors rely less heavily on the internal controls to do the financial audit than they do in larger companies. As companies get larger and more complex, the auditor relies more heavily on the internal controls. This is the basis for us drawing a line as to where to grant an exemption.

As to preventing fraud, or helping to prevent fraud, in micros and smaller companies, internal controls are much less reliable as a vehicle for preventing fraud than in larger companies, the reason being that management can much more easily override internal controls.

Therefore other mechanisms are more effective for preventing fraud. These include whistleblower programs, the presence of independent directors, and other good governance
checks on the power of management.

Therefore, overlaying the same complex, expensive internal control documentation, testing and audit requirements on small companies when it does not provide the same level of quality assurance that it can for large companies is imposing form over substance at a very high premium for what it provides.

An additional factor supporting our recommendations is that while micros and small companies represent a large number of companies, they represent approximately 6 percent of the total market cap. The concern with a very large company like Enron, WorldCom, or Global Crossings is that undetected fraud in just one company can have a significant impact on the capital markets. With micros and small companies, undetected fraud in any one company is inconsequential to the market as a whole. This does not mean that fraud in any one company is not a concern to the investors in that company, but, as we have indicated, auditing the internal controls is not the most effective way to detect or prevent that fraud.

Recognizing these unique features of micro and small caps, we are proposing recommendations based on the overarching principles of this Advisory Committee:

One, further investor protection;

Two, seek cost/value inputs;
Three, keep it simple;
Four, maintain culture of entrepreneurship; and
Five, encourage capital formation.

Turning your attentions to Slides 33 to 45, I will now lay out our five recommendations. They are interdependent and they build on one another

MS. DOLAN: Recommendation 1. Exempt microcaps from 404 subject to achieving certain corporate governance standards.

Microcaps are companies with market capital under approximately $125 million and revenues under $125 million. We added a revenue filter to catch those outliers that have large, complex operations, but which happen to have a small market cap because they are in financial distress.

Although we recommend exempting companies from Section 404 -- micros from 404 -- for all the reasons I've just set forth, they should remain subject to all other SEC regulations and requirements, such as 302 certifications, external financial audits and applicable corporate governance standards set by the exchanges on which they trade.

Our subcommittee believes these measures are the kind that do provide real value to microcap investors and should be extended to more companies. Therefore, for companies that do not trade on an exchange, such as pink sheets or the over-the-counter bulletin board companies, we recommend that to be eligible for this exemption, they need
to comply with the corporate governance standards established by the Corporate Governance and Disclosure Subcommittee of this Advisory Committee.

Consistent with current 404 rules, companies relying on this exemption would be required to disclose all material weaknesses known to management, including those uncovered by the external auditor and reported to the audit committee.

Recommendation number 2. Exempt smaller public companies from external audit requirements of 404. Small public companies would still be required to complete a management assessment of internal controls under 404. Small companies are companies with less than approximately $750 million market cap, and less than $250 million in revenues.

The big question for our subcommittee, I'm sure, is why are we imposing a revenue test on this committee's size recommendation? The answer comes from my earlier remarks.

If we had the ability to write size AS2 for smaller companies, or if AS2 had been implemented in a much less complex manner, we would be able to provide relief to more companies; that is, to all of those within our committee's small company definition.

However, since we have to deal with AS2 as it is, we tried to determine at what point many company operations become large enough and complex enough that auditors rely
heavily enough on the internal controls for the financial audit to justify the external auditor involvement prescribed by 404.

While we may debate, and believe me, we did debate, where to draw that line, the smaller the company, the less the need for external audit involvement in Section 404.

As with the micros, these companies remain subject to all other SEC regulations and requirements and must comply with all applicable governing standards set by the exchanges on which they trade. Those seeking the exemption which are not listed would be required to follow governance requirements of our Governance and Disclosure Committee. They would also have to disclose all known material weaknesses.

Current companies subject to 404 would be exempted immediately. However -- and this is a very important however -- exempted companies can elect voluntary compliance with the external audit involvement portion of 404. If companies think their exemption status will undermine their ability to access capital, they can choose to not take advantage of the exemption. This allows the capital markets to work efficiently to strike that right balance between capital formation and capital regulation.

Regulation 3, ASX. This may strike you as an enigma, so let me put it in context. First, we strongly
I recommend that the SEC adopt our recommendation 2. It is
clear and straightforward. It provides for ease of
implementation. Most importantly, it provides immediate
relief.

However, if for public policy reasons the SEC feels
that some level of external auditor involvement in 404 is
desirable for small companies, then, as an alternative, we
recommend that the SEC change its rule for the implementation
of the external audit requirement of 404 to a cost effective
standard providing for an external audit of the design and
implementation of internal controls. We call our proposed
auditing standard ASX.

The reason for this alternative recommendation is
that even if the SEC cannot accept our exemption
recommendation for small companies, their problems do not go
away. Small companies still need a cost effective external
audit of their internal controls.

We spent a considerable amount of time developing a
proposed ASX for small companies within the committee's size
definition. As I said, because of the time, complexity and
uncertainty of developing a new standard to provide relief,
we came down on the side of granting immediate exemption
relief for a smaller population of companies. However, if
the result is no exemption relief for small companies, then
we recommend that the SEC pursue the development of a new
standard for small companies.

We do not make this recommendation lightly. Asking for a new standard is a very risky proposition. We have seen the challenges that have arisen with the implementation of AS2. In our highly litigious and regulatory environment, each new standard brings its own set of problems. However, we have seen the cost and the diversion of management and board time that AS2 has caused for the accelerated filers. I think it is safe to say it is well beyond anything Congress anticipated when it enacted the Sarbanes-Oxley legislation. This has been the experience with the largest companies, those with the most sophisticated staffs who are best able to navigate the complexities of AS2. That burden to date will be nothing compared to the time, effort and expense that small and microcap companies proportionately will face trying to take on the one-size-fits-all AS2.

The AS approach we would recommend is the following:

Ask the SEC to direct the PCAOB to develop a new standard for smaller public companies that would be an external audit of the design and implementation of the internal controls only, to make it more efficient and effective for those companies. This report would be similar in scope to the report described in Section 501.70 of the
AICPA's Standards for Attestation Engagements Plus Lockthroughs. It would not involve any testing of the operating effectiveness of controls.

This recommendation should be subject to a cost value analysis prior to such a standard being issued in proposed form, with follow-up analysis prior to issuance. We think the lack of field testing of AS2 contributed to the extensive, unintended consequences with which we are dealing today.

In the interim, there would be no external 404 audit requirement for the small public company. Again, because of the problems of recommending another auditing standard to solve the inequities of the first auditing standard, we are recommending exemption as the preferred remedy.

Recommendation 4. Additional guidance. While most of the criticism of 404 has been about the implementation of the external audit testing and attestation portion, there is also a significant shortcoming in the management assessment requirement.

404 requires that management assess the internal controls over financial reporting, and yet there is no standard to guide management as to what constitutes adequate internal controls. Therefore, the default standard becomes AS2, which is actually an auditing standard.
All companies could benefit from greater focus on the management assessment, but certainly micro and small companies can. While COSO is the default standard used, we recommend the SEC ask COSO for assistance to develop further guidance.

We all want the same thing, which is efficient and effective internal controls over financial reporting. The more we can do to help every company design, build and operate them, the more likely we are to reach that goal.

We've listed a number of recommendations that we think COSO could incorporate into that guidance for small companies, such as expanding the monitoring guidance. These are just suggestions which we have received through testimony. They are not at all inclusive. Rather, they are only meant to be illustrative of the kind of guidance that make a significant cost and efficiency difference.

Included in Recommendation 4 are also requests for further actions by the SEC and the PCAOB to provide greater clarity and assistance in meeting the current and future requirements of AS2 and other regulatory requirements. Both agencies probably feel they've made everything abundantly clear.

However, we continue to hear that the auditing on the front lines, first by the external auditor and then by the PCAOB, checking the checkers, continues to create a
risk-adverse culture. It's easier to say we are better off overauditing than underauditing. However, overauditing comes at a price. And when that occurs on a large scale across all of our capital markets, the cost to our economy is huge.

We all acknowledge that we are operating in an increasingly more complex legal and regulatory environment. The more we can do to help companies find their way through these complex standards and requirements, the more quality -- quality assurance we can build into our financial reporting. Helping assure compliance is a much better approach than prosecuting failures.

There is no perfect place to inject a comment about global competitiveness, so I will do it here. We have all seen what happens to companies and cultures when they mature and become unduly bureaucratic. They get challenged and often overtaken by the young upstart that is innovative, entrepreneurial, and able to create a new game with new rules.

We are all looking down the barrel of the 21st century and a new, more competitive global economy. Our capital markets were the envy of the world in the 20th century. They can continue to maintain their leading position if we make smart rules that create value and a competitive advantage.

However, if our solution to every problem is to
continually build more rigid and complex structures in which we must operate, we will eventually sink under the weight of our old, bureaucratic old game. No one knows where that tipping point is. But we all need to ensure that in implementing significant regulations like 404, we do so in a way that adds value but does not add unnecessary complexity and rigidity. I think I speak for our whole subcommittee when I say that has been our goal in making these recommendations.

Recommendation 5, Special cases. In any broad-based regulation, there are special cases that need to be treated separately to minimize the unintended consequences of painting with too broad a brush. Therefore, as the SEC implements any of our recommendations, we urge it to look for those companies that fall between the crack; those that do not fit neatly into well defined boxes.

We have not had time to identify them, but we urge the SEC staff to do so. The only one that comes easily to mind is the debt-only issuer. But we know there are other types of entities that are currently exempt as nonaccelerated filers and that should be looked at separately based on the nature of their corporate structure.

In closing, I want to thank all the members of our subcommittee. We are not in full agreement on everything. However, we have great respect for each other, and the
sincerity with which each of us has wrestled with these
issues. These are not easy issues and there are not easy
answers. If there were, we would not be here today.

On behalf of our subcommittee, I want to thank Herb
and Jim for their engagement, their support and their
guidance. We all appreciate the time and the effort that
they have devoted to all of our subcommittees.

On behalf of our subcommittee, I want to thank Dan
Goelzer, the PCAOB observer for our subcommittee. Dan has
provided great value and input, and he has represented the
PCAOB very professionally throughout our work.

And finally, I'd also like to thank Allan Bellers,
Gerry LaPort, Mark Green, and the whole SEC staff that
provided us technical expertise and support whenever called
upon. We have appreciated it very much.

With that, I will close. We welcome your comments,
your questions and your insights. This is a work in
progress, and we want to ensure that our finished product is
the best that we can deliver. And we know that the added
contributions of our entire Advisory Committee as a whole
will add to our efforts.

Before we open it up to questions, I would like to
call upon one of the members of our subcommittee, Kurt
Schacht, who would like to make a statement as well.

Thank you.
MR. SCHACHT: Thank you, Janet. Thank you, Chairman Thyen, Chairman Wander for allowing me a brief moment here just to add a bit of further commentary, because I was the one dissenting vote on these recommendations of the subcommittee.

I do want to recognize all the hard work of this group. We went through lots of things in our discussions, and it was a pleasure to work with you. I think our work is half done, but we've had a good collegial relationship.

As a committee overall, we focused on a number of issues affecting smaller public companies, but I think by far the issue of Sarbanes-Oxley 404 and its cost of implementation has been proven to be one of the more challenging issues that we have talked about. And while I do not agree with several of the recommendations of the subcommittee, I think Section 404 is one of the key things for us to focus on overall.

Notwithstanding that I am the lone dissenting vote on the subcommittee, I do want to acknowledge that this group has considered my views. It has considered the commentary of many other groups that have put in ideas and raised issues with respect to how to properly fix the 404 problem. And we have discussed dozens of ways and dozens of options for reducing costs while maintaining investor protections. And I would say that even my New York cabbie last week weighed in
on Sarbanes-Oxley, so the debate has come full circle indeed.

(Laughter.)

MR. SCHACHT: I think we all agree that the cost issue is really the thing that we should be focusing on.

It's been too high. It's exceeded all estimates. It's hit small companies much more significantly. And I think depending on which study you look at, they have been -- these costs have been very stubborn in terms of mitigating, at least in the near term. And I think obviously there are a number of companies waiting in the wings that have yet to go through this process and will certainly experience very high costs. There's no question about that.

I also think that we agree that the internal controls at public companies are important. They are an important feature of investor protection, an important feature of accurate financial reporting, and an important feature of market integrity overall.

I think some argue that Sarbanes-Oxley has actually brought a bit of remediation to a problem that has been festering for a long time, and that is that internal controls have been somewhat neglected at public companies and that Sarbanes-Oxley has brought about some assurance that internal controls are in place, and that they're working as desired. How the markets get that assurance, and that is, what level should there be in terms of verification and testing by
management and outside audits is the rub.

The subcommittee goal was to reduce the cost burden but to maintain investor protections associated with Section 404. And in my view, in our view, these need not be mutually exclusive. My concern is and my dissent is based on the fact that these recommendations before you make them mutually exclusive.

We seem to say that we cannot have meaningful cost reduction without throwing out 404, including the investor protection piece, for a fairly significant portion of public companies in this country, which will effectively be over 80 percent of the companies that are public in this country.

One could cite several flaws with respect to that approach, but I want to mention three specifically this morning. First of all, I think the entire premise of Sarbanes-Oxley was to bolster investor confidence by requiring meaningful corporate governance and financial reporting reforms.

Properly designed and functioning internal controls over financial reporting was and I think is the cornerstone of this legislation. Proper structuring and proper implementation of 404 requirements is very different than throwing those out completely for a broad segment of U.S. companies. And I think that approach while it may be simplistic, but I think it's factual, is against the
legislative intent of this statute, and I think it's also
gainst the directive that we heard from both Chairman
Donaldson and Chairman Cox earlier in this process.

The second thing that I would raise is that it is
unclear to very many folks out there whether the broad
exemptive recommendations of this subcommittee are even
within the legal authority of the Commission. Comprehensive
and sweeping exemptions for Section 404 may not even be
possible under the current legislation which specifically
excludes Section 404 from the Securities and Exchange Acts of
1934.

And I think perhaps as this work of this larger
committee continues toward a final recommendation, it would
be well served to try to resolve that issue, because I think
if it goes forward with these broad exemptions, we're subject
to almost certain legal challenge on that point.

And finally, and maybe most importantly, it is the
small public companies that need checks and balances over
financial reporting most of all. They are consistently the
ones that have more misstatements and restatements of
financial information, and they make up the bulk of the fraud
cases under review by both regulators and the court system.

We think that a more balanced approach to fixing
404 is to continue to require the manager assertions and the
auditor attestation of internal controls but to direct the
appropriate regulatory and de facto standard-setting bodies
of COSO, the PCAOB and the SEC to develop specific guidance
for small companies. These would specifically outline
appropriate control structures for those companies,
specifically outline the proper scope of an audit for smaller
public companies under 404. To use a popular catch phrase,
this is a Sarbanes-Oxley lite approach.

In fact much of the outline for this approach
already appears in the recommendation, Recommendation number
3 and 4 of the subcommittee. However, it only comes after
the main recommendation of exemptive relief as a fallback or
an alternative position. I think that for the sake of
continued investor confidence in our markets, we deserve an
approach that is not mutually exclusive. We need one that
preserves the investor protection piece as well as reduces
costs of implementation.

It is clear I think to all of us that something
needs to be done for small companies, but I think giving them
a pass on any verification and any oversight of internal
controls will come back to haunt us. If nothing else, as we
have talked internally here, these recommendations will now
be subject to a much fuller public debate, and hopefully
we’ll get more input on some very important policy issues.

I would offer this challenge to investor groups and
related groups out there, and really to anybody that is a
consumer of financial information or a participant in the financial reporting process to get involved in commenting on these recommendations, because as we mentioned, it's important to get this balance correct, the balance between cost and protection.

We think that realignment, not elimination of Section 404 is the way to do that.

So, thank you, Janet and thank you Chairman Thyen, Chairman Wander.

CHAIRMAN WANDER: Thanks very much, Kurt.

MS. DOLAN: Obviously, that completes the report of our 404 committee.

CHAIRMAN WANDER: Thanks, Janet. Why don't we open up the floor for questions and comments? But I'd first give an opportunity to anybody on your subcommittee to make any comments, and then I'd like to perhaps go around the room clockwise. Is there anyone on the subcommittee who has any further comments, discussion?

Okay. Dick?

MR. JAFFEE: I think, Janet, you anticipated my question, and I raised it an e-mail the other day, was the revenue test issue. And last night at dinner, somebody explained to me that that was to bring in some people who maybe hadn't had financial problems but still had large sales.
I looked at it from the other point of view, because we had testimony on this issue a couple of meetings ago. And I looked at it from the point of view that if the overarching principle is investor protection, that a company, taking the example of either a biotech or a dot.com or something, that had very little revenue but had for whatever reason gotten huge market cap, shouldn't get a pass out of the 404 issue.

So, I'm not 100 percent clear, frankly, on the recommendation. You're saying that you have to have both of them or one of them, or -- can you just give me a little explanation on the revenue --

MS. DOLAN: Right. We are saying it is the combination, that is, depending on which group you pick, but either one, you have to be under the market cap, and then you look at the revenue cut as well.

MR. JAFFEE: So if you had a large market cap but small revenues, would you be exempt?

MS. DOLAN: No.

MR. JAFFEE: You would not?

MS. DOLAN: No.

MR. JAFFEE: Okay. All right. Well, then that seems to make -- clarifies for me then. Thanks.

CHAIRMAN WANDER: Although I should say we've gotten a letter just recently from --
MS. DOLAN: Biotech.

CHAIRMAN WANDER: Biotech Association group.

MS. DOLAN: A trade group.

CHAIRMAN WANDER: Who has made the recommendation to us that -- would you want to -- Rick?

MR. BROUNSTEIN: This is Rick Brounstein, and I'm, among other things, I guess I'm representing the biotech. And indeed, one of the proposals, and I guess I'm willing to put it back on the table here, the biotech companies raised, and we discussed it, and we ultimately eliminated it just because of complexity.

But the issue is if you look at our report on page 34, there are about 534 companies that have small revenues but are in that middle market cap. So, zero to $125 million in revenue. We're going to get an exact number, but I believe there's a couple hundred companies that are typically biotechs that start up, get well funded, but are very simple organizations.

You know, they have a few R&D people and they're working on, you know, a very long-term process. But their revenues are somewhere north -- I mean, their market cap is somewhere north of 125 to 700 million, our small public company definition.

So the question is, you know, in Recommendation number 1, should there be an exemption for companies that are
very simple that have, say, less than $10 million in revenue,
but have a larger market cap?

And that's really what this letter was proposing,
and it's something that we discussed within our subcommittee
pretty extensively, and it's probably worthwhile, you know,
hearing opinions from the rest of the group.

CHAIRMAN WANDER: Okay. Thank you, Rick. Janet?

MS. DOLAN: Also, I want to respond, Dick, that the
way our subcommittee used the revenue filters was really
quite different for the micro versus the small. For the
micro we, you know, cut it off at the market cap. And then
we sort of said, are there any unintended consequences here?
Would somebody sort of fall into it because of a circumstance
that we really didn't intend? And so that's why we used sort
of the outlier concept.

When we debated a revenue filter for the small
companies, then it was a very different approach, which is
how big should this category be? And as we said, there's no
science to this. We just debated and tried to come to a
cutoff point that we thought had some rational foundation to
it and provided relief to the companies we thought could most
benefit.

So, anyway, we used the revenue filter in very
different ways when we were doing this.

CHAIRMAN WANDER: Steve?
MR. BOCHNER: Janet, I was just -- that was an excellent report. I was just wondering whether you would comment on your thoughts about an IPO phase-in, your thoughts about a company going public and 404 compliance.

MS. DOLAN: I hate to say that we didn't have enough time to get everything under the sun evaluated, but we really, unfortunately perhaps for those very important kind of special cases, left special cases to the end of work. Because as you can see, we've been down many different paths on the big part of our work.

And so we just realistically said we wouldn't do a haphazard job of trying to pick different kinds of special cases and say what should or shouldn't be done. So we largely said -- but we certainly know there are examples like that, and certainly the emerging IPO company was that kind. But we just said, we didn't give it the kind of quality work it deserves. Maybe we'll get more time before now and the end of the report. But we certainly wanted the SEC staff to do that.

MR. DAVERN: And if I could just add one point to Janet's comment, too. We did feel that for certainly microcap IPOs that they would receive relief. And for small public companies, if they were under $250 million, they would also receive some relief in the first year. So there would be some effective relief. And then I certainly support
Janet's point 100 percent that someone needs to really examine any unintended consequences of pulling in the rest of the nonaccelerated filers.

CHAIRMAN WANDER: If any of you have any additional sort of special cases other than -- we've got three really on the table. Janet mentioned debt-only issuers, biomedical and IPOs. If any of you have any other suggestions, please do mention them so they can be put on the table for further consideration.

Anyone over on this side of the room?

CHAIRMAN THYEN: Could you, building on that classification, Alec, could you calibrate for our Advisory Committee then what is the percent of companies or the number of companies that fall in that area? Smaller public companies under 750 market cap but above 250 revenue that effectively then do not receive any relief.

MR. DAVERN: Yeah. If you look at the data on Chart Number 34, for smaller public companies, 68 percent of the companies that qualify as small public companies, i.e., those under 750 million, 68 percent of them have revenues of less than $250 million. And that 68 percent would receive relief from the external audit attestation portion of 404.

As you move down in market cap -- or, excuse me, as you move up in revenue to 500 million, that incorporates another I think about 15 percent. And then the next I
believe 17 or 18 percent is over 500 million.

So the proposal we have on the table right now, a $250 million revenue cutoff, captures 68 percent of the companies in the small company category. It will also pick up another 3 percent of the microcap companies.

So those microcap companies that have revenue over 125 million, another portion of those will fall under the relief of the small company category.

But if we look at the small company category in particular, there will be about one-third roughly of the companies that would not receive any relief under this proposal.

CHAIRMAN WANDER: Drew, and would you -- would everyone -- I forgot to mention this earlier -- state your name?

MR. CONNOLLY: Thank you, Jim. This is Drew Connolly. Firstly, I did not prepare remarks, and for that I reluctantly say we're going to attempt to respond. But, Janet, I will never come to a meeting without prepared remarks again.

Thank you so very much for that erudite presentation and the length and breadth of what I discovered in talking to both Alec and Rick last night of, you know, overnight, weekend meetings in Chicago, offline with Herb, and really taking witness testimony and exhaustive committee
work. And for that, I'm certainly grateful and the microcap commu-
ity that, some of whom I represent, is entirely grateful for your rec-
ommendations.

But I have one overriding concern to one area that you mentioned, and it really is -- I've decided to finally say it. We here are the Capital Formation Subcommittee. And from the very beginning of the founding and the bylaws and the statement of mission for this committee, somehow encouraging capital formation has always come fifth.

And it occurs to me that without capital formation, without investors being able to access opportunity, and without companies being able to approach and attract involvement, the rest of it, the regulators, the lawyers, the accountants, the brokers, the research analysts, would literally be unnecessary.

So my request the next time you make this presentation is can we move up encourage capital formation slightly higher in the pecking order?

The other thing I wanted to just mention is that, unfortunately, the statistics that you all have and that we all have and that the SEC has been able to make available to us, largely ignore the several thousand companies and the data that is not available here from pink sheet-listed companies.

And I am trying very hard to sit with Cromwell
Coulson with the pink sheets because there is some data collection and gathering and statistical analysis that I think we need to have of pink sheet-listed companies. Because there are a couple thousand of them that are not part of the calibration and the numbers here.

And that would go I think to Kurt's -- one of Kurt's points, which is that it is very definitely true that microcaps represent in terms of numbers of open enforcement actions an outsize proportion.

I am reminded, however, as early as today -- or as late as today -- with Ken Lay blaming his CFOs as opposed to taking personal responsibility and having a depth of internal controls that one Enron more than compensates from the financial loss perspective, and more importantly, the difficult money, the pension money, the 401(k) money, the widows and orphans money that rightly is attracted to allegedly investment grade equity opportunities.

I don't think anybody is using that portion of their involvement dollar -- or shouldn't be, and there are rules in place to not allow that -- in the microcap space, and certainly not in the pink sheets.

So, while I am mindful of the extensive enforcement actions that are unfortunately still required in the microcap space, the investor losses, potential losses, are insignificant comparative to an Enron or a WorldCom, which
brought the entire Sarbanes-Oxley issue to the fore, number one.

And number two, it is deeply distressing to me that we are at this late date, because I do know there is some confusion, and it was a concern of mine back last year, as to the legislative intent. And I think the legislative intent of Sarbanes-Oxley is in fact at slight variance to the legislative intent of other federal securities laws and other congressional interpretation.

So I am concerned that we're looking for ways to blunt this committee's recommendation. While I support very much the minority view and understand the basis of it, I am concerned that we're looking for or calling for potential congressional response, questioning whether the SEC has the right to an exemptive authority, pointing out the fear of litigation, and finally calling upon investor groups to come forward in vast numbers to object.

Because frankly, I've worked very hard over the last six months with this committee to get the issuer community, the microcap issuer community, and the small, independent broker-dealer community, to -- who are on the front line every day, make their livings doing this and work very hard to get it right, to have them have a voice here as well.

And it is disturbing to me that there is not
enough -- in the House, we are already being heavily lobbied. The American Bankers Association has I guess the first comment letter on our desks today objecting to some portion of the draft recommendations. I know the AFL-CIO has weighed in on one side. The Consumer Federation and the Chamber of Commerce have weighed in on the other. And there's no question that there are some boxes to be gored with whatever this committee does, including inaction.

So, in an attempt to balance the competing stakeholder interests here, I can understand where calling upon the outrage of the citizenry and the legislators to blunt the rather bold efforts of your fellow committee members may be an effective tool, but I think that ultimately I appreciate the fact that you have that position, and I know that the certified financial -- chartered financial analysts are a significant gatekeeper for investor protection.

As you know, I work with and represent a firm that retains a number of them and provides independent research. It's a critical element. By the same token, we do have a problem, and I think Janet's majority recommendations go a long way to addressing some of those.

Thank you.

CHAIRMAN WANDER: Further comments along this bank?

MR. SCHACHT: Herb, can I just make one response to Drew? I appreciate your comments. Just to be clear, I have
not requested anybody to come forward to object to this. What I have simply said is that these are very important policy issues.

I think you've hit on precisely the policy issue as to whether we should worry about that bottom 1 percent or bottom 6 percent of market cap and concentrate on the more important financial impacts with fraud at the higher end of the market cap spectrum.

But I'm not suggesting that any group or any individual should come forward and object to this. I'm simply saying that people that an interest in this debate or participating in the financial reporting system ought to have -- ought to take note of what's going on and weigh in with their views of how they should be resolved.

MR. CONNOLLY: I completely support that, Kurt. In fact, we have -- and I'm making, the folks I'm talking to, there's one more on the schedule, there's one more 30-day window pretty much in the month of February where comments are going to be open-ended, and I think the more, the merrier.

MS. DOLAN: Herb, I just want to respond to both Drew and Kurt and to say that I know I speak on behalf of our whole subcommittee, we certainly all recognize and agree that there's a very large number of companies in the micro and even, as we say, listed or unlisted. So we all acknowledge
that.

And I think we all want to see good internal control environments developed as early as we can in companies so that they can mature as they get bigger. And that's why we're recommending that this is not all a takeaway. This is -- in exchange for the exemption, you now have to do some things that you wouldn't otherwise be required to do, to create as good governance climate as you can have.

So, we're all for starting to build as much good governance as you can. We just don't happen to think that the external auditor involvement in the 404 as it is currently implemented is the be all and end all of how to do that.

And in fact, it just, for the cost of it, doesn't provide enough value. But that many of these other things create -- cause -- create a great amount of value, and they're at an implementation price that is -- creates enough cost value benefit for the companies that it's fair to ask them to do it in exchange for the exemption.

MR. BROUNSTEIN: Let me just -- this is Rick Brounstein. Let me just kind of maybe just reinforce that, because definitely there was a lot of discussion at the lower end as to, you know, how much is too much, how much is not enough. And, you know, to me, there were a couple of
significant pieces.

If you take a look at how the simple organizations are audited today, the financial audit, it is a far more substantive audit than a larger company where you need to rely on the processes to produce the numbers.

So there is clearly auditor involvement in both the micros and our definition of smaller company with the revenue cap.

When you get down into the smallest of the micros, those on the pink sheets, the bulletin board and a lot of those that may be, you know, with the definition of beneficial ownership should now be reporting that aren't, I think our overriding thought was transparency.

And it didn't seem to high a price to pay to have something as simple as, you know, an independent audit committee from whistleblowing, and, you know, file a 10-K and 10-Q to get some audited financial statements. And people then have the information to make the decision.

And so that's where -- that's how we ultimately came out.

CHAIRMAN WANDER: I'm going to go around. Leroy?

Richie?

MR. LEISNER: A question.

CHAIRMAN WANDER: Richard Leisner.

MR. LEISNER: This is Richie Leisner. I have a
question for Kurt. If I understand you correctly, you want
to keep 404 fully and then direct the appropriate authorities
to come up with standards that are tailored for smaller
companies. Is that right?

MR. SCHACHT: I think that's the solution that's --
MR. LEISNER: And what would you do between now and
when those new standards would come out?

MR. SCHACHT: Well, I think we've postponed any
responsibility to comply with this for the smallest group for
another year and a half. Isn't that correct?

MR. LEISNER: Right. But we're talking about the
other group between the smaller public company up to the 750,
what would you do with them in the meantime?

MR. SCHACHT: They're already complying with
Sarbanes-Oxley 404, and been through the cycle now I think
the second time, and I think it's appropriate to --

MR. LEISNER: I'm not sure that that's true in
every case, but I think, if I can put words in your mouth,
they would continue to be subject to 404?

MR. SCHACHT: That's correct.

MR. LEISNER: Okay. Thanks.

CHAIRMAN WANDER: Leroy?

MR. DENNIS: Richie asked a great question, because
that was exactly where I was headed was what was going to
happen.
CHAIRMAN WANDER: Leroy Dennis.

MR. DENNIS: Leroy Dennis. I'm sorry. Because it seems to me, as I listened to Janet's presentation at the start, she talked about a need to -- that if we had a better AS2 standard -- I'm putting words in your mouth -- you might have gotten to a different recommendation. And that seems to be where Kurt's headed is a better AS2 definition. And I wonder if there's a process or a -- it seems like you're really close as a, you know, as dissenting view versus the majority view.

I wonder whether there's some kind of phase-in that you can think about, or have you thought about, where let's get AS2 right for the middle group, maybe some relief in the meantime, but continue providing relief for the smallest? And, you know, and it may be a fairly extended period of time, but is there eventually a goal to get to some kind of AS2 for the microcap companies? And if you had that kind of availability out there, where would you -- where would the committee head, or what was the thought process? And that was kind of my question.

MS. DOLAN: As you've probably gathered from our nice weekends and holiday meetings, we have really debated all these alternatives, and, as I said, there is no easy answer. If there was, we wouldn't be here.

There is a lot of hesitation to opening up AS2 and
redoing it because you're just getting used to one standard. You have to start all over. Will it be opened up for all companies or not?

If you don't do that and you do a separate standard for small companies, how long will that take, and what would you do? That's where the majority and the minority view are different. We would, of course, exempt until you got that, because we're here because these companies are saying this is too onerous for what we're getting from it.

And that's going to continue. Just because you've been through it once doesn't make it any less foolish to keep doing it. Because there's something about beating your head against a wall that I think we should remember here.

So, you know, I don't think it's -- it's not our view that you say to somebody, just because you've gone through something that we agree probably wasn't well implemented to start with, that we're going to keep making you through it until we get a better remedy.

So we looked at let's just make the recommendation, change AS2 to everybody. It has some down sides. We are under the auspices -- our charter is to look at small companies. We looked at making a separate recommendation, an auditing standard for smaller companies, and, as you can see, we've done a fair amount of work on this. We've done a lot of modeling on it.
But when we really came down to it, we said, look, let's go back to our overarching principles. What can you do that is clear, easy to enforce, can provide immediate relief, you know, and just -- and that's when we came back to where I would say we actually started, which is -- I mean, like anybody else, you start with exemption, and then you kind of think, well, maybe there's another way, another way, another way, and it kind of came back to it.

So, yes, we're not that far apart, but we would take very different approaches to what you would do in the interim.

MR. DENNIS: And I guess, Janet -- this is Leroy again -- clarify for me -- I mean, your opening remarks kind of talked about wishing there was a different AS2. Are you recommending that we try to develop that over a period of time, or just exemption, and that's the permanent solution?

MS. DOLAN: We are recommending exemption immediately because that provides immediate relief, is easy to implement, and -- but then we -- as you will see in Recommendation 4, we are asking both SEC and the PCAOB to take a very hard look at AS2 and how it's being implemented, and really ask themselves, have they done everything so far they can do? Is there more than that they can do? Can they only do it through interpretation? Should it be rewritten to put
interpretation?

I mean, there's all kinds of variations on what they could do. We're not prescribing that, but we're certainly asking them to do it. But we don't think that provides the immediate, straightforward, simplistic, easy to enforce remedy that we think is called for right now. And so that's why we are recommending that remedy right now.

But we're not foreclosing, as this whole effort matures, that we won't all end up, all companies, at perhaps a very different point as we get more and more experienced with AS2 and how to implement it and what to do about it.

MR. DAVERN: If I, Janet, could make one comment on that to Leroy's point, and this is --

CHAIRMAN WANDER: Alex.

MR. DAVERN: Alex Davern. -- it's a personal opinion.

I don't think it's feasible, frankly, to develop an audit standard for microcap companies that would be sufficiently cost effective, that auditors would be willing to put their name on, where the benefit would exceed the costs, is my personal opinion.

So I definitely feel there should be a permanent exemption, because at that level of company, as I said, personally, I just don't see any way you can have that auditor involvement and make it cost effective.
CHAIRMAN WANDER: Dick Jaffee?

MR. JAFFEE: Jim, I think I'm convinced that there is a rationale for a revenue test in both these categories. But there seems to me to be a sort of lack of symmetry in the numbers that were chosen.

And bear with me for just a minute. And I'm not sure this is, by any manner or means, the best way to look at it.

But in the microcap area, the size committee came up with a percentage number that, roughly speaking, is $125 million in market cap. And then you chose a revenue at the same level, which would be a one-to-one ratio.

Then in the other category we've got a 750 market cap and a 250 revenue limit, which would be a three-to-one ratio.

And I'm looking at it kind of in a common sense way. If you went out to make an acquisition of a company, what do you pay times revenue? Of course, it depends upon the business.

But in the consumer products area, you know, they do sell at multiple times their revenue. In a business like mine they don't. They sell at 50 cents. Our market cap is 50 cents, or maybe 75 cents off of our revenues.

And so it occurs to me that -- I have a question and I have a comment. Were these numbers of 125 and 250
generated after the economic office did some research for
you, or were they very subjective numbers, based upon what
you think the complexity of the company is?

MS. DOLAN: Well, it depends. And I will tell you,
we -- as I tried to say before, we didn't spend as much time
on the revenue number for microcaps. There just was a lot of
alignment that -- the microcap market cap wasn't anything
that we were going to debate. And so, really, we were just
working with the microcap market cap.

And then as you do, as you fine-tune, we started to
say, well, but wait a minute. What if this company -- you
know.

And so we really did just put a governor on it by
saying, well, let's pick a revenue number --

CHAIRMAN WANDER: Yeah.

MS. DOLAN: -- that still means the company is
largely small enough in its operation that we could justify
it being exempt.

It was very different when we came to the small
companies because -- perhaps because we had spent so much
time trying to have a remedy for this whole bucket of
companies.

So I just want to say -- and, you know, we are not
at all suggesting there's any bright line that has been there
the whole time, and we just went and found it.
We just tried to say, what is the level of complexity and size and scale and everything else of a company when the auditing of the financial statements really does depend more and more on the good controls being in place. And we just drew it where it was. But we recognized that it could be drawn elsewhere, but that's where we agreed.

MR. JAFFEE: Well, I would just make a comment. I think your revenue line at the microcaps is too low and that ought to be just kind of re-thunk. Because the example you gave of a company who was in financial trouble, and so the market cap was, you know, tanked, could also be considered as a special case.

I mean, in special cases, we got somebody in bankruptcy and the stock is selling at pennies, that's a different -- whole different deal. So --

Anyway, I'm sort of convinced the revenue test makes sense, but I'm not yet convinced that the levels of revenue that have been chosen, you know, couldn't be thunk through a little more carefully.

MS. LAMBERT: If I could just make an observation about how we came -- oh, I'm sorry, Debbie Lambert, and I was a member of the subcommittee.

If I could just make an observation about how we came up with those numbers. They were a little bit late in
the game, and we started realizing we had an unintended
consequence of companies that might be in those microcaps.

We actually had -- we were throwing around revenue
numbers before we had the table of statistics. The table of
statistics came after the fact, and the revenue numbers, as
we were trying -- and we looked at different revenue numbers
and had different proposals on the table -- we were trying to
really look at the underlying complexity of the company and
where the company and the company's auditors looked to deeper
internal controls for their own preparation of financial
statements or the audited financial statements and where
those underlying process type controls really aren't as
important, or aren't as useful in the process.

So we really did, I think, come at it from a -- it
was subjective, but of complexity and how internal controls
really operate within the entity. And that was where those
revenue numbers came from to start with.

So it's subjective, but it did intend to look at
the complexity and the nature of the operations of the
companies.

CHAIRMAN WANDER: Do I see any other questions,
comments? Jim?

CHAIRMAN THYEN: Yeah, this is Jim Thyen. Could
you talk a little bit about how you came to the conclusion
that revenue and complexity align?
MS. LAMBERT: Well, I think in terms of being an auditor, my own input into that process was that there are certain pictures that come to mind when I know -- when I'm trying to think about how I'm going to approach an audit of a company, and often revenue is one of the primary indicators of what I expect the complexity in terms of systems and level of underlying and process controls be in place.

Obviously, each company is a unique situation. For any example you can show me an outlier that doesn't do that. But there are certain factors. So if you tell me there's revenues of $100 million or revenues of $200 million or revenues of $500 million, that, as an auditor, paints a picture in my head of how I expect to likely be approaching that entity because of what I expect the underlying control structure and operations of that entity to be like.

And so from my perspective, that's one of the factors that I put into that thought process and why I think that that is a relative indicator of what's appropriate in the internal controls.

MR. JENSEN: This is Mark Jensen. Jim, to try to help -- and there may be some confusion in the committee on how those recommendations really work.

In the microcap area under 125, the recommendation is to exempt both management and the auditor from what they do. So there would be no -- management, we would assume,
would do their own assessment, but they would not make an
assertion under Section 404 that their internal controls are
working, and so on and so forth, because --

We felt that was appropriate because, first of all,
it's difficult for management to do that, and, secondly,
there's such limited guidance out there around how management
would conduct that assessment.

When we moved into that second category, we
basically said the auditor would go out of the equation, but
management would still do their own assessment and then make
their assertion under Section 404.

There's really no change to what management would
do under the new proposal. It's only the auditor that's
going to get the change.

The rationale was -- and, again, just speaking as
an auditor -- was, at that level of company, an auditor
really is going to pay attention to internal controls, and we
felt that a company saying we want the auditor out of this
would not be credible to the auditor.

The auditor would basically say, you know, I've got
to audit these controls because I'm relying on them for
internal financial -- for your financial reporting and for my
audit opinion, and, therefore, you know, we didn't feel like
you would -- there was much left to exempt after the auditor
got to that conclusion.
And so we just kind of said that's the -- that's where I felt where you would cut it off, because the auditor simply isn't relying on it, or will start to rely more heavily on controls at that point. That was the rationale.

CHAIRMAN WANDER: Ted, did I see your hand up?

MR. SCHLEIN: I'm Ted Schlein. I was just going to chime in, I guess, mostly because I was the most vocal on this whole revenue thing for the last bunch of the months, although I stayed quiet for the last two meetings and didn't talk about it. But since everyone brought it up here -- And it really had to do with the fact -- it's interesting it's come back around -- for Jim, exactly what you just said, to me, revenue is the greatest indicator of complexity. And if the purpose of 404 was to measure and assess complexity of a company, then that would have been the natural way to do take a look at it.

There is a large number of companies in the world I live in that have de minimis revenue and very large market caps, and, you know, I could audit the books. And I have no basis for doing that.

So, you know, I applaud it being brought back into the fold. I could maybe argue about the different levels and how it's being applied. The end of, you know, the $700 million and 250 I think might break some people through that barrier pretty quickly, and, therefore, not allow them to
have the exemption, even though they probably are far less complex companies than companies that would have the exemption.

And I don't see that as being -- I don't look at those as fringe cases. I think there's actually a lot of cases like that.

But to some extent, you know -- and I might be quibbling over some crumbs here from that standpoint, but I do draw you to -- which, actually, I'm sure Rich Brounstein had probably brought up a lot because the biotech industry is indicative of this as well, but --

So I -- it's kind of where do we see the purpose of 404 for? If it's to measure complexity and, you know -- and help monitor that, then revenue is the natural indicator of that from my perspective. So I'm happy to see it brought back.

CHAIRMAN WANDER: Rick?

MR. BROUNSTEIN: Yeah, just a quick comment on that, just more of a fact, and you can find it on slide 34 again. But what Ted's talking about, there's about 190 companies that have revenues under $250 million, but are market cap of over 750.

There may be a few down in the very lowest group as well, but that's separate from the biotech, which I think we're going to look at as an exception.
One other just unrelated nit, but just to get it on the record on the exceptions is -- one of the things that we did mention was the debt only companies, and just to point out, as we sort of wrestle with that, that when the SEC recently went through and defined the WICC companies, they did look at the debt only companies, and they set a definition of $1 billion in debt issued over the previous three years as their cutoff criteria.

So I just point that out for the record so we can consider it as we try to figure out what that exception might be.

CHAIRMAN WANDER: In response to a couple of the questions, when you say there's no management internal attestation or internal reporting for the microcaps, I assume we're not going to suggest overruling the '97 amendments, the Foreign Corrupt Practices Act, which does require --

So there still is a requirement that each company have internal controls. And I also assume that you are maintaining the certifications, even for the microcap companies, whereby, in the quarterly and annual reports, the CEO and the CFO are certifying really to internal controls as well as disclosure controls once you mature.

So it's not quite a total exemption for management, if I'm correct. Is that right, Janet?

MS. DOLAN: It's the management affirmation within
the 404, right. 302 can continue, so you start to get kind of fine distinctions in terms of what your -- what base you do your 302 on is still there, so -- okay.

CHAIRMAN WANDER: Okay, thank you.

MR. SCHACHT: Just so there's no confusion this -- I mean, there is -- 302 continues for the microcaps, but what the committee has proposed is essentially a repeal of Section 404 for microcaps. There is no manager 404 and there is no auditor 404.

CHAIRMAN WANDER: But there still is the Foreign Corrupt Practices Act and the certifications, okay. It's a clarification point, not a value judgment. Bob?

MR. ROBOTTI: Hi, Bob Robotti. My approach to looking at these questions -- and I think I'm a proponent of good corporate governance. You know, I come from an investor background, most of the eyes at which I look through these processes. I'm not an issuer, I'm not a service provider to an issuer, and I'm concerned about the unintended consequences of not having the immediate exemption from 404.

I believe in the arsenal of good corporate governance investor protection, Section 404 safeguards are very low in that totem pole. And, of course, part of our concern of our committee and also the corporate formation is, you know, at what point does one register or deregister as an SEC filing company? And today, of course, that requirement
is 300 shareholders of record.

And I clearly think that one of the unintended consequences is going to be that a significant number of companies probably have the ability to avail themselves of the option to deregister as SEC reporting companies.

And I think that would clearly be, for all the affected companies, a significant disadvantage, and those investors would not be better protected, but clearly worse off than where they are today.

We've talked about changing that number, and also the formation committee has talked about potentially giving corporate formation -- capital formation committee has talked about some changes to give some kind of relief.

But I think the implementation of 404 to small companies is going to have an impact where a company is going to avail themselves and will leave SEC protection.

So in the context of investor protection, I think that there's potentially a large disservice to be done by the process.

And specifically since the requirement is that certain companies, including all bulletin board companies, that have no obligation to have the more important parts of Sarbanes-Oxley, which are the corporate governance, the independence, the order of committee issues, they are not subject to those requirements, which clearly are more
important.

So that that group of companies clearly is going to be mandated -- that we're asking them to have extra regulation that they are not required to comply with today, and those investors will clearly much better off in that situation.

So I don't necessarily think that, oh, we're just giving a pass to people and saying going away. Actually, in certain cases, we're requiring companies to do more than they're doing today, but that more they're doing has relatively low cost, but with a huge significant advantage.

So I think we're, you know, measuring the two different things. And as one investor who specifically is in the small cap -- microcap area, this is my area.

I am concerned -- my only interest is as an investor. How am I best protected? How will my constituency protect their interests? I really think that 404 --

I've also had firsthand experience being on an audit committee in the last year and see the work that's been done on a company that has 17 people, and really think that the benefit derived from the process and the specifics that I know about, there really is almost no benefit derived from the 404 process.

That said, you also have to -- I always stick with caution -- when I talk to a management, they say, well, you
know, potentially we're going to deregister because this 404
is just outrageous.

Of course, you hear that from managements all the
time. Oh, the cost of regulation is horrible, and it's a
terrible thing, and, oh, it's -- we're going to do these
different things.

I really have come to the conclusion that 404 is a
significant expense that has relatively little benefits, and
that managements would almost be negligent if -- and a large
number of them have the ability to, based on current rules,
and even if we amend the rules and make it 750 shareholders,
to deregister, and, therefore, there are no investor
protections at all.

So that's the tradeoff in my mind and why immediate
implementation makes more sense. Because if we do that,
immediately give exemptive relief, there's going to be
pressure on us to say, oh, you can't let that stand as a
permanent process.

And so, therefore, that will, I think, also push
the other groups, including the PCAOB and the SEC, to say,
okay, what's an alternative process that we need.

In the meantime, I think, the large issue is
who -- as it's been pointed out, the 404 process is not cost
effective for them either. Fortunately, they can afford to
pay the money because it's relatively inconsequential. There
will be more of a proponent push for how do we change this
rule to make it cost effective?

So I think that we'll put in process from all the
constituencies and force the solution to where 404 that makes
sense, that is cost effective, because the current one
clearly is not cost effective. Thank you.

CHAIRMAN WANDER: Thank you. Mark and then Alec?

MR. JENSEN: I'm going to -- I'm probably going to
spark a debate here, and maybe this has been too polite so
far. But I wanted to -- it's something I think the committee
should think about as we move to voting on these proposals.

I just want to take my hat off for a minute. I
want to put my auditor hat and my Big Four hat on here for a
second and kind of let everybody know what's likely to happen
and how the profession, the people who actually have to
deliver these reports, are likely to see this. And if
somebody's got ideas around this, this would be the time to
get them out on the table.

I think universally I think you will see the larger
firms -- in fact, it is universal, I think -- would prefer
that we see -- and that if there needed to be exemptions -- I
think -- first of all, I think they'd prefer there would be
nothing, but if there needs to be some solution for these
companies, then their preference would be that the companies
be exempted from 404.
The firms, at least the larger firms -- I think you should speak to the smaller firms so that -- I think it's just in the interests of getting this in the public -- in the public forum.

I'm not going to draw a conclusion for anybody, but this is going to be the debate, and we should start to think about it, and that the development of a new standard, at least in the larger firms, is not going to be favorably looked at.

And the reason is, is that the experience with AS2 implementation was not good, as we all know. The firms I think are fearful that they're going to wind up in another situation like that.

Secondly, there is some concern that the auditor may be asked to sign an opinion that doesn't have any -- they don't have any significant workaround. That they really haven't been that close to it. And so now they're being told by a standard to sign something they haven't really done substantive amount of workaround, and so they're concerned about that.

There are other concerns as well, just from a practical standpoint of could you develop such a standard, where does it exist in the literature today, what's the theory behind it and how auditors would deal with it. And then, finally, the overall question I think is around a quid
pro quo, and that that is that if there is a new standard, then companies will expect significant reduction in work and in fact an approach that comes out by the PCAOB or the SEC may not result in significant work going away by the auditor, and therefore, they're the ones left in the hot seat to explain it all to everybody.

So those are going to be the concerns. I'd like to address the smaller company, the smaller firm's point of views so that again, I think it's important that we start to have this debate. Because otherwise, we're going to go into this and all of a sudden everybody is going to be surprised at the letters that are coming in. And they are going to come in, and there is going to be a lot of dissention to this.

CHAIRMAN WANDER: John?

MR. VEIHMEYER: Thanks, Herb. Since Mark has teed it up, I guess I was patiently waiting for the clockwise thing to come around, but I think Mark has gotten us into a couple of issues I wanted to touch on. And I just want to -- and this is John Veihmeyer, by the way.

Janet, I think you probably had a bigger challenge than Solomon, so I want to compliment you and the rest of your group. I know how much effort you've put into this thing. And personally, from where I sit, I think 404 will ultimately be viewed as a very good thing for investors as we
get down the path on this thing.

Having said that, I think we all recognize the first year implementation costs have been dramatic, and it is probably largely what has led to where we are today in terms of this meeting and this conversation.

You know, I would point out, you know, there is some reason for optimism on that front. The Big Four firms commissioned a study recently that was released last week that indicates some positive movement in terms of year two and where those total costs of implementation may be headed. We'll know for sure in a short period I think here in terms of whether or not actual experience in year two is anywhere near the 40 percent or so projected decline that that survey would show.

And, again, recognizing that audit costs are less than 40 percent or so, based on first year implementation costs, less than 40 percent of the total costs that companies are incurring in implementation.

So having said all that, I think, and notwithstanding any of that, I think clearly there is an issue here that needs to be addressed, and I think your primary recommendations in Recommendations 1 and 2, I think try and -- are an attempt to be responsive to the concerns of the smaller company spectrum of the marketplace to deal with a lot of the issues we've just talked about. And I'm not
prepared to oppose those recommendations at all.

I am concerned when you get to Recommendation 3 as the fallback recommendation, if you will, if 1 and 2 are not accepted, and it starts to get into some of what Mark just commented on, which is why I kind of jumped in, that a standard that provides a different level of assurance, depending upon the size company you are, and I think will do more to create confusion in the marketplace and in the minds of investors than it will to clarify anything.

When we get into an auditor's report that focuses on design and implementation but not operating effectiveness of internal controls, it seems to me that much of the public debate since Sarbanes-Oxley was enacted in total, there has been a tremendous amount of focus, and I think that focus has been positive, on all parties involved in the financial reporting system, whether you're talking about management, audit committees, boards or auditors, there has been tremendous focus on the operating effectiveness of internal controls and the impact of that on the financial reporting process.

And the key there is are the controls operating effectively? I don't think the critical question is are the controls designed effectively. I think the critical question that the marketplace is concerned about is, are they operating effectively in a company?
So I'm very concerned about, as an auditor, maybe widening the expectation gap that already exists out there in our profession around much of what we do that the public doesn't understand by attaching our names to reports that only run to design and implementation of the internal control system and doesn't speak to what I think is the key concern in the minds of all the users of those financial statements, which is are those controls operating effectively or not?

And we've seen that somewhat, you know, we have I think an example of this in the SAS 70 reporting on service centers, where we have Type 1 and a Type 2 report, where Type 1 runs to design, Type 2 runs to operating effectiveness, and I think we've seen tremendous confusion in the marketplace in terms of a lack of understanding about what a Type 1 report really tells you and what kind of assurance you can take away from that report.

So, I think to, you know, the point again that Mark teed up, I am concerned on a couple of fronts, one from an investor standpoint as well as other users of the financial statements that a Recommendation number 3 type of approach is simply going to introduce more confusion into the system than we've currently got.

And I just sit here and anticipate a conversation that I'll be having with an audit committee in two years, once all of the emotion around the cost benefit and a lot of
what we're dealing with today here is long forgotten, and you're discussing an error that has popped out, you know, in the company's financial reporting system.

And maybe it's not material, if you will, but an error nonetheless. And our involvement in terms of the formal reporting on internal controls has simply been to design and implementation but not operating effectiveness.

And I think it's going to be a very difficult conversation to explain to that audit committee member why the work we did in the internal control system potentially didn't catch that error that maybe isn't material to the financial statements but maybe is important in the minds of a audit committee or a board member about what that demonstrates about the company's reporting system.

And it's just going to create I think a very difficult situation in terms of trying to articulate what we've done. And I think it is reasonable in the minds of people relying on auditor's reports and financial statements when they see an auditor's report, they're going to see the reports on the larger companies, understand what that means, I think in terms of an AS2-type audit of internal controls, see a report on a smaller company, I think not fully understand and appreciate the nuances of what we didn't do in that situation in rendering our report, that we do do in other situations around reporting on internal controls, that
I'm just very uncomfortable with.

And I think, you know, the follow-on step then is, I think to Mark's point. And I was confused, although today's presentation helped a little bit when I first read the recommendations, when you get to that last bullet of Recommendation number 4, it wasn't clear whether we were actually recommending something.

Because actually I think Recommendation 4 hits a lot of very key points in terms of additional guidance that is needed for all the participants in this process, not the least of which in my mind are the registrants themselves. Because I think the points you made earlier about the default position whether the registrants have de facto adopted the auditing standard as their only guidance in terms of how to deal with 404 is one of the major I think issues that has come out of this.

But the last bullet that I think just indicates there's a question remaining, but it's not framed in the context of a recommendation. It wasn't clear to me whether we are actually recommending that AS2 be reopened and revised.

And I think for many of the reasons that Mark started to articulate, I think I'd be concerned about doing that right now, after we've just gone through the experience we've all suffered through in terms of a first year
We've gotten I think in the minds of the auditors a tremendous amount of guidance since that first year experience. I think we are in the process of trying to implement that additional guidance. There are probably areas where additional guidance would be helpful, and I think working together, I think we continue to focus on those things.

But to at this point, before we've even gotten to year two of implementing a very difficult standard, to open that up and begin to rewrite that standard I think would be a mistake.

MR. DAVERN: Janet, if I may, I'd just like to make a couple of comments. It's Alec DaVern here. I'd like to first respond to Rob's point. And just to be clear on recommendation, it is immediate relief for microcap companies and it is immediate relief for smaller public companies. And it is permanent relief from AS2 for categories that fall into the size category.

So we're talking about immediate relief that's permanent, first off.

The second thing, I'd then like to just comment on John's comment. You know, obviously the costs will play out as we see, and the Commission will know. Unfortunately, I find it very difficult to believe the conclusion of the
survey that the Big Four published, but that will all come to pass in the finish.

What did come out of the Big Four survey is that costs for smaller public companies are 10X what the SEC said they would be, and they're vastly more expensive proportionately than they are for large companies, which supports the basis for our conclusions.

On the other issue of AS2, you know, we're focused on the practical relief. And your basic comment, I'm going to paraphrase your words, is that re-changing AS2, et cetera, et cetera, gets very impractical, and there's lots of consequences to do with that, which is why we're pushing for exemptions.

I would, however, and I think, and other people can comment here, my view on AS2 is that we shouldn't view it as something handed down from God, with all due respect to the PCAOB, that's carved in stone and unchangeable.

(Laughter.)

MR. DAVERN: And my view on this question is that we should move now to exemption for the smaller public companies that are within the purview that we have been given a remit to examine.

But I don't think that in the end of the day we should conclude that AS2 is ultimately untouchable ever. And I think the Commission and the PCAOB and issuers need to
continue to review its implementation.

And its implementation practically -- speaking as a large public company, because I don't qualify under the smaller public company for National Instruments -- but its implementation needs to continue to be refined and needs to continue to be improved. And as several of the commissioners have said, the costs need to continue to come down dramatically.

And if that doesn't happen at the larger company scale, then in some period of time, we should not view it as handed down by God. And if it doesn't work and the costs don't come down over time for bigger companies, I think somebody should be tasked ultimately to look at it.

Thank you.

CHAIRMAN WANDER: John, and then Leroy.

MR. VEIHMEYER: And I appreciate those comments. I think the -- I guess a couple things I would point out. I don't think any standard, you know, is exempt from refinement and making sure as you go forward that it's really achieving its objective.

So I didn't mean to imply that if that's what -- I do think that right now it would be a big mistake to reopen AS2. We are on the front end of the second year of implementation, a year in which a lot of guidance that came out about a standard that was continuing to be refined up to
the very last minute that we were all charged with implementing it, which made it a very difficult situation for all.

I think it needs to play out to some extent, and I think my concern in terms of the role where I sit in this dynamic from a financial reporting system is to ensure that as we go forward, if there are legitimate places to provide additional guidance, which I think the PCAOB and the SEC are in a position to do on an ongoing basis, or potentially amend some aspect, it's very important that -- and I want to focus on the comment you made about which would imply that the sole focus needs to be a focus on cost.

And I think at some point there is a danger that if in fact from a public policy standpoint we believe it's important that investors and the marketplace have the assurance that someone is doing an audit of an internal control system, that may be expensive to achieve that objective, expensive in relation to what the initial SEC estimates of those costs were.

And I think the real fear which Mark started to articulate, is that we get into a situation where because of the significant concern over cost, we get some amendments of AS2 which appear to significantly reduce or weaken the requirements to enable you to report effectively on internal controls, and somehow that gets out of whack in terms of the
work we're actually doing and therefore the level of assurance that someone can assume they can take away from a report on internal controls, if the sole focus is cost.

I think it needs to be balanced, and we can't -- at some point in time, there will be a decision point that if in fact this is the cost, it's gotten as efficient as we can get it, we've gotten all the guidance we can get, and in order to provide the kind of assurance on an internal control system that is necessary to be able to render a report, the cost is X, and I think there will be a number of companies who view that, no matter what it ultimately gets down to, as higher than they would like to be incurring, then I think the more fundamental decision, which is why I'm not prepared to oppose Recommendations 1 and 2, I think that's essentially where we are as a group, I think must have given rise to the Recommendation 1 and 2, that at some point, there must be a belief that we can't -- we can't get to the point where we can provide assurances on a system of internal control in that size company, which from a public policy standpoint we believe will ever be viewed as cost effective in that equation.

And I just want to caution that we don't creep into a situation where we get to a similar place for larger companies by a weakening of the standard.

I don't know if that makes sense or not.
MR. DAVERN: No, certainly that makes sense, and that's my belief. And that's certainly why -- I'm not sure if I interpret "not oppose" as support, but I guess we'll see.

(Laughter.)

MR. DAVERN: But, you know, I certainly agree that's been conclusion effectively is that it's not going to be cost effective, and it's an almost impossible task to come up with a standard for the microcaps that will be, which is why I voted the way I did.

And, obviously, large public companies are outside of our remit. But there are some smaller public companies who will still be subject to an AS2 audit. And that's why we wanted to make the points clearly where we see improved guidance necessary, which we did, and also leave open the door that ultimately over time for these smaller company group, if the cost benefit equation is not there, then these things will have to be reconsidered for the group that we are still leaving inside the net.

We're not advocating a reopening of AS2 today.

MR. VEIHMeyer: And my point is simply the decision in my view, and whether I agree personally that there's not value to an investor of a small microcap or at least a smaller public company as defined in 404, and that's probably the nuanced words, if I'm not prepared to oppose, as opposed
to support.

But I think irrespective of that personal view, because I think there is value there and benefit, the decision it seems to me is either/or. It's not -- which is exactly what the subcommittee I think has put forward in terms of its Recommendations 1 and 2.

It's either if you want, if it's important to have that level of assurance on a company's internal controls, then let's audit it and let's report on it appropriately, which is why I can support 1 and 2.

But Recommendation number 3 is very troubling, because I think it's in a middle ground of somebody wants some assurance and is willing to pay some minimum amount for some minimal involvement, but there will be no basis based on that minimal involvement I think for people to come away with the assurances that they're going to come away with once they see an auditor's report on internal controls irrespective of what it actually reports on.

CHAIRMAN WANDER: Leroy, did you have a comment?

MR. DENNIS: Sure. Leroy Dennis. I'll give a couple comments and then respond to Mark. You know, John and I have had a lot of discussions over the last couple weeks with what's going on.

You know, I think one of the things we've got to keep in mind is, at least what I heard on the testimony is
that investors do treat smaller public companies differently
than the treat larger or middle market companies. I didn't
hear a lot of support for 404 being a deciding factor some of
the investors in smaller public companies.

I also am less optimistic with the cost predictions
going forward on 404 than maybe what I've heard in the
markets. And I think a lot of the cost things are going to
come -- cost reductions may come from management's internal
costs, outside consultants, those kind of things. I'm not
sure the audit costs go down significantly.

But like Alec and John both pointed out, time will
tell. We'll know that in six months.

I did get a chance over the last three or four days
to talk to most of the middle tier firms. I would say there
is less resistance there to a design standard. I think there
is some concern by that group of can we audit to that
standard?

When you look at what things generated material
weaknesses in the last year, it really was the substantive
audit procedures as opposed to a design testing or an
operation effectiveness testing that generated 90 percent of
the material weaknesses that were reported out there.

So I think there's some concern by, at least the
auditors I spoke to, as to whether or not we could
effectively audit to a standard of design. But I think
that's a standard-setting problem that needs to be -- would
have to be addressed if your Recommendation number 3 was
discussed.

I would say there's general concern with
Recommendation number -- well, let me back up. I think
there's general support for Recommendation number 1, that
exemption for the smaller public companies, except for one
firm I talked to, which would share more of Kurt's view, that
everybody -- that there's a price to pay in the public
markets, and that price is AS2 and 404. But the other firms
I talked to had a general support for Recommendation number
1.

There is concern with Recommendation number 2, and
I would say that concern is not so much from the exemptive
part of the -- for the companies, but more from a concern
that this will lead to further concentration of auditors of
companies over $250 million basically being with the Big
Four, Big Six, Big Eight type firms, and that the smaller
firms, when they only have maybe one or two of those type
companies in their portfolio, may have a more difficult time
competing effectively in the market for those kind of
companies, and does that effectively exacerbate the problem
of auditor concentration?

I think that's a separate issue that just needs to
be addressed. I don't think we're going to snap our fingers
by making a recommendation, all of a sudden there's only
going to be three firms or four firms or five firms that are
auditing these kind of companies.

But I think that is something that if we head down
the road of a Recommendation number 2, we need to keep in the
back of mind as a potential unintended consequence
that -- and what kind of things can the SEC and others put in
place to help with the competitive nature of those kinds of
companies.

Mark, I hope that answered -- I think that's what
I've heard from the other firms. And like I say, there was
general support for exemption except for one firm was not
supportive of that.

CHAIRMAN WANDER: Janet?

MS. DOLAN: Yes. I would just like to respond to
kind of the auditor input we've had over the last few minutes
to three points.

One is I would just urge, it's very easy when we
say, well, it just needs to cost whatever the price of it is,
and we should perhaps just bite the bullet and say if that's
what it costs, that's what it costs.

And that's exactly the point we're trying to raise.

Those costs are there because they represent activities. And
what we are hearing from people is we are engaging in
activities in these 404 audits that are not substantive
enough to create any threat to the integrity of the financial
statements.

I mean, that's what registrants have been trying to
tell us, is that we are causing companies to document and
test and have affirmations and attestations to low level
controls that simply have no relationship to what I think
Congress wanted, which is give us at least a reasonable level
of assurance that the controls are in place that we need to
know are in place to rely on the integrity of the financial
statements.

So, I just -- it can easily become mom and apple
pie, which is regulate at any cost and that should just make
us all feel better. That cost is there because we're doing
something to generate that cost. And what we're trying to
ask is, the other bodies, the PCAOB and the SEC, to examine,
have they put something in motion that is just creating a lot
of activity that isn't going to improving the competitiveness
of these participant companies in the global economy, which
is where their activity should be going.

So I just want to address that. And I certainly
know Leroy's raising a concern would the -- if we got to the
point of Recommendation 3 and it was in fact a new auditing
standard, we'd get caught with an auditing standard where we
don't know how to audit to it.

And that's our point of saying, look, we are not
only making Recommendation 3 should it come to that, but
we're actually trying to give some guidance as to how to do
it, which is field test it. Get a lot of input. Find out
will it work.

I mean, if it won't, then obviously don't do the
same thing we've already done, which is end up going down a
road with something that, if we could redo how we got here,
we might have done it differently.

So we're not blindly saying this is the answer, but
we're saying we just keep trying to say look in the universe
of all, thousands and thousands of companies that range from
hardly any income and no market cap to the very biggest.
There's just a wide variety of companies, and taking only one
approach and trying to say either you fit in it or we throw
you out, you know, maybe that's the approach.

But maybe there's another way, which is to say,
look, you have kind of an evolving, maturing approach to this
where you start out with exemption. Then you go to kind of
design and implementation, which is kind of framework. And
then ultimately when you're big enough, you actually go to
full auditor involvement.

As I said, we think immediate relief and exemption
right now is the answer for these companies that we've
focused on. But that's how we got there. It wasn't just to
say, well, let's just go make something new. We thought that
would actually sort of fit the maturation of companies as they grow into their capability to actually implement full 404.

Anyway, so that's where it came from. And then the last one, we are very cognizant of the concern that what we're recommending may in fact create even more of a monopoly and reduce the number of audit firms, and that is not a good thing. And that's why I said, there are no easy answers here. I mean, we don't like that possible consequence of what we're recommending. We actually debated it. But you have to weigh all the factors. And that, opposed to the downside of some of the other alternatives, we simply came to where we were.

But we are cognizant of that concern.

MR. DENNIS: This is Leroy again, Janet. Like I said, I think that's potentially an unintended consequence. I don't think that by our recommendation today if this is adopted and it goes forward and it's adopted by the SEC that we're going to snap our fingers and all of a sudden we'd only have a lesser number of firms doing this.

But I do think that's something that over time that the SEC and the regulators and Congress, you know, we need to address that. You know, the market may work and may get us to where we do have enough competition in there. You know, I'm not saying I wouldn't support -- I don't support your
recommendation just because of that. I just want to make sure we're all aware that that's a potential issue out there, and that's something we need to work -- I think there is continuing work that needs to happen in that to make sure that we don't go further to a concentration than what we've got right now.

CHAIRMAN WANDER: I'm going to try and move on. It's a little after eleven. But having the prerogative of the chair, I'd like to make a couple of comments that I know were considered by the committee, didn't come up in the discussion, but I think the record should reflect them, because they may appear further on when we go to the actual writing of the report.

One is the comments we've just made about concentration in the accounting profession. I think that is a public policy issue. The chairman spoke about that last week to the AICPA meeting. I think -- I've heard Bill McDonough speak on that subject a great many times. So I think whatever we do, that is something that we have to keep in mind.

The other two are what I call the 800 pound gorillas, maybe the King Kongs. And one of them is liability. And Janet and I both personally devoted considerable amount of time trying to figure out if there was some sort of safe harbor or some way to deflect this focus of
being litigation conscious that seems to permeate the accounting firms, all of them, not just the Big Four, but everybody.

And it's a real issue. Because, for example, if I'm counsel for an accounting firm, I'm going to be recommending to them they be conservative, et cetera. But that's -- the cost of that possible litigation exposure may be one of the engines driving all of the problems that we've seen. And we thought about that issue and haven't had -- haven't come up with some solutions, although I did read some articles where people suggested that.

And the other 800 pound gorilla, frankly is the inspection process at the PCAOB. I think from everything that we've heard on high at the PCAOB you're telling your inspectors to be reasonable, to reasonable assurance, et cetera, et cetera. But I think there's a disconnect between the advice and the guidance and what happens in the field.

And it also happens at the accounting firms. No accounting firm is going to -- supervisor is going to say to the audit partner, you're doing too much. I mean, can you possibly believe that anybody's ever going to say that and wind up having that quoted by the audit partner when trouble comes up, that you did too much auditing, et cetera?

So I think there are built-in things in the system that somehow we should rectify that's causing some of these
problems.

Jim, did you have some comments?

CHAIRMAN THYEN: Yeah. I think one thing that I've been listening for and I haven't heard, and those of us that are leading companies that are trying to create wealth for shareholders, there is a disjoint in our dialogue in how we're approaching these internal controls, because the real heartburn comes in the fact that imposes a cost structure that totally ignores the consumer.

And the consumer and the customer ultimately are the individuals that have enough trust to buy the product or the service, to give the dollar to a company, and hopefully the company manages it effectively, and there are a few pennies leftover that create shareholder wealth. And investment in a company is not risk-free. It's not a T-bill investment.

And in this whole discussion, we are ignoring that customers, very knowledgeable, very sophisticated, know what they want, when they want it, how they want, what price they want to pay, and they very seldom ask where is made.

And when you start looking at the costs of venues around the world and what it does to your cost structure, there is a fixed cost structure that varies by market, and they are getting tighter and tighter and tighter. And imposing more and more burden for regulation that is totally disjoined
from what the customer wants ultimately is destroying shareholder value and it's going to assure that smaller public companies remain smaller.

CHAIRMAN WANDER: Thank you.

MS. DOLAN: Herb?

CHAIRMAN WANDER: Yes, Janet?

MS. DOLAN: I wanted to make one last comment which I should have made. And I want to say that I want to, on behalf of our whole subcommittee, thank Kurt for all of his involvement. I know the fact that you have a minority view can somehow suggest that there was lack of appreciation in the committee for that minority view, and it is just the opposite.

Kurt has done just a superior job of being engaged and very, very well representing the input and the views of the investor community. So anyway, I just wanted to acknowledge that, that we have -- the very best thing about any kind of advisory board like this is to get real, substantive debate going. And so that it's -- we all gain from it, not lose. So I want to thank him for that.

CHAIRMAN WANDER: Thank you. I'm going to move on to Steve for the report of the Subcommittee on Corporate Governance and Disclosure.

MR. BOCHNER: Thank you, Herb. I would first of all like to acknowledge the efforts of my hardworking
committee, Bob Robotti, Pastora Cafferty, Dick Jaffee and Rusty Cloutier. And Rusty apologizes that he can't be here. He continues to deal with the aftermath of Hurricane Katrina in New Orleans, and we wish him well as he deals with that.

I'd also like to thank --

CHAIRMAN WANDER: I should add, I think he was just appointed co-chair of the -- I guess the committee to reconstruct Louisiana.

MR. BOCHNER: I'd also like to thank Kevin O'Neill and Gerry Laporte in particular as well as the rest of the staff of the Securities and Exchange Commission that's provided us with just excellent support through this entire process.

We have ten recommendations today. Two of those recommendations are now the subject of the SEC proposals that were made after the time we started deliberating. So, we're going to continue to keep those recommendations in our preliminary recommendations and in our final to lend our support to those efforts. But those are the subject of SEC proposals. So that leaves eight other recommendations.

We don't -- we had a lot of divergent views and lively debate. We don't have a minority viewpoint, I don't think, at last count, our recommendations are unanimous. And they are preliminary, of course. And I'm going to point out a couple of areas where I think additional work needs to be
done to get from a preliminary recommendation to a final.

I do want to comment that we evaluated a lot off aspects of governance and disclosure regulation, and we've concluded that many of the current rules, including the recent reforms in the area of governance and disclosure are working well.

In particular, we think that the board independence provisions, particularly the audit committee independence requirements, the CEO/CFO certification requirements and processes associated with that, in particular disclosure controls are working well.

We think the enhanced responsibilities of audit committees, the whistleblower protection, more frequent SEC review of periodic reports, and the additional guidance and focus that the SEC puts on the MD&A, the Management's Discussion and Analysis sections of SEC Reports and Registration Statements, are really creating what I think is more of a tone at the top issue. And our subcommittee I think believes that those types of things are more effective, more cost effective than, for example, 404, as I think Janet has eloquently articulated.

So with that, let me run through a few of our preliminary recommendations. All of them have you before you. Most of them we've seen and discussed in prior meetings. They are on the SEC website. And I'm going to
skip over, Herb, unless you'd like me not to, some of the
things that have either been proposed -- I'll just mention
them -- or that I don't think are very controversial, and
then people can interrupt and take me back to those.

CHAIRMAN WANDER: Sure.

MR. BOCHNER: Okay. Thank you. So I'm not going
to talk about the first recommendation. It's
self-explanatory. It's the subject of a Commission proposal
already that smaller public companies not be phased down
beyond the 75 days for a 10-K and 40 days for a 10-Q, not be
phased down to tighter filing deadlines.

So the first recommendation that I want to talk
substantively about is something that the 404 subcommittee
asked us to specifically take a look at, which is that if we
end up recommending that 404 be eliminated for some or all
smaller public companies, and should the Securities and
Exchange Commission go forward and accept that
recommendation, the 404 subcommittee asked that we take a
look at whether there should be enhanced governance
requirements and perhaps other requirements as a quid pro
quo.

So that if we're taking away the 404 internal
auditor attestation because it's just not cost effective,
good idea, that internal controls are important, but it's
proving to not be cost effective, not helpful the way it was
intended, costs wildly exceeding the benefits, should there be some giveback by the issuer community to provide some additional levels of assurances to the issuers out there that are getting this relief.

And so what we've taken a look at are two things to recommend in this area. One is, we're calling it governance hygienics or governance standards that we would impose upon these issuers getting this relief. And what we -- the job here again is a cost benefit. We don't want to impose, because we're also talking about the smallest of public companies in addition to the wider range of smaller public companies, but we don't want to impose overly burdensome requirements. And so we're trying to take a measured approach.

And what we think may be useful here and is in our preliminary recommendations is taking a look at an already existing SEC Rule 10(a)(3) and suggesting that those be imposed on smaller public companies, regardless of whether those smaller public companies are subject to those SEC requirements by virtue of the listing standards on the markets that they're listed on.

The NASDAQ stock market and the New York Stock Exchange, for example, would already impose those requirements, but the pink sheets and the bulletin board listing standards may not. And so what are those?
These are audit committee independence requirements, responsibility for selection and oversight of auditors, procedures for handling complaints, so-called whistleblower provisions. And then the authority to engage independent advisers and separate funding.

Let me also say that since we deliberated last, I received a study put out by John's firm, an integrity survey that suggested that when employees were interviewed, the view of management integrity and the reported misconduct that was perceived at these companies was substantially less at companies which had legal and ethics compliance programs.

So one of the things I want to go back to my committee, my subcommittee on between now and the time that our report becomes final, is to discuss whether we should add to that list I've just described perhaps an ethics and legal compliance requirement, which is already defined by SEC rules and implemented by the NASDAQ and the New York Stock Exchange as part of their listing standard. So you may be hearing more about that. And we'd love your comment on that.

There are governance -- we could have gone further than that. We could have suggested overall board independence. We could have suggested nominating and compensation committee independence. We could have suggested shareholder vote provisions like some of the listing standards articulate for a whole range of things such as
stock option approval, but we decided to cut it off there, because we don't -- we're trying to take a measured approach, and we're mindful of this cost benefit analysis that we've been asked to do.

So the other aspect of additional requirements in the area of 404 relief, should it be granted, would be with respect to enhanced disclosure of the internal control environment beyond that required today in SEC rules such as exist in Item 308 of Regulation S-K. And the thinking there is that if we go ahead and take away this outside auditor attestation, this assurance, perhaps the companies should disclose more about -- self-disclose more about the internal control environment.

We have more work to do there, but let me give you some thoughts about how that might look, perhaps describing the resources that exist within companies in the internal control area. Is there an internal auditor? Is there a controller? Is there audit committee oversight? And then perhaps, and I say only perhaps, a broader discussion of other types of reportable conditions maybe beyond the material weakness level. And there I would like the input of the accounting subcommittee and the 404 subcommittee.

But that's our current thinking with respect to what would be required if the SEC moves forward with 404 relief.
We have also -- and we may be a little too late on this one, but we've also recommended that there be some clarification for foreign private issuers and the phase-in date for 404, because foreign private issuer status is tested at the end of each fiscal quarter, and so certain private foreign issuers that are not accelerated filers may not know until the end of the fiscal year in which they have to test whether or not they have to test, and we think that creates an unnecessary hardship.

But we're coming up on the -- we may be -- the train may have left the station on that. But we have put that into our recommendations, preliminary recommendations.

The next recommendation, and this one I think is also controversial, is the possible amendments of the thresholds under Sections 12(g) and 15(d). And these are the thresholds to require registration and subsequent reporting under the 1934 Act and deregistration.

And there's really two concepts baked into this proposal. The first is what are we measuring? Are we measuring record holders, or are we measuring beneficial holders, equity holders, or are we measuring something else? And then the second is, once we figure out what it is we're measuring, what are the right numbers?

With respect to the first issue, I think all of us believe that the use of a record holder test can undermine
the intent of Section 12(g). And that is that a company could have a large number of shareholders but a small number of record holders, and therefore not have to register.

And similarly, a company might be smaller but not have a lot of record holders, have beneficial owners and have to register. And we think that that ability to manipulate that result is just not the right result, and we don't believe that was the intention of the statute.

Now, the trouble is, where do you draw the line here? And we received -- switching to the other issue of where the threshold ought to be if we change the standard, the measurement standard from record holder to beneficial holder, what should we do?

And we've received comments as recent as five minutes before this meeting started indicating concern about the levels that we've proposed here, that the thresholds be increased to $15 million in total assets and a thousand security holders, meaning beneficial equity holders, and the deregistration provisions be increased from 300 to 750 security holders, again, beneficial, not record.

And the problem here -- and I think we need to -- we need to get more data before I think we're all prepared to move forward and turn our preliminary recommendation into a final recommendation. And we've worked with the SEC in deriving this data.
We want to know if we do these things, who's swept in, who's not in, and if that data turns out to be harder to get, then certainly I appreciate it, and I think we need, frankly, to get that data.

But I think we're all agreed that the current standard of the record holder test is one that can certainly undermine the intention of figuring out what number of shareholders should -- is a company large enough to require reporting, SEC reporting?

And that's the fundamental question, and we think an equity holder versus a record holder test is a better measure of determining that.

The other recommendation within this particular preliminary recommendation is that we exclude from the count of the number of security holders, holders of exercise options that are issued in compensatory transactions.

And we may come back and talk about that, because I know a few of you have had questions about that.

I'm not going to spend much time on the next preliminary recommendation dealing with the loan prohibition. We strongly support that. But we think that issue of community would benefit from some clarification in the areas we've identified.

We then have a number of recommendations that are intended to reduce the costs of smaller public companies in
the reporting area, while we believe not impairing investor
protection.

One of them is to change the requirements as to the
years of audited financial statements that need to be in SEC
reports from three years to two years for all smaller public
companies, not just SB filers.

And the thinking there is that that third year is
generally widely available on the Internet. It does cost
money to put that third year of financial statements in. It
makes changing auditors more difficult because you've got to
deal with predecessor auditor requirements. So we think that
is an area where investors won't be disadvantaged, and we can
perhaps achieve some cost efficiencies.

We then recommended -- and part of this was helped
along by the SEC's recent securities reform release, where
they decided that because 70 percent of Americans have
Internet access, that final prospectuses could be delivered
by posting the final prospectus on the website.

And we asked ourselves, well, you know, why
shouldn't all SEC reports have the ability to be delivered
that way, and, in particular, proxy statements and annual
reports.

And, indeed, the Commission on November 29 has
proposed that very thing for comment, and we're going to
continue to support that, as well as the concept that this
access equals delivery presumption be applied to a wide range of SEC filings so that the production and dissemination of paper copies only be made where shareholders really need it.

And we're also supportive of the protections that the SEC has put into its proposal in this area, that shareholders who desire paper versions of SEC-filed documents be able to access those at no cost and on a timely basis, such as through a toll-free number.

The next recommendation deals with allowing a broader range of companies, smaller public companies, to file more cost effective SEC forms, such as Form S-3, which incorporates by reference information that's already on file.

And, again, leveraging off this thinking that maybe the time has come now that most investors do have Internet access, why we put companies through repeating information that's already filed, already available, specifically incorporated by reference.

So our preliminary recommendation asks the SEC to allow smaller public companies to use Form S-3.

And we're also proposing that the requirement as a condition to the use of Form S-3 that the company has timely filed in the last 12 months, all reports be eliminated, and that the only requirement in addition to the -- the only requirement for S-3 be that the company's been reporting for at least 12 months, and as of the time of filing is current.
And we think there that the penalty for having to go back and spend the money to, again, incorporate previously filed SEC documents that are widely available into a form and to spend that money, that punishment doesn't fit the crime, if you will.

That the market reaction, the risk of an SEC enforcement proceeding, the listing actions that the SROs can take are adequate remedies to companies that don't timely file and companies should not have to go through that expense simply because they might have missed an 8K along the way.

We -- two more. We recommend that the SEC establish a task force to work with other governmental bodies to reduce inefficiencies associated with governmental filings, including synchronizing filing requirements involving substantially similar information.

I've been made aware of similar efforts going on in the country by U.S. banking regulators and in other countries with respect to the banking regulators. I understand there's a call report modernization project going on, using the XBRL format, and we think that the SEC should take a look at reducing duplicative governmental filings when that same information is both widely available and out there.

And this was a recommendation that was voiced particularly strongly from the local banking community, that we're really just feeling the crush of regulation and the
crush of duplicative filings.

So we strongly urge all of you to support this preliminary recommendation, and, if so, we will urge the SEC to take this one seriously.

And in the same vein today many public companies pay several thousand dollars to third party intermediaries to get SEC reports filed on EDGAR. Is that really necessary? We're all sending around documents on Word and other formats. Isn't there a better, cheaper approach to that? Aren't there technological advances, again, such as the SBRL, XML standards that might be looked at as more cost effective alternatives that might also have the benefit of enhanced tagging techniques to enhance research capabilities and actually end up being beneficial both to investors and to issuers by cost reduction.

So we're going to urge you to consider that and the SEC to take a look at whether EDGAR can be upgraded or modified to reduce filing costs that are particularly disproportionate on smaller public companies.

So those are our preliminary recommendations. And maybe I will ask if any members of my subcommittee present have anything else to add.

MR. JAFFEE: Just to help out -- Dick Jaffee. You know, even though we labored long and I think very diligently, I would characterize -- and I don't know whether
you agree with me, Steve, but I don't think our recommendations are very revolutionary in a sense. I think they are more tweaks, and they are more for the practitioners who have to do this work in the securities area, and I think that they seem to make sense.

Other than perhaps the 404, which seems to be the big deal of the day -- and the only concern I have there is that we very carefully consider what these additional governance hygienics and so forth are so we don't throw ourselves from a frying pan into the fire.

Finally, you know, I would say -- and I have this ongoing discussion with my friend to my left about -- I think the jury's out on some of the benefits of SOX, at least in my experience. We're all saying, oh, yeah, independent directors are great.

I think independent directors are good on the audit committee. I'm not yet sure that requiring this majority of independent directors is so great for everything. But it's too early to tell.

Just like somebody said, you know, we've got to wait a few years before we see what the actual cost of 404 implementation is. And I accept that as a sensible thing to say and believe.

I think it takes -- it's going to take longer to decide whether the stuff really has had much benefit. I
just -- well, as long as I got the floor, I'd like to add something to what Jim said.

Jim's been focused, and I think very appropriately, on -- we're all talking about the investor protection, and Jim raises the issue of the stakeholder who is the customer.

There's a third area here, who are the employees of these companies. And this cost burden that has been imposed upon companies is also having an effect on the employees because what is given to pay for regulation is not available for compensation, either in salary or in bonus.

And in my own company we had a big fight last year over the incentive bonus because there was a huge amount of unbudgeted cost for 404 compliance. So --

Anyway, those are my comments. I think we really did consider a lot of important things, and I support the recommendations that Steve articulated.

MR. ROBOTTI: Hi, Bob Robotti. One of the issues that concerns me, of course, is the unintended consequences of companies deregistering as part of the process to escape 404 and the cost of 404.

And, you know, one of the key parts of our change is also the change in how do you count shareholders. Instead of counting of record, you count beneficial shareholders. And, you know, the number I'm more concerned about in my constituency is the 300 to 750, raising that number.
What I do like is the recommendation by the capital formation subcommittee on potentially making it easier for companies to go private. And by private, I assume that you mean the deregistration process. You don't mean actually completing a transaction, in which all of the outside shareholders are bought out of the company.

So the deregistration, and potentially the companies -- the interplay of our role with their role to, you know, have the contingent of -- I'm a little bit hesitant to raise the number from 300, because, to a certain extent, you know, it's kind of the in pool and you're already paying the cost and you're already in there. You know, why give somebody a pass and an out?

I think the reason to give a pass and an out is potentially the cost of 404, and if you put those two rules together, you don't change the 300 up to 750. If you do, or maybe even go higher -- because the concern is, once you've deregistered, the obligation to disclose information to shareholders who are not insiders, there is really -- the only requirements are state requirements, and there's an extremely minimal -- it depends on the state -- and almost nonexistent.

So, therefore, there is no flow of information. So, therefore, to give them the exit that's 300, but will go to some higher number -- if you voluntarily say we're going
to continue to provide information on a regular basis, which -- shareholders continue to evaluate what is going on at the company, I think the potential interplay of our tools is, you know, a logical conclusion to come to and one that I would support.

CHAIRMAN WANDER: Pastora?

MS. CAFFERTY: First of all, let me agree. I think ours are modest proposals, but I think that they are very important proposals to really address what I believe is an important cultural change in transparency in the board room while offering relief from the, I think, unintentional cost of 404.

And I think the -- I don't want to say compromise because it hasn't been. I think this committee has really discussed all of this, pushed and pulled in every direction, and had great leadership from Steve, who has managed somehow to keep herding us to conclusions.

But I believe that the important tradeoff is granting this relief, and I think in a way many of our recommendations dovetail very nicely with the recommendations of the other committees.

But at the same time keeping what I believe is the intent of SOX and the value of SOX, which is really providing an independent voice and transparency to the internal affairs of a company.
Some of that may cost a bit, but this is where cost
benefit, I think, starts being a tradeoff. I believe the
cost of transparency is something that needs to be looked at,
but I think also needs to be borne, and it's part of the
price of being a public company. It's the benefit of having
investors bear the cost and giving them to access to ensure
that indeed there is a profit, and that there is at least the
very great effort from management to account for the money
that the investors put into the company.

At the same time I think a lot of what we're
recommending is perhaps modest and perhaps so sensible that
it seems small, but it will significantly reduce the cost of
doing business. And I think that that's what we're here to
do, to increase the benefit and reduce the cost of
transparency.

So I enthusiastically support these
recommendations.

CHAIRMAN WANDER: Any questions? Kurt?

MR. SCHACHT: I have a quick question, and would
like to probe you a little bit on this corporate governance.
Governance hygienics, I like that term. It's a good term.

Having tracked corporate governance for many years,
good corporate governance is obviously better than bad
corporate governance, and it improves accountability and it
improves independent oversight of the officers of the
The question has been raised, and we've had a couple of comments on this, as to whether it really is a substitute for, or should be considered a quid pro quo for internal controls.

Directors, whether you're talking independent directors or you're talking independent members of the audit committee, don't test, they don't design, implement, test controls. They don't sign the financials. They know enough to ask questions about internal controls.

But in terms of a substitute for verification of internal controls, I'm not sure I fully understand how that works.

MR. BOCHNER: Yeah, I don't think we're -- you're making the comment, Kurt, that I agree with, which is the two are little apples and oranges, right? I mean, 404 --

So our recommendations are not meant to say that if you have an independent audit committee, whistleblower protection, a legal ethics program, that's as good as the auditors going in and testing the internal -- that's not what we're saying.

What we're saying is that, for all of the reasons that Janet and others articulated, that the cost of this benefit, that we all agree is a benefit, this internal control attestation, is just too high.
You know, it's great, it's not working, it's punishing smaller companies, public companies, in particular, and I might add a lot of companies that aren't smaller public companies. The costs have wildly exceeded the benefits.

If we do that, then is there something else, particularly the companies that are not listed and so don't have the benefit of these listing standards can do to try in perhaps other areas. And I admit there are other areas to try to give the investor some more protection.

And I'd say it's better to have an audit committee that's independent overseeing internal controls than not. It's better to have whistleblower protection anonymously where somebody can report violations that might impact internal controls.

So I hope that's an answer to your question. I'm acknowledging that it is not -- when I use the word, quid pro quo, I don't think any of us here think that it somehow takes the place of an outside auditor going in and doing that attestation.

CHAIRMAN WANDER: Alex?

MR. DAVERN: Yeah, I'd just like to make one comment, Steve. I agree with your recommendations.

I do personally feel, however, that the comp committee is a very key committee. I agree with Dick that it remains to be seen if a majority in the directors will really
work out for smaller companies.

But I'm strongly supportive of a majority independent audit committee, and I'm also personally strongly supportive of a majority independent directors on the comp committee, because I feel that that's a key area as well that needs independent oversight.

And then I just want to add on to Kurt's comment, in that the independent directors are required to sign financial statements as part of the 10-K filings. So that's just a point of clarification. Thank you.

CHAIRMAN WANDER: Mark?

MR. JENSEN: This is Mark Jensen. I don't want to use Alex's microphone for obvious reasons. I sit here trying -- it means I'm a little sick, that's all.

MR. DAVERN: Yeah, I was going to --

MR. JENSEN: Yeah, I'm just going to keep inching away. I have two comments I wanted to make.

The first one, I guess, is to try to respond to what Kurt said earlier. And I guess maybe I'm the modern day Diogenes, but I keep believing that there are honest people out there who want to get things right.

And, you know, as an auditor, I can tell you I never had a problem my client didn't have, because it all started with them, you know, and it started with the fact somebody got it wrong to begin with.
And I think this over-reliance on auditors and the assumption always that an auditor has to be involved is leading us down a slippery slope in this country. I really believe management needs -- there needs to be higher accountability. That's what Sarbanes-Oxley was about, and it put all of that burden back on management and started to take some of it off of the auditors' shoulders. And, frankly, that's where it belongs.

And I think we need, as a matter of public policy, to really start to focus on that one essential element. Because, you know, this notion that auditors are going to keep these companies out of trouble is -- it's not worked so far, and it's probably not going to work in the future either. So I would encourage us all to think about that a little bit.

The other thing that I wanted to ask the committee to maybe pay attention to is on page 42 of the 404 subcommittee's recommendations. Janet went through that because it's not one of the main recommendations, but it is one of my main recommendations, and has been ever since we've started.

And it harkens back to what Irwin Fetterman said to us in San Francisco when he talked about getting things right the first time, as opposed to building quality in versus inspecting quality in.
And I'd mentioned to some of the folks at the SEC at our last meeting that I would really think -- I really still believe the SEC in many ways is a throwback to earlier management styles, which is investigate, inspect, and put -- build quality in after somebody else has done it, as opposed to a forward-thinking organization, which says let's really help these companies get it right the first time so that we don't have these kind of blowups in the future.

And one of the recommendations we had was the creation of a center of excellence where smaller public companies could go to -- and this, I mean, I guess I would see as a website. It could be any number of things that would allow a company to go and get free advice, quality advice, in the forms of FAQs, you know, best practices of how companies maintain corporate governance, whatever it might be.

But I think the SEC would be successful when their division of getting it right is bigger than their division of enforcement. And I just think that reflects modern management thinking versus maybe the way we thought about things in the thirties, when all of this was brought into being.

CHAIRMAN WANDER: Drew?

MR. CONNOLLY: Hi. This is Drew Connolly, and I would like to add some candle power to your lamp, Mr.
Diogenes --

(Laughter.)

MR. CONNOLLY: -- because the truth of the matter is that that is -- it may not be the headline recommendation, but it is the one that can be implemented with just a mind change here at the Commission. It does not require, it would seem to me, five to three out of five or five Commissioners saying yes, it's a great idea. This is a mid-management, somewhere buried in the management level of the Commission ability to recognize, and I think the only thing I have ever heard is the concern that, you know, in reliance on our advice if something goes wrong and therefore there's a litigation issue, but if it's neutral enough to avoid that and informative enough to address that, it would be incredibly helpful, so I truly embrace and welcome that recommendation, knowing that the vast majority of microcap companies are looking to rely on counsel who often are navigating difficult shoals of regulation themselves. Their auditors have, we have certainly discovered have not been able by their interpretations of some of these rules to be good counselors, as I suspect they previously have been, and that is a phenomenally good idea, so I thank you for it and put some candle power there.

In terms of corporate governance, Steve, thank you very much for putting it in a framework that the balance, in
fact, if we adopt later today or Friday, whenever we finalize, and in fact the Commission implements the 404 committee's recommendations, it seems to me that the tension, I guess, the frisson between reluctance to exempt while simultaneously layering on the protections that I think Sarbanes-Oxley were rightly meant to address is exactly the right balance and that truly is something.

Pastora, very simply, you are absolutely right. If we don't find ways to lower the overheads, the physical costs, whether it be in, you know, access equals delivery, paper versus electronic forms, we are making America an uncompetitive place.

I harken back to our first public meeting in New York. Right after we finished I went down to Wall Street, met with a firm, and we were interviewed by the director of marketing for the A market in London, and the man said to me, "The best marketing tool we have ever had is Sarbanes-Oxley."

So clearly the cost structure of growing these microcap companies, because I believe everybody in this room would agree that if we find a way to assist those microcap companies who my two good friends at the Big Four don't audit, to in fact grow, they may become farm team future audit clients, so hopefully some of these issues get resolved that way.

CHAIRMAN WANDER: I would sort of like to move on,
if that's possible.

Two questions -- well, there are three. Rick, Leroy, and then Jim, and then let's move on, so that we can have the two other reports and then break for lunch.

MR. BROUNSTEIN: Okay. Rick Brounstein. Mine may be more boring and maybe more just thoughts for drafting, but I have three, maybe four, comments, although the fourth may be more for the next committee.

The discussion of enhanced disclosure, the only comment that I would -- you know, describing the resources, all that, sounds very good -- I think when you look at what is required, essentially material weaknesses, my recommendation would be that is where we would probably stop, that if you look at the discussions that we have had internally in the recent PCAOB guidance on November 30th, you know, it was made clear that the focus of the 404 audit is to look for material weaknesses. Out of that you are going to trip on some significant deficiencies and some deficiencies, but the report on, say, significant deficiencies when we are not particularly looking for them even at the S-404 level, you know, will lead people to the impression that we got 'em all, and that has clearly been clarified is not the focus of even the 404 audit.

Secondly, I'm differed on the recommendation 4, on the thresholds. The talk of 300 to 750 and 1,000, or if you
look at the ABA paper today I think they are suggesting like 2,500, I think we do have to get more data. I mean just my little company is probably more than 30 to 1, recordholders versus, you know, if you eliminate CD and replace it with the beneficial holders, so I think we have to be very careful and I think, you know, 300 and 750 may not even equate, but if 300 was in fact the right number or 500 was the right number, I sense that it's a relatively larger number for de minimis among shareholders.

On the two year financials and the S-B filers, I think as we go to draft, we just have to comb through the S-B filings. One jumped out at me, but there may be other unintended consequences and that is right now the smallest of the companies -- and we are now talking about dragging in a bunch of really small companies that I think is the cornerstone and really support the pink sheets, many of them that may not even be reporting and should be today is that we've got to be careful that we don't trip them on something.

So one of the things that jumps out at me, and maybe there's others, is that you are an S-B filer you have 90 days to get a K out and 45 days to get a Q and the regulations of proposal one really addressed the larger small companies, and so we should, you know, not make it any more onerous on the smallest of the small if we are going to bring them into the system, and maybe there are a few other things
that are unintended consequences that we should just be
careful with.

CHAIRMAN WANDER: In fact, I would like you -- and
Pat as well -- aren't you an S-B filer? No, you're
not? -- to go through the S-B requirements to see which ones
should continue to be appropriate for smaller public -- for
the microcap companies.

I did, myself, but since I don't really do much of
that work, I may have missed some.

MR. BROUNSTEIN: I'm happy to work on that with
Steve's group.

The fourth thing, and it's sort of addressed in the
accounting standards, so maybe we'll defer to them, but when
we talk about wanting independent audit committees, and I am
100 percent and back, we should take a look at what
independence is, especially if the smallest of small
companies -- I think it was testimony -- I don't want to say
ABA, but it was -- I think it came from Wilson Sonsini, but
it was a paper written to us and it talked about for the
small companies are venture capitalists involved, and there
might be some definitions of people who really, you know, are
quite independent and don't meet the rules, or you look at
the 60,000 threshold to kick people out. If we are going to
want to have good people on these independent boards, we
should look at the population and look who's now being
regulated off, and maybe they -- maybe they are pretty
independent.

CHAIRMAN WANDER: Okay. Steve and then Jim and
then Leroy.

CHAIRMAN THYEN: My questions have been answered.

MR. BOCHNER: And I heard, I know you want to move
on, so yeah, I think we will look at that independence issue
I think you are talking about, the compensation, intolerance
of the current rules, and also the affiliate can't be
independent. It's kind of easier to draft off current
independence definitions in the rules, but maybe we ought to
step back and see if those ought to be less, and, you know,
that zero compensation for anything other than board service
is the right threshold for smaller public companies.

You know, I also wanted to say the comments, and I
think the lawyers out there would find me remiss in not
mentioning this, but the comment has been made
that -- questioning whether the SEC has the authority to
impose the type of governance listing standards that I
suggested, and I think the thing we are going to ask the SEC
to take a look at in that regard, would those issues be
implicated if indeed we're not imposing them but rather
companies don't have to comply with 404 if they implement
these standards. Is that a way around it? And if not,
there's an alternative that we require prominent disclosure
with respect to the corporate governance reforms that we have mentioned, but I wanted to acknowledge that that issue about how far the SEC's authority can go in imposing governance standards has been raised a couple of times.

CHAIRMAN WANDER: Leroy.

MR. DENNIS: Thanks, Herb. Leroy Dennis. Steve, I know you and I talked about this individually and I just kind of want to get it on the record, and that's my concern about the comments made in here about stock options.

I think we make a comment in your report that says stock option holders who haven't exercised securities and made an investment decision should not be counted as determining the number of holders.

My concern is that -- I mean I believe that a stock option holder does make an investment decision every day. They make a decision whether to hold the option. They make a decision whether to exercise it and then ultimately a decision whether to exercise and sell.

And so I am just concerned about that. I could envision a situation where I am less concerned about an unvested option because they don't make that decision every day -- they have no choice but to hold, but once they become vested they are making a decision every day it seems to me. I am a little concerned about not counting them as a security holder.
The other question I would have for you, and I agree with Kurt or maybe it was Rick that said more research needs to be done on the numbers, but is your intent on the conversion to a beneficial holder standard to really keep the same number of reporting entities out there, or is your intent to increase or decrease the number of people who could report under the SEC's filing requirements by changing to this different definition?

MR. BOCHNER: We have not yet thought about it in those terms. I think the way we have thought about it is that the current approach allows manipulation and results in, from a policy level results in companies that are actually larger in terms of equity holders perhaps not reporting and companies that are smaller getting thrown in simply because they don't have enough holders in street names, so I think from a policy level we have looked at that, and that's been where some of the comments have come from that the approach doesn't make sense from a policy level. We should pick a number. And I think the question is at what number of shareholders is a company big enough that that number of investors ought to get the protections of the '34 Act.

I think that is the policy level issue and, you know, most of the comments we got suggest that it should go up. I think we have numbers that range from 1000 to 2500. There might be some outliers out there, so I think that is
the zone.

I think the first question is what is the metric? Let's get a metric that's fair and that is applied in an even-handed way, and once we do that, then let's decide at the policy level whether we want to keep things pretty much close to the status quo, if that's done, and if not understand sort of who's being swept into the system, and if there's people that are being swept into the system that we think, you know, 2000 shareholders is a number of shareholders that's big enough that companies ought to be reporting, then so be it.

So I don't think we've quite gotten to your question there.

CHAIRMAN WANDER: You might also consider whether the number of shareholders is a relevant criteria. You know, if you have a low market cap, you know, you divide the number of shares, you've got people with penny shares. You know, I'm not so sure that's -- I'm just throwing it out. I am not making a judgment on that.

Janet, and then we will move on.

MS. DOLAN: Right, and mine may just be a subset of Leroy's. I was just wondering any time you move a bar, the question is why are you putting it where you are. Are you saying these are just placeholders for right now? These numbers could change quite a bit, or is there anything
MR. BOCHNER: No.

MS. DOLAN: Okay, so these are just places --

MR. BOCHNER: Yeah.

MS. DOLAN: You're saying it's going to move. You don't know what you are going to recommend.

MR. BOCHNER: I think it's going to move. We want to look at the data and understand which is sort of frustratingly hard to get a hold of, and we have tried, but I think we want to look at the data and then try to make some intelligent decisions and come back to you.

MR. ROBOTTI: On that topic, you know, my personal point of view is that an investor today in certain companies either has protection or doesn't have protection and bought in kind of under that scenario, and so therefore the bias in my mind is to give more protection on who are we going to sweep into the system and make that number larger to sweep less people in, because the investors in those companies bought in in a situation where they didn't have that protection.

On the other side, on raising the number on the low side, I am less inclined to raise that number because those people are already investors in a company. They invested in a company. They have those protections. To take away those protections seems to me to be, you know, inequitable, so my
personal bias is don't raise the 300 so much. You can raise
the thousand more because you don't want to necessarily
include it, and of course that's a regulatory issue
too -- how many companies come in to the burden and how big
that number is.

CHAIRMAN WANDER: All right. Leroy, we are moving
on to the accounting standards subcommittee preliminary
recommendations.

MR. DENNIS: Thank you, Herb. Leroy Dennis.

First off, I want to thank the members of our
subcommittee, Pat Barry and John Veihmeyer, advisor George
Batavick from the FASB staff, and then especially the SEC
staff -- Tony Barrone and Allison Spevey and Jerry and Kevin.
And the SEC was very accommodating to us. We would ask for
input from people and I would be on a call with myself and 10
other SEC staff people, which tends to be a little daunting
at times, but there was a lot of interest in the staff and a
lot of cooperation by the members, and we really did
appreciate it.

I am not going to go through all the
recommendations. We have got a summary on the first two
pages. I will highlight a couple of them or a few of them
that I think are the more important ones.

Recommendation number one, we have recommended that
microcap companies be permitted to apply the same effective
dates that the FASB provides to private companies in implementing any new accounting standards.

Usually the FASB, when they adopt a new standard, will apply an accelerated adoption date for SEC companies and a longer adoption date for private companies. That is to allow the standard time to work and get the kinks out. We think that the microcap companies ought to align themselves more with the private companies in adoption of new accounting standards.

Recommendation number two, the SEC should provide a de minimis provision in the application of independence rules. We have noted instances where a seemingly insignificant violation of an auditor independence rule could have some very significant consequences to a company requiring it to change auditors, at a very minimum causing consultation with the SEC. We think some judgment and some de minimis provisions for relatively insignificant immaterial violations of independent standards should be considered.

And we think that also could go to allowing more cooperation between the auditor and the client, and really helping with a better corporate governance overall.

Recommendation Number 3. The SEC should consider additional guidance for all public companies with respect to materiality related to previously issued financial statements.
We've all seen the large increase in restatements that seems to occur in the last two years.

Our concern is that several of those restatements, although deemed material in the accounting sense, may not have been as meaningful to the investor and material to an investor, and certainly when a restatement happens, there are very significant consequences on the company's stock.

We're also concerned that, you know, if this trend continues, at some point in time, a restatement will be less of a big deal and just be a normal part of an operating business for a public company, and we don't think that's appropriate.

So we're asking that the SEC look at materiality specifically as it relates to prior financial statements and prior quarters, and we've got some recommendations surrounding that.

We support Steve's recommendation and actually our Recommendation Number 4 deals with the same recommendation to move to a two-year financial reporting versus three-year financial reporting for smaller public companies.

We believe that in addition to the comments that Steve made, it also helps with -- we heard a lot of comments about the high cost to change auditors, and we think by pulling out one less year for a consent, that that would help drive competition and lessen that cost for an audit committee
to change it.

Recommendation Number 5 is very theoretical. We don't have a lot of solutions for the SEC, although there's a lot of comments around Recommendation Number 5.

But it says that the SEC should formally encourage the FASB to pursue objective-based accounting standards. I think it has done that in speeches and other comments.

We also would recommend that, and I know this has been taught by some of the folks at the SEC, that simplicity and ease of application should be important considerations when adopting new accounting standards.

We feel that in order -- that comparability is one of the best things you can have in any accounting standards on the U.S. economy, and the more complicated and theoretical that a standard is, the less likely it is applied consistently and correctly, and we would actually give up a little bit of theoretical correctness to get ease and simplicity in the accounting standards.

Recommendation Number 7 we talked about earlier with Janet's committee on the concern about auditor concentration.

We think that the SEC and the PCAOB should work together to promote competition among the audit firms using their influence to include non-Big Four firms in committees, public forums, et cetera that increases the awareness of
those firms in the marketplace and their ability to audit
especially smaller public companies.

We also are concerned, and there are a lot of
registered firms with the PCAOB, I think at last count well
over 900 U.S. registered firms, and I don't think there's any
formal education requirements for partners serving SEC
accounts, and we think that the PCAOB might want to look at
that as a way to more equalize and make sure their views are
being communicated.

And I think just what the AICPA and the SEC did
here last week with the AICPA conference is an excellent
vehicle to do things like that.

Those are the recommendations I wanted to
highlights. We did have 10. We do have unanimous approval
of those recommendations by our full committee.

And with that, again, I'd like to thank everybody,
including Jerry and his staff, and open it up to Pat or John
if they have any comments or questions or comments they want
to make.

MR. VEIHMeyer: I would just make one quick
comment.

I think as you go through our recommendations, it's
fair to say that for many of them they are just as applicable
to large companies as they are smaller public companies, so
some of you may be sitting there with that reaction as you
read through them.

We didn't think that should discourage us from making recommendations that we thought would benefit all registrants, recognizing that the proportionality that we talked about in 404 exists no matter what you're talking about.

By definition, regulation is not proportional. The costs of an audit of a financial statement is not proportional. It's much higher on a percentage and pro rata basis for a smaller company.

So to the extent we can benefit all registrants, our view was we'd probably benefit small public companies more than larger, so I just wanted to point that out.

CHAIRMAN WANDER: Thank you very much.

Any other questions, comments? Drew?

MR. CONNOLLY: This is Drew Connolly.

Leroy, I'm only struck by the fact that Number 10 of your recommendations is the one that was not on the record, and I'd like very much to put some serious candle power behind this one, because it not only mimics but expands on Mark's prior strong recommendation, and if I may, I'd like to read your Recommendation Number 10 into the record.

"The SEC should commit more resources and professional staff to an office of ombudsman or a help desk to provide assistance to smaller public companies.
"The SEC should also public guidance on reporting and legal requirements and assisting smaller public companies."

There is no question that the thousands of companies at the lowest tier, the entry level public companies, the folks who we are hoping to nurture into the smaller public company space, and then ultimately the WICS space if they're good enough, could benefit from a -- and I'm certain that if Jerry could speak in a budget meeting within the organization, I doubt that he'd dispute any of this.

But given the resources and given the focus and given the opportunity, I would think that his office could and would meet the challenge.

So I'd like to make sure that Number 10 is spotlighted in your recommendations strongly.

CHAIRMAN WANDER: Thank you. Other questions? Rick?

MR. BROUNSTEIN: Yeah, two, I don't know if these are small points or not, but on the recommendation that I think is Number 3, where you're talking about materiality versus meaningfulness, I think we all know it, but the whole issue of restatement because it's in error versus restatement because it's intentional, the perception out there today, and so I guess what I'm suggesting is we go into the drafting. Maybe there's other exceptions.
Because the -- you know, I just came off of two fairly large accounting conferences in the last few weeks, one with CPE, Inc. and one that FEI hosted, and various, you know, presenters, and one guy yesterday, Jim Milliken, and I forget the organization, but it's an ISS type organization that a lot of the institutions look for the voting, and his comment was when you see a restatement, you know, his comment for a restatement is it's the Wall Street walk.

So any time there's a restatement, all the institutions, their direction is. just sell. You know, don't wait around to figure it out.

So as we look at this, I think it's a lot -- you know, it's actually a fairly large issue where you talk about maybe watering these things down, but at this point in time, you know, Refco talks about material weaknesses, and everyone buys their stock, and there was only upset afterwards when they find out that there was some meat behind them.

But a restatement, innocent or not, is treated as something terrible and is a huge hit to the market cap, and as I look at restatements, not all restatements are created the same. You give a couple examples.

Maybe, I don't know how broad we can go, but maybe there are other ones we can at least consider, and maybe Number 6 that you talk about with the safe harbor is a little bit like that.
I have my own, and that's my other comment, I have my own sort of opinion on fair value.

Yeah, theoretically, it's great, but I can take five experts and sit down with, whether it's 123-R or, you know, convertible stock with debt or any one of a number that are coming out, and get five very different answers and it's a very easy way to manipulate earnings without the auditor being able to make a good judgment.

I mean, a slight move in an industry can have a huge move.

I know it's very big at the international accounting standards level and so it's probably way out of our realm, but, you know, it is clearly, you know, something that I think down the road we're going to all be looking back at and say why did we do it, and most companies that I deal with, every time there's one more like that, they could care less whether I get it right or not. They don't want a restatement.

And ultimately, they want to know what really is the underlying income statement when you pull out all this subjective theoretical.

But anyway, that's --

CHAIRMAN WANDER: Well, you should really communicate with Leroy to see if there are other examples to be added.
MR. DENNIS: Herb, if I can just -- I mean, the two examples we put in materiality are not intended to be the only ones.

I mean, they are examples that maybe are the most problematic at this point that we see.

And I agree with you completely on fair value. That is a very, very difficult standard with a lot of judgment and the more we move to that, the more judgment and less preciseness is involved in the accounting that companies have to do. It's not an audit issue, it's an accounting issue.

CHAIRMAN WANDER: Steve?

MR. BOCHNER: I guess to just add color to Leroy's suggestion on materiality -- by the way, I'm glad I'm not the material water carrier anymore, Leroy, thanks for taking that on.

But the question is can -- you know, is there a way short of amending a 10-Q or a 10-K that one could, so we have, so issuers have an objective test -- you know, I don't know whether percentage of revenue or some other test -- but that doesn't go to disclosure, so it still might be something that in MD&A or perhaps in an 8-K, either under 10b-5 or maybe mandated, maybe in MD&A there could be a requirement to disclose any changes that are, you know, that the issuers conclude are not material to the previous financial
statement.

So you don't have an actual restatement and all of the effort and cost associated with that, but that might be divorced from disclosure.

If it's under 5 percent, the issuer may -- perhaps we should look at whether it's required disclosure or self-disclosure from a 10b-5 point of view.

I think the point is that these restatements, I think people are erring on the side of conservatism, so when in doubt, restate, causes market dislocation, causes securities class action lawsuits, and costs companies a lot of money.

So I'm hoping what we're saying is we're divorcing sort of the investor disclosure side of things from sort of the technical restatement and all the costs and other implications that that has.

We're not saying that, you know there shouldn't be some disclosure necessarily if there's been a change.

MR. DENNIS: Yeah, I agree with that.

I think it's very difficult to come up with an objective standard of materiality, because the facts and circumstances are different.

I think there may be a situation where something is immaterial in a quarter, or material in a quarter but maybe immaterial in an annual financial statement, and whether or
not you go back and correct that is one of the things we've
addressed here.

I think one of the things you got to -- you also
got to deal with, though, is as you go forward, how do you
make sure that you have comparative data that's accurate, so
that you're comparing apples and apples?

And it may be -- and this is something we've tossed
around a little bit -- it may be that changing that Q on a
comparative basis doesn't necessarily mean you've restated
the prior year as long as it meets certain materiality
standards and is under a certain level of materiality.

I think all of us were in agreement that if it's
material on an annual basis, if your 10-K is materially
incorrect, you just probably should go back and fix that, and
that's a restatement and I don't think any of us proposed
that that be treated on a prospective basis or anything like
that, that we do have to get the numbers right on an annual
basis.

John, do you have anything you want to add to that?

MR. VEIHMEYER: I would just add, without getting
into the specifics, I think the broad -- the underlying
principle in this recommendation is a weakening of confidence
in the financial reporting system in general increases the
cost for everybody, and if there are restatement occurring
that are occurring so frequently because maybe we're taking
collectively a much too narrow view of what's really relevant
in some cases.

We're not talking about clearly immaterial errors
that are discovered.

We're talking about things that are on the margin
at this point and I think, Steve, to your point, maybe we are
pretty consistently erring on the side of conservatism, and
could we give some clear guidance that without adversely
impacting the quality of financial reporting might strengthen
confidence in the financial reporting by not having
restatements be a pretty regular occurrence.

CHAIRMAN WANDER: Alec?

MR. DAVERN: It's Alec Davern. One very quick
comment, Leroy, and then I just wanted to express my very
strong support for Recommendation Number 3.

I think you guys in the two examples, not
precluding there might be other examples, but the two
examples you've laid out are very well articulated, and I
strongly, strongly support that we adopt that recommendation.

Thank you.

CHAIRMAN WANDER: Jim.

CHAIRMAN THYEN: Leroy, real quickly, maybe you
could explain how you set your order of importance?

MR. DENNIS: You know, Jim, it's been a while since
we set that order, so it's kind of ancient history to me.
We started off with what we thought affected probably the most companies and where we thought the most pain was at, and kind of worked down from there. And we probably set this order two months ago, three months ago, and, you know, it's tweaked a little bit in the last 30 days, but not much. And I would guess, you know, that's how we came up with that.

We probably also looked at what was the easiest to implement, and, you know, for example, the simplicity in the accounting standards I would put at number one if we could figure out how to do that. I think that's a lofty goal. By the time I retire from this career, from my career here, if we make progress toward that, I'd feel really good.

You know, I think there's a lot of complexities that cause that to be very, very difficult to implement.

So that's my input --

MR. VEIHMeyer: I would just say it's fair to say, with the guidance that Herb started us with this morning, I think we probably collectively need to go back, take a look at that, and make sure that if in fact there's some desire -- we viewed all of them as important. I think we did try and scale them the way Leroy said.

But I think we'll take a closer look at that, Jim,
and make sure that when we finalize these, they are in some order of priority.

CHAIRMAN WANDER: Great. That would be terrific.

Other questions or comments?

(No response.)

CHAIRMAN WANDER: Good. We're now to David.

Everybody has been very patient. Thanks for all your patience. And we will have the report of the Capital Formation Subcommittee.

MR. COOLIDGE: Thank you, Herb. David Coolidge.

Seeing as how I'm the only thing standing between you and lunch, you-all and lunch, I will try and remove that obstacle quickly.

But let me first thank my fellow subcommittee members for their work, and our thanks to the SEC for their assistance in facilitating our work.

Our recommendations, which you've all seen and really heard before in some respects, not the detail that we've got it in the report, but we've done this in a couple other committee sessions, but these recommendations are designed to facilitate the capital raising process, ease burdens on smaller public companies which have seen an increase in regulatory requirements, and hopefully improve in some fashion the trading markets for smaller public companies.
We have eight recommendations for consideration. They are listed in the order of priority, and I think our listing is based on what we think is the hardest one to get through, so we focus everybody on the hard ones first and leave the easy ones at the end.

They are, and I will go through them quickly:

Number 1. Adopt a new private offering exemption that does not prohibit general solicitation and advertising for transactions with certain purchasers.

This is a little bit of a paradigm shift, I guess, in that our feeling was that it's the -- if you're interested in investor protection, what you need to be worried about in these private offerings is who the investors are, not how many people know about the offering.

And so that's kind of the basis for this recommendation, but it obviously would allow private offerings to go forward on a different basis than they have in the past. There's a number of changes in the existing construction that this particular recommendation refers to.

Number 2. SEC should spearhead a multi-agency effort to create a streamlined NASD registration process for finders, M&A advisors, and institutional private placement practitioners.

There is a report out there by the ABA making this recommendation.
What is the case is there are lots of people engaged in these practices that are not NASD members and it seems that we would like to, I don't want to call it have an amnesty program here, but in effect create a different registration process that would allow lots of people to come forward and get an NASD registration affected.

Obviously, if this is an NASD registration light, our view is that these types of advisors would not hold customer funds, and we're really in the business of assisting companies to raise money and should be allowed to do so because it does again assist in the capital formation process.

Recommendation Number 3 is to -- is really not dissimilar than Recommendation Number 1 with respect to other private placement exemption adjustments.

I won't bother to go through the details of that, but they are changing of certain rules.

Number 4. Come up with a new way for companies to go private.

It's, for small companies, microcap companies in particular, it's a very burdensome regime requiring all sorts of filings and things to happen before that can go forward.

So we don't have a lot of detail on this particular recommendation at this point in time because we didn't have the opportunity to work it all out, but we think that that's
a logical place to go, given the increased burden of regulation.

If people want to opt out of the system, it shouldn't be a horrendous regulatory burden to opt out of the system.

Number 5. Trading markets.

One of our concerns is that with the changes at NASDAQ becoming an exchange and the NASD taking back the OTC bulletin board market with the NASDAQ running it on a contractual basis, that this very important trading market for microcap and smaller public companies be a viable one and, hopefully, that things can be done at the SEC level and the NASD level to make sure that it remains viable.

And there is one item in this recommendation that I would like to delete -- this was a typo, I guess -- which is 5(b) trading markets, where it talked about compensation being allowed to be paid to market-making dealers by the companies. That was not meant to be. That was a suggestion that had been made at an earlier session, and we decided not to go forward with that one.

So 5(b) is out of our recommendation.

Number 6. Research.

The SEC should adopt policies that encourage and promote the dissemination of research in smaller public companies.
As we all know, the amount of research published in smaller public companies has been declining. This is due to regulatory issues. It's also due to marketplace pressures. But we think that the more research, the better.

We're suggesting that company sponsored research be okayed with full disclosure and that soft dollar payments for research under current safe harbor provisions of Rule 28(e) -- that was also a typo that was left out under 6(b), just write 28(e) after a rule -- ought to be allowed to continue.

The only reason we're recommending a continuation is because that subject has been discussed in various venues and we think we would like to come out in favor of continuing with Rule 28(e).

And then Number 7. Rule 701.

Basically an amendment to the dollar amounts that are allowed in that rule to kind of catch up for inflation. It's not a huge change, but something we thought we ought to mention.

And then Number 8. Securities class legislation Relief for employee stock options has occurred in a few cases.

Employee stock options have been traded, the same as voting securities, and we don't think that's correct, so we've got a recommendation on that subject.

As I said, most of these you've seen before, with
some changes in the final report that we have here, but essentially, those are our eight recommendations.

We do have a note here on PIPE relief, but it's a note, it's not a recommendation at this point in time.

And I want to especially acknowledge Richie Leisner, who helped me considerably in this whole process, and I'm sure he's got a few things he would like to say.

MR. LEISNER: Actually, I don't have anything to add to that except that I think we should, and I know we should mention that, although not a voting member, Jack Herstein to our right provided us with valuable input from the regulatory standpoint.

And I'm sure Jack will speak for himself in a little bit, but Jack pointed out to us that he had a lot of concerns about our number one proposal.

And we're happy to talk about people will have concerns about it.

The one thing I would say is, having the perspective of been a securities practitioner for a number of years, I have seen changes in the requirements for private placements and at several instances when there have been incremental changes in what the standards were, people who were involved in the process threw up their hands and said, "Oh, my goodness, you're opening the floodgates to fraud," and that did not prove to be true in the past.
Most recently, the largest change was when Regulation D was adopted in the early 1980s or late 1970s. Prior to that time, the SEC staff position was that to have an effective private placement, every offeree had to meet the investor suitability requirements that today apply under Regulation D only to purchasers.

And the thought was that it would be inappropriate to offer investments to people who couldn't qualify to buy them, and so that was the logic for offeree suitability, but it worked out in a number of instances, for example, if an issuer didn't have records to show that every offeree was suitable or even who all the offerees were, everyone could get their money back. That was perhaps an unintended result.

More recently, in the last decade or so with the growth of the Internet and other types of communication, the staff has provided arrangements by which non-issuers have been allowed to engage in very broad solicitations of prospective clients without offending the private placement rules.

And on top of that, on an experimental basis, in 1992, the Commission approved testing the waters in Regulation A offerings, which has not been embraced, for two reasons, the first of which is hardly anybody does Regulation A, and the second of which was this was a proposal that was not embraced by the states, which sort of brings me to the
end of this discussion, which is that our proposal is to make
this exemption under NISMEA, which means it would be a
covered security, and that would mean that it would not -- it
would -- the states could collect fees, but the states could
not impose duplicative or different standards if this were
adopted.

Finally, from a technical standpoint, I don't think
it would make much difference to the subcommittee where this
exemption got stuck, although Jack might have a suggestion
where we should stick it.

But we'll talk, Jack and I will talk about that at
lunch.

So you could put it as part of Regulation D, you
could -- we're really talking at a conceptual level, and we
hope that this is responsive to what Jim and Herb asked us
for back in April, which was to be bold.

CHAIRMAN WANDER: Thank you Richie, David.

Anybody else on your subcommittee have comments?

I'll start with Drew and then Jack.

MR. CONNOLLY: I'm going to be brief, which will be
refreshing, I'm sure, Herb.

David, I think this, and maybe we'll talk about
this off-line, but in terms of 5(d), the part that I thought
we agreed on, this is not for continuous market-making, but
rather for the submission of the 211 form, which was
previously allowed, and the rule changed by the NASD to
preclude a broker-dealer from collecting compensation, due
diligence fees as it were, for filing and comment period, not
for making the market, but rather for going through the
effort, professional effort to get a market initiated,
recapturing due diligence expenses, et cetera.

I think that --

MR. COOLIDGE: We can revisit that.

MR. CONNOLLY: Okay.

CHAIRMAN WANDER: Jack?

MR. HERSTEIN: Richie, I tried to be bold.

The past morning, this morning, I've heard investor
protection used a lot by various subcommittees.

From my standpoint as a state regulator, investor
protection has a different meaning.

Basically, we are on the front line, we're the
grassroots effort, and basically it's our primary function as
state regulators for investor protection, not once the
individual gets inside the company, but before the individual
gets inside the company.

I just have a couple comments to make a on a couple
of the recommendations.

The first one is the new private offering exemption
regarding the general solicitation and advertising for
transactions with certain purchasers.
I might refer to them as, you know, maybe super purchasers, because we're talking about accredited investor. Okay.

Accredited investor is defined, I think, in Footnote Number 2 as somebody who has a net worth of $1 million or has a $200,000 annual income and/or $300,000 in joint annual income with husband and wife.

Now, it's suggested in number one that the -- not the term accredited investor, but basically a super investor have a $2 million joint net worth or $300,000 annual income or $400,000 in joint annual income.

A little history of Regulation D and the accredited investor.

In 1982, that's when the SEC I believe introduced Regulation D and also the definition of accredited investor. In 1988, Reg D and the accredited investor was amended and only was amended that $1 million net worth still was the same as in 1982, except that they did add in 1988, they added a $200,000 individual annual income and the $300,000 joint annual income.

So since 1982, the definition of accredited investor has not been changed.

We all know basically in the last 10 or 15 years how the wealth of this nation has increased greatly, how many millionaires and multi-millionaires we have out there.
On the rate of inflation, under consumer price index, CPI, which is a widely used measure of inflation, based on that definition and their formula, since 1982, the $1 million net worth should have basically been moved, bumped up gradually 'til about $1.8 million, the $200,000 individual annual income about $340,000, and the $300,000 joint annual income approximately about $510,000.

Now, I'm not saying change the definition of accredited investor. I'd like to see it, but I'm not suggesting that.

However, I would like to see for this proposal that the suggested net worth of $2 million be increased to $5 million and have it be $1 million in annual income for natural persons or $1 million for joint annual incomes.

I think that basically would be approximately twice what accredited definition should be as of now.

The other problem that I would like to see a little more worked on in this Recommendation Number 1 is that, Richie, last time in October you talked about selling this to rich people and to smart people without money, and I believe your smart people -- and your smart people without money would be in the investment sophistication, which I think probably needs to be defined more. I think there's a void there.

MR. LEISNER: You think I wasn't smart enough to
define it?

MR. HERSTEIN: I think that might need to be a little worked on.

Recommendation Number 3 --

MR. LEISNER: Jack, this is Richie.

Would you review the bidding on the financial wherewithal, just the ones that you want?

MR. HERSTEIN: Well, I think you suggested -- I'm suggesting $5 million, $1 million annual income, $1 million joint annual income. I know my letter was higher than that. I rethought the issue. All right?

Okay.

The other recommendation that we proposed is Number 5(d), as in dog. Drew had a problem with 5(d). I have a problem with 5(d) as in dog, trading markets.

If we recall, again going back to our meeting here on October 25th, Steve Bochner brought up the suggestion that earlier the day before our subcommittee meeting about how NASDAQ small cap companies should be covered securities. I expressed some concern at that time.

Since that time, I believe on November 17th, Steve called me and also e-mailed me some thoughts and suggestions and proposal regarding the small cap be included either as to cover securities or I believe the SEC could just change the definition and make them exempt securities very similar to
the NMS securities.

Backtracking real quick, there's approximately 2,650 securities that are on the NMS market, which are now exempt, and there's 578 companies that are listed on the small cap.

After Steve's letter, he also suggested or he made mention in his phone call that there was a meeting with NASDAQ and I'm not sure if Steve was at that meeting, but there was a couple state securities people at that meeting.

NASDAQ expressed their proposal to them, and the state people basically more or less bought into that may be small caps with the change that is taking place on the NMS and NASDAQ, that the small cap companies possibly should be treated the same as the NMS.

A couple of the states presented this in a phone call to the NASAA board of directors. They took it under advisement. They had no objections. And that will probably be discussed sometime later on.

When I opened the document on our committee meeting on December 7th, I noticed that, under 5(d), next to the NASDAQ small cap stocks were the OTC bulletin board stocks listed. That is my concern.

There are basically over 3,300 over-the-counter bulletin board stocks. Some of those companies are very fine companies, some are not.
OTC bulletin boards are only a quotation medium for subscribing members only.

There are no listing standards or requirements, and there are no corporate governance standards available, so basically they're companies that buy their way onto this market, and that is it, and I do not believe that they should be given the same treatment as the NASDAQ small cap markets. So my proposal is, if we're going to vote on this when we come to 5(d), I would either recommend that we eliminate the second half on the OTC bulletin board or vote on them as separate issues.

CHAIRMAN WANDER: Thank you Jack

MR. HERSTEIN: And one other item here.

CHAIRMAN WANDER: Oh, sure.

MR. HERSTEIN: Yeah. Something that didn't make the list, under capital formation issues.

I would like to recommend and this is under the chairman's or the subcommittee's advisement, I would recommend that both Rule 505 under Reg D, Regulation D, and Regulation A, both be the amount of money that can be raised in a 12-month period now set at $5 million.

I know Richie has mentioned before that nobody uses Reg A for various reasons, so I would suggest that we raise that issue, that total dollar amount, and also 505 at the same time, bump it up from $5 million to $10 million in a
1 12-month period.
2
3 CHAIRMAN WANDER: Anything else, Jack? Thank you very much.
4
5 Rick?
6
7 MR. BROUNSTEIN: I didn't have a comment until the last one.
8
9 My comment would be on the recommendation that I agree with on the OTCBB, you need to tie it into everything else going on.
10
11 So in other words if we pass the entirety of what we're talking about here, then there are going to be corporate governance standards for the OTCBB.
12
13 MR. HERSTEIN: Right, but it has to be tied in with everything else.
14
15 I mean, there can't be a stand-alone over here and the other subcommittees do nothing.
16
17 So basically I see the format, all the other subcommittees, OTCBB would have to have the corporate governance standards, would have to basically be different now than on NASDAQ, and the last thing that would happen, they would get covered securities treatment.
18
19 Am I correct? You don't put the chicken before the egg.
20
21 MR. BROUNSTEIN: I guess I think it's all going to be part of the same drafting process, but, you know, it's a
good point. If we decided to not do one, then it impacts looking at the exemption for the other.

MR. CONNOLLY: There's got to be a blended recommendation.

CHAIRMAN WANDER: I understand both Jack and Rick's response, and I think probably we will have to make sure that we follow that to make sure that it works out in the drafting.

And unfortunately for you, Jack, you don't have a vote. You're an observer. But we will make sure that we follow that, because I think it was a good point, and I think there is support for that.

Richie?

MR. LEISNER: Just speaking individually, I don't have any objection to splitting that proposal into two pieces. I think that that's for voting purposes.

But I would just want to point out to everybody that when the concept of a covered security was adopted, the bulletin board did not have the regulation on it that it has today.

The bulletin board at that time did not require the companies to be 34 Act registered, which they are now, and have for a number of years since 1999, have been required to do, so that's a pretty dramatic change in the quality of information that is provided.
CHAIRMAN WANDER: So you're all aware of this, the OTCBB, you have to be 34 Act registered, which means you supply people with 10-Ks, 10-Qs, proxy statements, Section 16, current reports on form 8-K.

However, there are no listing standards, such as the majority of independent directors, et cetera, which is -- and market cap -- and all of the independence rules, the voting on stock options, for example, all of those things.

So that's the difference we're talking about.

MR. LEISNER: I guess the point I really was making is that in 1996, when the law was passed, the NASDAQ didn't have those rules, either.

CHAIRMAN WANDER: No, that's true. That's 1996, and today is almost 10 years later.

Janet.

MS. DOLAN: For those of us that don't work in this every day, I just want to know, I mean, is removing this bar to decide if, you know only Bill Gates and Donald Trump get to have access to these great investments?

I mean, is there some framework? I mean, is there some framework you would link this to, like, you know X percentage of the population, I mean, or do you just try to move it way up and then say we'll grow into it and 10 years from now we'll change it again?

I mean, for the rest of us, what's a framework that
we could decide whether it should be here or farther up?

MR. CONNOLLY: Janet, thank you for colorfully posing my concern, as well.

The issue is very simply, from a regulator, investor protection standpoint, they are the folks who have the stop sign saying, you know, not only should you stop, look, and listen, but you are not allowed to be here.

So my concern as someone who has done capital formation professionally most of my life and someone who is hoping to stay in that arena competitively is that the only way that I would embrace some part of Jack's recommendation, and I doubt it would be $1 million annual income, because, you know, there may be a couple guys in the room, but it's not me, would be that if we tripled the non-accredited investor exemption -- typically, you can do it for 35 or fewer offerees -- I know that if -- I'm in the middle of trying to do a $5 million private placement raise right now with an underwriter, private placement agent.

And I know that if I can only show and enroll accredited investors under the current definition, I am precluding doing that offering quickly and I'm precluding allowing folks who are neither wealthy private equity funds, hedge funds, well-endowed super purchasers to have access to what I consider to be one of the finest early stage investments out there. And I'm certain that they're across
the board.

If we don't let people into the game for the best deals at the earliest stages because we're afraid that they could lose money, all of the anti-fraud provisions still exist, there are no other reasons, other than some perception, and I'm not in any way assaulting this, because, you know what? Jack is a cop.

Jack is -- and police and law enforcement people every day see the bad. There is no I don't think recognition that of every public company that Jack, or investment prosecution that his division happens to engage in, they're not seeing the 20, 30, 50, or 80 proportionately that are going about their business and returning investor returns.

So it is right and proper for him to focus on the concern, but I think that the Bill Gates outsized opportunity keeps far too many people out of the market.

CHAIRMAN WANDER: Let me try just a slightly way.

What we're talking about is the registration requirements under the 33 Act. In other words --

MS. DOLAN: I understand that. I just want to know what rational --

CHAIRMAN WANDER: Let me -- the Supreme Court has held that the private offering exemption from the registration requirements shouldn't apply to those people who don't need the protection that registration would provide.
And so when the SEC adopted Regulation D, there was a forerunner to it prior to that time. This was a surrogate.

There are eight categories of buyers that sort of by definition are able to fend for themselves under the Supreme Court's definition.

And Jack is absolutely correct that the amount of money, the income, 200,000, 300,000 joint income were selected 10, 15 years ago, and as we see with the SEC regulations, they don't tend to get updated to reflect what's happening in the economy.

There are a couple of other places in the securities laws where numbers like that appear.

One is, can you invest in, in effect, an investment company and not become a registered investment company, which is a much higher amount that you would have to invest in, and I suspect that the selection here was done based on some analysis of what an appropriate level would be, and as you hear, Jack thinks it's too low, and Drew thinks it's too high.

MR. CONNOLLY: But Herb, I must just quickly say it is not necessarily true that Jack and his 49 compatriots don't have a vote, because were these recommendations to be embraced by the commission, clearly as they're implemented state by state, they're going to have an outside --

CHAIRMAN WANDER: Absolutely, and that's why I said
we're going to keep that on the agenda, because I think it is
important.

Rick.

MR. BROUNSTEIN: Rick Brounstein.

Just I think maybe this can all be a subject as we
get into drafting, but to me, we got to look at the intended
consequences of our proposals in their entirety.

I mean, I look at the PIPE discussion and it needs
more broadening. When you look at a PIPE and you say it's
unregistered, it's unregistered for a very short time.

If you look at the OTC argument we're having, to me
we should have the pink sheets in there.

We're turning around and we're going to say, you
know, everybody who is in our reporting system, so you don't
have enough -- if you have too many shareholders, you're
going to report.

You're going to have Ks, you're going to have Qs,
you're going to have independent audit committees.

We've raised the standards so that there's a lot of
transparency out there. We need to look at some of these
areas here that you're discussing and make sure that that
transparency, you know, gets with it the benefits that it
deserves.

CHAIRMAN WANDER: Okay.

MR. HERSTEIN: If I can answer Janet's question
very quickly about the bar high.  
I mean, it's arbitrary numbers, but I would like to see the bar raised higher just because once it's basically into law, very seldom do they get raised after that.

CHAIRMAN WANDER: Leroy?

MR. DENNIS: I'd just like to ask the committee, based on Jack's comments, did you look at -- explore the definition of accredited investor and what discussions did you have around that?

MR. COOLIDGE: Not really.

The levels that were set in Recommendation Number 1 were clearly keyed off of the accredited investor. It was trying to make it a higher bar, higher standard, but we didn't talk about adjusting the accredited investor standards.

CHAIRMAN WANDER: I think to be fair, there hasn't been a lot of difficulty in applying Regulation D, at least that I'm aware of. I don't know if any of the other lawyers or professionals have had that problem.

What I'd like to do now is break for lunch. When we come back, let me give you my suggestion, which we can discuss when we get back.

We're going to reverse the order of the voting on the recommendations, and accept for Janet's recommendations, which I think we probably should vote recommendation by
recommendation on, I think that would be the fairest.

The other subcommittees we could vote on either as a package or if someone wants to discuss or debate one point or vote on it so that they could actually have a negative vote or an abstention on an issue we will accommodate them.

So what we'll do is say, for example, all of your subcommittee recommendations will be there unless some are voted on as one by the whole committee, unless someone likes to separate one of the issues which we would then vote on separately.

Steve?

MR. BOCHNER: Can I just ask? And when we vote to approve a preliminary recommendation, we're voting to authorize the subcommittee to move forward in taking that and turning it into a final recommendation, so we're not really -- I'm interested in what your view is of the import of a vote.

CHAIRMAN WANDER: That's a good point.

For example, I would suggest on the question of how you're going to scale the number of shareholders and the dollar amount that we frankly leave that blank because you've asked that, and so we should leave that blank.

And then what we're going to do is vote on it. If it's passed, you will, working with the staff, start preparing the formal recommendations in a report, and we have
a couple of reports around the room, so people can look at
what these reports look like.

And then we will bring the whole report with the
recommendations back to the subcommittee at our next -- I
mean to the whole committee at our next meeting at which time
we can debate any one of those issues again and approve them
finally and then they'll be out for public exposure.

MR. BOCHNER: Kind of directional concurrence, as
opposed to --

CHAIRMAN WANDER: Yes. I am sure we're going to
make changes from here on.

I think the areas are complex enough and we're
still learning that that would be appropriate.

So it's now 10 to 1:00.

Two o'clock, and we'll meet from 2:00 to 4:00 and I
thank all of you for your patience. We didn't have a break,
but I think we worked through this in a very efficient
manner.

(Whereupon, at 12:55 p.m., a lunch
recess was taken until 2:09 p.m.)

CHAIRMAN WANDER: Let's see. We are missing Dave,
Richie, Ted.

Before we go to the voting, let me reconvene the
meeting.

And I think we should discuss our next meeting
date, which, Gerry, is now scheduled for -- the master schedule before amended is down as January 9th, the sixth meeting, to consider the draft final report.

We think that's pushing too much, and so the date that we penciled in is January 23rd, if I'm correct, and gives us an extra 12, 13 days to get the report in shape for everybody to review before we meet.

Is that agreeable for everybody, or as many of you as possible? Yeah, it would be in D.C. again. The 23rd?

MR. DENNIS: Herb, the 9th is then canceled, then?

CHAIRMAN WANDER: Yes.

MR. SCHACHT: I can't be here on the 23rd. What will happen on the 23rd?

CHAIRMAN WANDER: We'll approve the report in its form to be submitted as a public exposure document.

MR. CONNOLLY: I don't recall, are there proxies for things like that?

CHAIRMAN WANDER: No, but you could be on the phone. Is that helpful to you, Kurt?

I'm sorry we had to change the schedule, but there was just no other way of doing it.

MR. SCHACHT: So there will be voting by phone?

CHAIRMAN WANDER: Yes.

Is that the date we selected? Is that Martin Luther King Day? Okay. Because that's a national holiday.
Okay, so for those who just joined us, we are canceling the January 9th meeting and our next meeting will be January 23rd, here in Washington.

We will then at that time have a draft of the recommendations and report, will review that, vote on it again, make any last-minute changes, and then that will go out for public exposure, so that we can again continue our fact-finding, and then meet again to finalize the report.

So is that clear with everyone?

Okay.

Anything else on the dates, time, schedule?

MR. BROUNSTEIN: The same preliminary redo of the master had a new date in March. Should we look at that, as well, right now?

CHAIRMAN WANDER: Yeah. What's the date?

MR. BROUNSTEIN: I think it's the 31st and I think it was the 20th.

MR. LAPORTE: Yea, March 20th, and I think it's been changed to the -- suggested changed to the 31st.

MR. BROUNSTEIN: Yeah. I mean, I have -- your revised master had it on the 31st, and my old book has the 20th. The 31st is a Friday.

CHAIRMAN WANDER: Is a Friday?

Yes, okay. So January 23rd and March 31st.

MR. LAPORTE: Subject to the fact of whether we can
get this room.

CHAIRMAN WANDER: I'm sorry. What are the dates?
January 23rd?

MR. LAPORTE: Right, and we're tentatively scheduling for March the 31st.

CHAIRMAN WANDER: March 31st.

MR. LAPORTE: Conditioned on our being able to get this room.

CHAIRMAN WANDER: Well, can we get another room?

MR. LAPORTE: Or we can get another room, right.

CHAIRMAN WANDER: All right. Two other items before we move on to vote.

One of those is that you all have at your places a letter Senator Enzi sent to Chairman Cox on December 12th, which the Chairman has suggested we distribute to everybody. It's asking that the Commission give I guess due consideration to our recommendations, and it's a very favorable letter to the work of our advisory committee.

Secondly, you have at your place the final report from the November meeting of the SEC's annual business--government-business forum on small business capital formation, so that you can look at that and indeed when we're preparing our report, we will have that information available to us.

MR. CONNOLLY: Will it be appended as part of our
report?

CHAIRMAN WANDER: I don't think so, but if you'd like to do that, when we get the report, you can mention that.

We're now going to vote and we're going to do it in reverse order. Capital formation recommendations.

And the way I see this, we could vote on all of them, but you have taken out 5(b), which you're going to talk to Drew about for possibly putting it back in with qualifications, and as I understand it, we're going to vote on 5(c) as two items, one to make available -- no, I'm sorry, 5(d), yes, excuse me -- make NASDAQ small cap stocks as one, as a covered security, and secondly, as a subset of that, a separate item, make OTCBB listed stocks covered securities.

Yes.

MR. DENNIS: Herb, just on 5(d), the second amendment with the OTCBB, I think that was also contingent upon the corporate governance standards passing?

CHAIRMAN WANDER: Yes. Yes.

We'll all get to look at that one again, because we're going to have to make sure they do actually dovetail.

Is there anyone who wants to separate any of these issues, or can we vote on them as one item?

(No response.)

CHAIRMAN WANDER: Okay. Is there a motion to
approve the capital formation subcommittee recommendations?

M O T I O N

MR. DAVERN: I'll move it.

MR. LAMBERT: Second.

CHAIRMAN WANDER: Second.

Any further discussion?

(No response.)

CHAIRMAN WANDER: All in favor, raise hands, I guess.

(A show of hands.)

CHAIRMAN WANDER: Any against or any abstentions?

(No response.)

CHAIRMAN WANDER: Okay, terrific. We might get out of here early, beat the snow in Chicago.

MR. BOCHNER: Herb, do you think the -- I just want to say to Leroy's comment, the work we're doing with respect to certain governance requirements that we would, that's the same type of governance listing standards that was, or should not -- may not necessarily be the same type of standards that one would want to get the kind of relief that we're talking about in this other context for covered securities.

So I guess I would suggest maybe some more work and thinking ought to be done about because I don't believe the SEC actually has the authority, unless they're listing standards, for the OTCBB to make them covered securities.
I mean, Gerry and Kevin can check on that for us, but I think there's a problem in making those covered securities without listing standards, and I don't think what we're doing would be listing standards.

So I just think somebody needs to do some more thinking about that.

CHAIRMAN WANDER: Okay. I think that's a good point.

We don't have the handle of getting the relief under 404.

All right, good. We're off to a good start.

The next one is Leroy's accounting standards recommendations.

Is there anyone here who would like to separate out and vote separately on any one of the issues?

(No response.)

CHAIRMAN WANDER: If not, is there a motion to approve those?

MOTION

MR. CONNOLLY: So moved.

CHAIRMAN WANDER: Second?

MR. DAVERN: Second.

CHAIRMAN WANDER: Further discussion?

(No response.)

CHAIRMAN WANDER: If not, all in favor raise your
hand.

(A show of hands.)

CHAIRMAN WANDER: Any no votes or any abstentions?

(No response.)

CHAIRMAN WANDER: None. Oh, I'm sorry. Oh, they just left their hands up.

The next item is corporate governance disclosure recommendations.

Is there anyone who wants to separate any one of the items?

Yes, Leroy.

MR. DENNIS: This is Leroy.

Herb, I'd like to separate the considerations around the stock options, and then as far as the -- I don't know how you're going to word the recommendation, Steve, on the 300, 750 shareholders of record in there recommendation.

MR. BOCHNER: Maybe as Herb said earlier that we'd put a number of security holders to be determined as additional data is obtained, if that --

CHAIRMAN WANDER: Well all have a chance to vote on it again at the next meeting.

MR. CONNOLLY: Before the vote, Herb, one other question.

In terms of the potential collapsing of the S-B regimen into, you know, S-K, is that -- the wording of the
recommendation says that we're going to ask the Commission to evaluate.

Is there any way that prior to a final drafting of this recommendation we can request feedback from Corporate Finance or somebody within the organization to see whether or not this is feasible?

I mean, we know loosely the number of S-B filers, but we don't know the position of the Commission on this. There's some controversy out there, that's all.

CHAIRMAN WANDER: I think we can, but I think we could also, between now and when the report is written up, also get a better fix ourselves on which of the existing S-B regulations we would like to include in S-K to be applicable to microcap companies. Okay?

So that we don't just throw the ball against the wall for the SEC, we give them a little more direction.

Yeah, Kurt.

MR. SCHACHT: I have one question, Herb. Kurt Schacht.

On your second dot point, that's the one that's dealing with the corporate governance enhancements, and what happens if exemption doesn't fly for smaller companies? Are you still recommending -- so instead we go with a better implementation of Section 404 as the alternative recommendation. Would we still be requiring the corporate
governance enhancements?

MR. BOCHNER: You mean if the SEC, if we either
don't recommend the 404 exemption or the SEC doesn't accept
that recommendation would we be imposing these? We have not
talked about doing that. We've talked about it as something
that would be imposed if the 404 exemption relief is
provided.

But it does dovetail with this concept of the
listing standards that was previously discussed.

CHAIRMAN WANDER: Any other questions? We're going
to vote on everything but the stock option issue.

(No response.)

CHAIRMAN WANDER: Is there a motion?

MR. DENNIS: Move it.

CHAIRMAN WANDER: Second?

MS. CAFFERTY: I second it.

CHAIRMAN WANDER: Second.

Any further discussion?

(No response.)

CHAIRMAN WANDER: If not, all in favor say aye, or
raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Any negative votes?

(No response.)

CHAIRMAN WANDER: Any abstentions?
(No response.)

CHAIRMAN WANDER: Now, we'll vote on the stock options. Does someone want to move that aspect of the report?

MR. DENNIS: Could somebody just recap the issue again, please?

CHAIRMAN WANDER: It's that, as I understand it, that holders of options, whether vested or unvested, are not counted as shareholders for determination of whether you have to register under the 34 Act.

Did I say it right, Steve?

MR. BOCHNER: Yes.

CHAIRMAN WANDER: And Leroy has raised an issue that he believes that anyone who does have a vested option really is always making an investment decision and therefore he would count them.

MR. DENNIS: Yeah.

MR. BOCHNER: Do you want me to respond to that, or should we just go to the vote?

CHAIRMAN WANDER: I'd go to the vote, but John, you hadn't said anything.

MR. VEIMMEYER: Actually, I was just going to ask, Steve, I think when Leroy asked that question, he asked two questions, and you got to the first one, and I'd be interested actually in how the committee evaluated the issue
that Leroy asked about to help me before I voted, because I think it is a legitimate question, and I'd like to understand just the rationale of the committee.

MR. BOCHNER: Sure, be happy to, and then I'll ask my subcommittee members to jump in.

So we -- my thinking on the topic and my bringing it before the subcommittee, and I think their thinking on the topic was helped along by Rule 701, which is an area where the SEC has said in a rule that, as long as options are issued in a compensatory transaction subject to certain limits that we're actually proposing to raise here, the capital formation subcommittee is proposing to raise, that there's an exemption from registration provided under the 33 Act because in that compensatory context the protections of the 33 Act aren't necessary, or may be outweighed by the need to grant those exemptions.

And indeed, you know, in the pre-701 era, companies had a hard time granting options under the private placement exemption.

It was a real problem, because you had to give options, but you couldn't, because you didn't meet the private placement exemption, so your alternatives were to, you know, not hire employees or start filing, so it just was not a tenable situation.

701 solved that, and I feel like we're dealing with
a little bit of the same problem again.

And so I think what Leroy says has merit. In other words, would it be better for an optionee to have more information than less in deciding when to exercise yes.

The problem we're trying to deal with is where a small company is growing, gets to, you know, 300, 400, 500 employees, grants options to those employees, maybe has done three rounds of financing, and now all of a sudden, if you include the optionees, guess what? We got to either stop granting options or go public.

And it seemed to us that in weighing those competing interests, that if you specified that they must be in a compensatory transaction, they must be unexercised, and we could also add, and I just thought of this today when I read the capital formation subcommittee's recommendation, but we could throw in a net exercise requirement to not be counted, meaning that the optionee wouldn't -- could have the -- I won't use the word option -- the alternative to pay, instead of paying cash, to use the appreciated value of the stock to exercise so they're not actually out of pocket.

So that could be something we could also consider.

But that's the -- that was our rationale.

MR. SCHACHT: Just one quick question. This is Kurt.
When do they go into the calculation for compensation expense, upon grant or upon vesting?

MR. BOCHNER: On grant.

MR. SCHACHT: Grant.

MR. DENNIS: And Herb, I'd like to maybe hear from also Rick and Alex and Pat, who maybe are more in the field with some of this stuff than I am, as to what their opinions are on this.

MR. BOCHNER: I think Ted might, you know, because a venture capitalist, I think he sees a lot of these things, too.

MR. SCHLEIN: Ted Schlein.

Steve's definition and the way he's looking at it is very similar to how in the venture world we would look at this and determine who is really a holder and who's not a holder.

But I also would jump back. If somebody wants to remove the stock option expensing from comp, I'm ready to -- you opened the door, but I'm right there behind you.

MR. DAVERN: Alex Davern here.

I would strongly support this provision.

Having worked at a company where we stopped issuing options specifically because of this exact rule, which was not a good thing for our business or our shareholders, I would strongly support this provision personally.
CHAIRMAN WANDER: Anybody else? Pat?

Pat said he had the same comment.

Leroy, anything further?

MR. DENNIS: No.

CHAIRMAN WANDER: Okay. Now, we’re going to vote on whether to accept this recommendation from the corporate governance and disclosure subcommittee dealing with stock options.

Is there a motion to approve that?

MOTION

MR. JAFFEE: I'll move it.

CHAIRMAN WANDER: A second?

MR. LEISNER: Second.

CHAIRMAN WANDER: Yes, Richie.

All in favor, raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Opposed?

(A show of hands.)

CHAIRMAN WANDER: Two.

Any abstentions?

(No response.)

CHAIRMAN WANDER: For the record, Kurt and Leroy were the negative votes. Okay.

MR. ROBOTTI: Herb, on that vote, the capital formation subcommittee had eight recommendations. The eight
recommendation deals with the same topic, doesn't it?

CHAIRMAN WANDER: But it's slightly different.

MR. ROBOTTI: Okay. But we've kind of authorized another subcommittee's report that kind of endorses a similar concept to approach the same issue, though.

CHAIRMAN WANDER: Yeah, but I think their approach was not dealing with the 34 Act registration, if I recall. It dealt with the amount of --

MR. ROBOTTI: No, they snuck it in there, Herb. It is in there. So Leroy already voted for it.

MR. BOCHNER: I think it also --

MR. DENNIS: You're right, Bob, and I wouldn't be opposed to, you know, increasing the limit of the number of shareholders.

I just personally believe they're shareholders, and, you know, do I exempt a penny stock shareholder or somebody that buys it for a buck a share? No, I think they're the same.

CHAIRMAN WANDER: Okay, let's move on.

We are now to --

MR. CONNOLLY: Do we give the right to object if --

CHAIRMAN WANDER: No, no. We voted.

If this was a really important issue, I might consider it.

We're now down to internal control over financial
reporting recommendations, and there are five recommendations, correct, Janet?

MS. DOLAN: Yes.

CHAIRMAN WANDER: And I think the best approach here, since I know we will have some negative votes, is to vote on each item separately and in order.

So the first item is obviously Recommendation Number 1.

MOTION

MR. LAMBERT: I move.

CHAIRMAN WANDER: Is there a second?

MR. VEIHMeyer: Second.

CHAIRMAN WANDER: There is a second.

Any further comment, discussion, questions?

(No response.)

CHAIRMAN WANDER: If not, all in favor of Recommendation 1 raise your hands.

(A show of hands.)

CHAIRMAN WANDER: All right, opposed is Kurt.

(A show of hands.)

CHAIRMAN WANDER: Okay. One opposed.

Any abstentions?

(No response.)

CHAIRMAN WANDER: All right.

So Recommendation 2 is the exemption for smaller
public companies.

Is there a motion to approve that?

MOTION

MR. DAVERN: Move.

CHAIRMAN WANDER: Alec. Second?

MR. LEISNER: Second.

CHAIRMAN WANDER: Ted.

Any further discussion?

(No response.)

CHAIRMAN WANDER: If not, all in favor raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Okay. It's everyone. And negative votes, Kurt.

(A show of hands.)

CHAIRMAN WANDER: Any abstentions?

(No response.)

CHAIRMAN WANDER: Recommendation Number 3 dealing with if 1 and 2 fail or if 2 fails, essentially, what the committee is recommending.

Motion to approve that?

MOTION

MR. BOCHNER: Move.

CHAIRMAN WANDER: Alex.

MS. DOLAN: Second.
CHAIRMAN WANDER: Janet, you can second it.

Yes?

Actually, you should get the motion on the floor so that you can --

MR. JENSEN: The motion is on the floor, so now we can talk about it.

The -- and I had previously signaled this to the group here.

A concern I've got is there is debate in the accounting profession right now as to the merit of another standard, and I think that that debate needs to occur, so I'm not trying to stop the debate.

On the other hand, being a member of that profession, although I voted previously for this, at this point I'm going to abstain from voting on it, and I just kind of wanted everybody to understand why.

And that is I think that the debate in the public accounting firms and in the profession needs to take place as to the merit of having yet another standard out there. I think there are a lot of things to consider.

My concern with AS2, as it was -- as we went through the process originally was that a lot of the comments from the profession, the people who had to deliver those reports, certainly everybody had an opportunity to comment on them, but I think it was pushed through so quickly and so
rapidly, I think that the providers of these kinds of reports need an opportunity to let the technical aspects of this be ironed out as well as the practical aspects in terms of their own risk, what they're willing to take on and what they're not willing to take on.

So for that reason, at this point, I'm neither going to vote no or yes, but abstain from the vote, and I just wanted everybody to know why.

MR. JAFFEE: Herb, can I ask a question?

These recommendations that we make, the commission will what? What will they do with them? They will accept them, they will modify them, or they will do nothing, or do we know?

CHAIRMAN WANDER: They will take them under consideration, and hopefully someday there will be a release out proposing what we recommend, or to a large extent what we recommend.

But they do not do anything formal with them unless they decide to propose some rules.

MR. JAFFEE: Because what I was going to suggest is that this Number 3 sort of says we recommend 2, but if you don't like 2, here we got 3, and what I was going to ask is, could we set up some kind of a process or format where after a certain period of time if nothing has happened, we have the opportunity of coming back with a fallback on anything?
CHAIRMAN WANDER: I'd like that, but we sunset, unfortunately, next April.

MR. CONNOLLY: Actually, as a followup to that, but different -- a followup to that, but different is, is there any way we could go on, formally go on record as suggesting that anybody within the SEC who would have the ear of one or more of the commissioners seeing the work product that we draft today and vote today to adopt and it likely will end up through the final work product could jump the gun, to borrow an SEC expression, gun jumping, and adopt and vote on and implement some of these recommendations prior to being finally delivered the work product?

CHAIRMAN WANDER: Well, I think that's already in motion, and for example, the SEC put out a release last week or two weeks ago really taking one of Steve's recommendations dealing with the dissemination of proxy statements.

So I don't think we need any formal statement.

Janet?

MS. DOLAN: I just wanted to respond to Dick, because I thought your question might be going down just a slightly different bent, which is that, do we dilute the power of, you know, of 1 and 2, particularly 2, by having an alternative?

And we debated this. We said, well, maybe we should put what came to be Recommendation 3, maybe it should
be in a footnote or maybe it should be an appendix.

And we actually came down on the other side, which
is we are so committed to providing relief for those that we
think really desperately need relief that we put them both in
to say, if you don't do 1, if you're just not willing, for
whatever reasons, to exempt, then we urge you to do
Recommendation 3, so we don't run into the situation where
they just don't want to exempt and then nothing gets done.

So we took the other side of it, which is to say
just how strongly we feel about this was to put both
alternatives and say you have to do something.

We think there certainly should be the political
will and everything else to do an exemption, but if not, you
just can't walk away. Then you have to address the other
alternative.

So that's why we did it that way.

CHAIRMAN WANDER: And also partly to really take
care of your situation when we're no longer in existence --

MR. JAFFEE: No, that makes good sense. Yeah.

CHAIRMAN WANDER: All right. I think we can go to
a vote.

All in favor of Recommendation 3, raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Okay. Abstentions?

(A show of hands.)
CHAIRMAN WANDER: There's one, two.

Okay.

Any against?

(A show of hands.)

CHAIRMAN WANDER: Two. Ted -- I'm sorry, you're right.

Against are Ted and John and abstentions were Pat and Mark. I got that correct?

Okay.

Recommendation Number 4, which -- additional guidance from COSO, the SEC, and the PCAOB.

Is there a motion to approve that recommendation?

MOTION

MR. DAVERN: So moved.

MS. CAFFERTY: Second.

CHAIRMAN WANDER: Second. All right.

It's open for discussion.

Yes, John.

MR. VEIHMEYER: John Veihmeyer.

This gets back to one of the items I commented on this morning when we were discussing it.

I'm comfortable with everything in Recommendation 4 except I'm not sure how to deal with the last bullet, which is not really framed as a recommendation.

We have a number of recommendations about different
bodies that we want to provide different guidance.

If 4 was written, for example, I mean if the last bullet in 4 was written to state as a recommendation that we want AS2 to be reopened and reevaluated, I think I would vote no.

So I'm just -- I'm unclear how to vote on this recommendation with the last bullet as it is, because I just don't know what we're recommending with that included, to be honest.

MS. DOLAN: Well, I want to be very precise, because obviously this is getting right to the heart of a lot of some very emotional issues in this effort.

We did not make a recommendation that AS2 be amended or changed, but we felt that we could not, or we felt we would be doing a disservice to the SEC if we didn't make a statement that said we're not recommending a change, but we, in all that we've heard, ask you to at least look at whether we're going through a lot of these efforts to remediate the fallout from the implementation of AS2, when in fact perhaps if you look at it, you may decide there is more benefit to looking at AS2 and considering whether it itself needs some work as opposed to just ignoring it.

So we didn't have -- we did not make a recommendation that yes it should be done, but we didn't want to ignore what a lot of us would call the elephant in the
middle of the room, in terms of the whole effort that we're all about here.

So that's as clear as I can be about why we put that statement in.

You're not voting for a recommendation to ask that AS-2 be amended, but it is a statement from our subcommittee that this entire advisory committee would also be endorsing, which is at least putting in front of the SEC that this is a question they ought to look at.

MS. DOLAN: That's as clear as I can be.

CHAIRMAN WANDER: Okay.

CHAIRMAN WANDER: I would invite any other members of the subcommittee who want to say anything.

MR. JENSEN: Let me see if it makes any sense.

We've -- we started down a path. We have been down every, I guess to use the expression, every rathole you can think of as it looked to how you might approach AS2 in a smaller company environment, and I think it's important that we keep this conversation framed in the smaller company environment.

This is not an indictment of AS2 and its implementation. It's not a commentary by this committee about how we believe anybody has implemented it or any other thing. And I think sometimes in the debate we all forget that.
What we're really talking about are the smallest of the small.

We're talking about companies who are having difficulties financially affording the implementation of 404, having difficulties obtaining resources to comply with AS2. You know, we've tried to lay out some logical patterns of what we thought could be a solution here that would allow companies to thoughtfully and affordably comply with the law.

If you really walk down the logic trail, ultimately it gets to the point where at some point, if there is no new standard that comes out, if there is no relief or exemption given to those companies, then I think someone really does need to sit down and take a look at the applicability of the standard as it relates to smaller companies.

And I think that that is something we've emphasized all along, and that's our charter, and sometimes gets forgotten.

As it relates to that population of companies only, then maybe something should be looked at.

If, in fact, it was determined that there are things in AS-2 that are driving behaviors of both companies and auditors too, an ineffective approach and an overly cautious or overly expensive approach. I think that's what this recommendation is trying to get to.
It might need some more words around that, too, because I do worry, you know, when you say it like this, it basically says AS2. It doesn't say for smaller companies, although that's incumbent in the recommendation. But I think people can start to take this argument to an illogical conclusion. We're not -- it's not a commentary, not meant to be one, on the entire adoption of that standard.

CHAIRMAN WANDER: Yes, John.

MR. VEIHMEYER: I appreciate that.

Janet and Mark, I'm just being real honest with you. I'm struggling with -- I want to support this recommendation. I'm struggling with the way this is drafted right now.

It's not in the form of a recommendation that you could either say yea or nay for, and yet it seems to imply that maybe there's -- it's not drafted as a recommendation, but I think if you wanted to come back afterwards and look at it, I think you could interpret that, and the subcommittee was recommending that the SEC go down this path of reopening. So I'm just trying to really clarify as much as I can what the intent of the subcommittee is.

I would hate to vote in favor of this recommendation and have a subsequent interpretation of what we were voting for be that the SEC should -- and the thing
I'm struggling with, as I tried to clarify today, I don't think this means God handed this down and we should never revisit, but the wording here that it is now time -- if -- it is now time to reevaluate or amend the standard, my view is now is not the time to do that, and I just want to make sure I'm voting for what -- either for or against what the subcommittee is intending, and I'm just asking if we could be as clear as we can be in the wording of this recommendation so that I can support what I think is an overall very good recommendation in Number 4.

CHAIRMAN WANDER: Dan.

MR. GOELZER: Could I just make a clarifying point? People might want to look at Slide 43, which contains a list of what to me at least are the primary problems that have been identified with respect to the implementation of AS2 in the first year, and/or just directs the PCAOB to correct those problems. If you look at the top of Slide 44, it includes possible amendments to AS2 as a way of implementing or solving those problem areas.

I guess I'm not sure myself what the final bullet on 44 adds to that discussion. I'll leave that to the voting members of the committee.

But I think I would say that from my perspective, with or without that final bullet, the PCAOB would already be
given some fairly specific instructions about the problems that have occurred and what to do about them.

CHAIRMAN WANDER: Kurt.

MR. SCHACHT: I appreciate -- this is Kurt Schacht. I appreciate the chance to take a crack at this.

If the fix to Section 404 is decided to be an implementation fix, there are essentially three ways to do that.

You can leave AS2 alone. Hopefully, as you go through it, some additional cycles that things settle in, the new guidance that's out there, that that settles in, and that there's better implementation through that method.

There is also thinking that you would possibly refine AS2 as it currently stands, to tweak it, to enhance implementation.

And thirdly, our thinking was that there could be a separate standard, an ASX, a small, tailored AS2 standard for small companies.

So if implementation as opposed to exemption is the way to go, there are a number of ways that you could get the better implementation, and I'm thinking that this group thought that all of them should be on the table for consideration.

CHAIRMAN WANDER: Okay.

Any other questions?
Janet, did you --

MS. DOLAN: Just in the interest of trying to create a process here whereby we might perhaps move forward and yet let everybody vote on exactly what they feel they can in good conscience vote on, we might parse this portion of it and separate that last bullet and make it a separate vote, but it stands on its own, and people voting for it have the opportunity to say, since we are advising the SEC, while we have identified some ways to fix it, we are actually putting in a separate vote that says we're not telling you to redo it for a small company, but you might decide on your own that it is the time to look at the whole thing.

Anyway, I'm just trying to find a way where we don't sort of like in this town an omnibus spending bill, throw things in where we get disingenuous votes, and that's not what we're trying to do here. We're trying to really provide clarity and a real roadmap for the SEC.

So I don't mind separating it and letting people vote and see what people are willing to vote for.

CHAIRMAN WANDER: Leroy, did you have a comment?

MR. VEIHMeyer: That would solve my dilemma.

MR. DENNIS: I agree with that.

I just, I do share John's concern as I read that. I think we ought to be clear. And I'd ask whether or not, you know, whether you amend any of the wording here.
I mean, if you're recommending that the PCAOB and the SEC consider whether AS2 is appropriate for smaller business, I think that's fine as a recommendation, and we can vote on that.

I'm not sure -- I agree with John on that. I'm not sure what you mean by this recommendation, and there's what I struggle with.

So I'd ask whether or not you propose any clarification of this that we vote on separately if you take it to that stage.

MR. DAVERN: I'd support Janet's move in the interest of time at this point, that we separate them and vote on them, and we'll be getting lots of public comment to consider as we go forward between now and our next meeting at the end of January.

CHAIRMAN WANDER: Okay, so it's been moved and seconded that we take Recommendation 4 now.

There's a proposal to amend it to bifurcate it, to have everything but the last bullet point voted on first and then the last bullet point voted on second.

Is that agreeable to the motion makers?

MS. CAFFERTY: Yes.

CHAIRMAN WANDER: Okay. Mark?

MR. JENSEN: Can I comment? I just wanted to comment on that.
I think when you do separate it, I think it goes from being a softer recommendation to a pretty hard recommendation, and I would have trouble supporting it as a separate recommendation, because I think it does, when it's out there by itself, it looks like it's a recommendation to amend AS2, and I just, I think we're going beyond at least where I think we wanted to be at that point.

But I'm not going to object to it, but I'm just telling you, I'd have a hard time supporting it as a separate recommendation.

CHAIRMAN WANDER: Janet.

MS. DOLAN: Well, I was not going to make it a proposal.

I was going to make it to be the advisory committee makes the following statement to the SEC, and leave it at that.

It is just simply a statement endorsed, if it is, by the advisory committee that says you may want to consider. That was it.

I wasn't going to turn it into a proposal, say we propose that -- anyway, that was all.

MR. JENSEN: Well, I think the importance of it is, and it's somewhat lost, and, you know, I don't know who the guy was that put this power point together, but, you know, I think it is in the way, you know, "You're fired," or "You're
off the island," or whatever.

But, you know, it should be under the heading of ask the PCAOB to provide greater clarity and to encourage greater cost effectiveness in the application of AS2.

That's the heading that it really is under.

It's not in my mind, and never was a separate bullet.

Now, maybe it intentionally was a separate bullet and I'm missing the point, but it seems to me that, because it says at the heading there, you know, is to basically consider all these things, you know, in implementing the foregoing, and then I think the question then was when you take a look at all of those things, is the only way to get to those things is through an amendment to AS2 or not, which I think the PCAOB has demonstrated they think there are other ways to get to these kinds of amendments without actually opening up AS2. Their guidance in November is an example, their guidance in May.

And that's actually what the bullet in the middle there says.

It says, you know -- because up above it says most effectively accomplished by amendments to AS2 or other things.

I mean, it's very open, saying, look, these are things that need to be fixed, and if the only way to fix them
is by an amendment, then do that, but if there are other ways, do that, and leaving it in their hands.

And I think keeping it in their hands is where it rightfully belongs. They're the standard setter and they should be able to do their job that way.

But, you know, I'm just saying if you break it out separately, it looks to me like that is our recommendation, and I might or might not be okay with that recommendation if I knew what we were recommending would be amended, but I think speaking for everybody, I think our fear is, if you open this thing up, everything starts to get amended, and we can't --

CHAIRMAN WANDER: Well, we have two divergent views.

MS. DOLAN: And they're both from auditors.

CHAIRMAN WANDER: One is to vote on this as is and one is to separate out the last bullet.

MR. DAVERN: I'd like to retract my earlier comment about separating them out, and I agree with Mark, and I think we should vote on them together. So I retract what I said earlier.

MS. DOLAN: I'm on a subcommittee as well, and I think we should vote on them separately.

CHAIRMAN WANDER: Well, why don't -- yes, John.

MR. VEIHMeyer: I just would again come back to,
typically when you have a situation like this, I think it's because there's a more fundamental issue underlying it. I think the fundamental issue that is highlighted by the fact that we have reasonable people disagreeing on this is that this, unlike everything else in the report, is not really framed as a recommendation.

It is a comment, kind of a throwaway comment off to the side, and I would just encourage -- so I don't know how we do it at this point in the interest of time, but I guess I'm questioning whether or not this is really like everything else in your work product, is this really a recommendation that anybody can actually vote yea or nay against.

CHAIRMAN WANDER: Well, we're going to have to vote, because we have to get out. Mike Eisenberg's party is going to be in this room a little later, his retirement party.

Why don't we vote on whether we want the last bullet point to be a separate point, and that's a procedural vote, and then we'll vote on this substantively.

All right?

MOTION

MS. DOLAN: All right. And to accommodate John, I will move it. I'm not necessarily supporting it, but I think it's important to at least move it so we can -- so I'll move it --
MR. CONNOLLY: I'll second it.

CHAIRMAN WANDER: So now we're voting on whether we should separate the last bullet point.

All those in favor of separating the last bullet point please raise your hand.

(A show of hands.)

CHAIRMAN WANDER: One -- one, two, three, four -- I'm sorry -- one, two, three, four, five, six, seven. Okay.

All those opposed -- I'm sorry.

Jim Thyen, Drew Connolly, Debbie, Janet, Rick, Leroy, and John. Okay?

All those in favor of not separating it, please raise your hands.

(A show of hands.)


So that -- I vote not to separate, but it doesn't matter.

So now we'll vote on it as it's not going to be separated.

We're voting on Recommendation Number 4 in its totality.

Yes, Mark.

MR. JENSEN: But I do think, in the interest of trying to get John over the line, is I do think this could be
drafted better, because in my mind, it was not intended to be an amendment to AS2.

It was basically kind of a catch-all at the end that in the foregoing, it -- if that was an approach that had to be taken, that was an approach that would be taken. It's not a recommendation to amend, and I think that needs to be really clear.

But it would open it up, and frankly, what we're trying to get to is the issue that was talked about earlier, that when this stuff starts to get resolved, we're not going to be here anymore.

And so it was basically trying to give somebody a roadmap that said, here's what we think needs to happen, and we kind of went down that path.

I think otherwise you strand these companies, that, you know, there needs to be something that changes, and then the work of the committee is done, we're not here anymore, and there's no roadmap for anybody to follow.

That was the logic of that, and I think that bullet could be better drafted to incorporate that and maybe as we go through drafting it's something we could vote on again later.

CHAIRMAN WANDER: We will vote on it and we could try that. That's a good point. Leroy?
MOTION

MR. DENNIS: That's what I was going to move, Herb, and try this.

If I move that we put this recommendation on the table with the instruction that the bullet point in question be worked on in the next 30 days to provide better clarification around that.

MR. CONNOLLY: Second.

CHAIRMAN WANDER: Well, that's really an amendment, so we vote on all of 4 with the recommendation that the language be examined and hopefully improved on in the next 30 days.

MR. DENNIS: Yeah, that's my move.

CHAIRMAN WANDER: Okay.

MR. CONNOLLY: I'll second that.

CHAIRMAN WANDER: All right. Any further discussion?

(No response.)

CHAIRMAN WANDER: All in favor of that, please raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Any opposed?

(No response.)

CHAIRMAN WANDER: No opposition.

Any abstentions?
Chairman Wander: No. Okay.

Recommendation Number 5.

Oh, Dick Jaffee was not here on the last three votes.

Recommendation 5, special cases. Very important. Needs a little more work, really. But we don't want to forget it because it is important here.

Is there a motion in favor of Recommendation 5?

Motion

Mr. Jensen: I would move that.

Chairman Wander: Okay.

Second?

Mr. Connolly: Aye.

Chairman Wander: Drew.

Further discussion?

(No response.)

Chairman Wander: If not, all in favor raise your hands.

(A show of hands.)

Chairman Wander: Any opposed?

(No response.)

Chairman Wander: Any abstentions?

(No response.)

Chairman Wander: It's all in favor except Dick
Jaffee, who is not here right now.

Janet, thank you. Thank you to all the other subcommittee chairs. I think we've had a very productive day.

Now, the work is not done yet, and we're not at the finish line.

We will be in touch with you about the drafting of the recommendations in a report form, and remind me, please to give me back my report, the earlier one, so I don't lose it -- the book, yeah.

Any other comments and suggestions?

MS. DOLAN: Herb, I don't have a comment or suggestion, but I was out of the room for the first two group votes, and I wanted to vote in favor of them.

I just want to know the process whereby I do that, or if maybe I just have.

CHAIRMAN WANDER: You just have.

MS. DOLAN: All right. I just want the record to reflect that. Thank you.

CHAIRMAN WANDER: I really do think we've had a very productive meeting, and one of the reasons is that I think all of you have done such hard work prior to the meeting.

There's really been a considerable amount of effort and good thought and dedication to this, and that's why I
I think we were able to get through this in I won't say record time, I don't know what the record is, but with, I think with thorough consideration. Everybody's views have been stated. And so now we're on to the next step.

Any other comments? Jim?

(No response.)

CHAIRMAN WANDER: Anybody else have any other good and welfare, anything to bring before the committee?

(No response.)

CHAIRMAN WANDER: If not, we're adjourned.

(Whereupon, at 3:00 p.m., the meeting was adjourned.)

CERTIFICATION

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

Herbert S. Wander
Committee Co-Chair

Date 1/26/06
Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its meetings of October 25, 2005 and December 14, 2005 and the date of receipt.

Dec. 14, 2005  Robin Rousseau, CPA
Dec. 14, 2005  Kurt Schacht, CFA
Dec. 13, 2005  Sarah A. Miller, Director & Chief, Regulatory Counsel, Center for Securities, Trust and Investments, American Bankers Association
Dec. 12, 2005  Michael B. Enzi, Member of Congress
Dec. 12, 2005  Frank E. Williams, Jr.
Dec. 12, 2005  Gayle Essary, CEO, Investrend Communications, Inc.; Acting Executive Director, Shareholders Research Alliance; Executive Director, FIRST Research Consortium
Dec. 12, 2005  Robert F. Reisner, Vice Chairman, Shareholders Research Alliance
Dec. 8, 2005  James C. Greenwood, President and CEO, Biotechnology Industry Organization; Mark G. Heesen, President, National Venture Capital Association; Lezlee Westine, President and CEO, TechNet; Victoria D. Hadfield, President, SEMI North America; David L. Gollaher, Ph.D., President and CEO, California Healthcare Institute; Megan M. Ivory, Executive Vice President, Federal Government Relations, Advanced Medical Technology Association
Dec. 07, 2005  Geoffrey Grier, Sr. Vice President Marketing & Sales, Research Data Group, Inc.
Dec. 06, 2005  Anonymous
Dec. 06, 2005  Anonymous
Dec. 02, 2005  Dr. Jeffry Haber, CPA, EQ Metrics, LLP
Dec. 01, 2005  DeAnn M. Duffield Vice President of Reporting and Administration and Secretary, Maxus Realty Trust, Inc.
Nov. 29, 2005  Frederick D. Lipman, Esq., Blank Rome LLP
Nov. 19, 2005  Gayle Essary, Managing Director, Investrend Research Syndicate / Investrend Research; Executive Director, FIRST Research Consortium; Interim Administrator, Shareholders Research Alliance; CEO, Investrend Communications, Inc.
ATTACHMENTS

Listed below and attached are the written reports submitted by the subcommittees of the Advisory Committee and referred to throughout these proceedings. Please consult the text of the proceedings to determine whether the recommendations contained in these reports were approved as submitted.

Report of Subcommittee on Internal Control Over Financial Reporting

Report of Subcommittee on Corporate Governance and Disclosure

Report of Subcommittee on Accounting Standards

Report of Subcommittee on Capital Formation