RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE
on
SMALLER PUBLIC COMPANIES

First Day of Meeting

August 9, 2005

1:00 p.m.

The John Marshall School of Law
Room 300
315 South Plymouth Court
Chicago, Illinois

The following individuals were present in person:

Committee Members:

Patrick C. Barry

Richard D. Brounstein

Pastora S.J. Cafferty

C.R. "Rusty" Cloutier

James A. "Drew" Connolly III

E. David Coolidge, III

Alex Davern

Joseph "Leroy" Dennis

Janet Dolan

Richard M. Jaffee

Mark Jensen

Deborah Lambert

Richard Leisner

Robert E. Robotti

Kurt Schacht

James C. Thyen

Herbert S. Wander

Committee Observers:

George J. Batavick

Daniel L. Goelzer

Jack E. Herstein

SEC Staff:

Cindy Alexander

Anthony G. Barone

Mark W. Green

Kathleen Hanley

Will Hines

Gerald J. Laporte

Kevin M. O'Neill

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

P R O C E E D I N G S

MR. WANDER: Why don't we all take our seats and begin. I'm going to make a few introductory remarks and then let everyone in the room introduce themselves and identify themselves who are either on Advisory Committee or our guests. And let me start by welcoming everyone to -- this is our third formal meeting session, our second where we are taking testimony. And the Advisory Committee is quite interested in hearing the views of all interested parties, issuers, investment bankers, investors, accountants, lawyers, everyone else, and we are continually looking for ideas on how to improve the regulatory system for smaller businesses.

Our hearings are essentially very formal. They are being webcast, so we will go down for posterity, and probably your voice will go in some sort of a time capsule that somebody will open up a hundred years from now. But we welcome all of your input.

And let me also note that we have published a questionnaire that is on our web page, which is on the Securities and Exchange Commission web page, and we are looking again for additional input in written form. I notice I got a stack about that much last night, so people are already responding. And we look forward to all of those.

So with that very, very brief introduction I'd like to introduce Jim Thyen, my Co-Chair, and then everyone in the room around the round table can introduce themselves.

Housekeeping item. Please will all persons state their names prior to speaking because the webcast can't pick out who we are without that.

MR. THYEN: Good afternoon. I'm Jim Thyen, President and CEO of Kimball International.

MS. DOLAN: Good afternoon. I'm Janet Dolan, President and CEO of Tennant Company.

MR. DENNIS: Hello, my name is Leroy Dennis. I'm executive partner of McGladrey & Pullen, CPA firm.

MS. CAFFERTY: Hello, I'm Pastora San Juan Cafferty, I'm a professor at the University of Chicago.

MR. CLOUTIER: Hi, I'm Rusty Cloutier, president of Midsouth Bank Corp. in Lafayette, Louisiana.

MR. JANKOWSKI: Hello, I'm Jess Jankowski, I'm the CFO of Nanophase Technologies in Romeoville, Illinois.

MR. PERKINS: I'm Don Perkins, Chairman of that Board and I brought Jess with me because he's my brains.

MR. ROBOTTI: Hi, I'm Bob Robotti, President of Robotti and Company in New York.

MR. JENSEN: I'm Mark Jensen, a partner at Deloitte &

Touche.

MR. BOCHNOWSKI: I'm David Bochnowski, Chairman and CEO of NorthWest Indiana Bancorp.

MR. SPEARS: I'm Mark Spears, CFO at LKQ Corporation.

MR. SCHROEDER: Good afternoon. I'm Mark Schroeder, President and CEO of German American Bancorp.

MR. DAVERN: Alex Davern, Chief Financial Officer at National Instruments.

MR. GOELZER: My name is Dan Goelzer, I'm a member of the Public Accounting Oversight Board.

MR. HERSTEIN: Jack Herstein, with the Nebraska Department of Banking and Finance.

MR. SCHACHT: I'm Kurt Schacht, with the CFA Center for Financial Marketing Integrity in New York.

MR. LEISNER: Richie Leisner, I'm a lawyer in Tampa, Florida with the Trenam-Kemker firm.

MR. BROUNSTEIN: I'm Rick Brounstein, I'm the Executive Vice President and Chief Financial Officer of Calypte Biomedical.

MS. LAMBERT: I'm Debbie Lambert, I'm a partner with Johnson Lambert and Company, a CPA firm.

MR. CONNOLLY: I'm Drew Connolly, principal of IBA

Capital Funding and Executive Director of the CEO Council.

MR. COOLIDGE: Dave Coolidge, Vice Chairman of William Blair and Company, investment bankers.

MR. JAFFEE: Dick Jaffee, Chairman of the Board of the Oil-Dry Corporation of America.

MR. WANDER: Thank you all for introducing yourselves and for attending today. We have scheduled the first panel of witnesses for two hours, and what we have been doing in the past we'd like to continue to do and that is give each an opportunity to make opening remarks and presentations, and then the members of the Advisory Committee will ask you appropriate questions. So why don't you make your introductory statement. Give us a little of your background, I think would also help for those here in attendance and for those listening on the webcast.

And I guess, Mark, we could start with you since you're on the left.

MR. SCHROEDER: Thank you. Again, I'm Mark Schroeder, President and CEO of German American Bankcorp located in Jasper, Indiana. And I do thank the Committee for the privilege of being allowed to speak here today. I suspect my invitation was somewhat because I was -- Mr. Thyen and I are two public companies in the same small town, and I was pleased when Jim was named Co-Chair and called him to vent a little bit on Sarbanes-Oxley, hence have this opportunity today so I'm glad to be here.

German American Bankcorp was formed in 1983. We are a bit unique in the community banking corp. We are a multi-bank holding company. We have five small community banks as part of our group. We were formed for the express purpose of giving the small bank shareholders an opportunity and a vehicle to band together to operate in a more efficient manner. And part of that was listing our stock on NASDAQ in 1993. Today we have about 3200 registered shareholder and a 150 million dollar market cap. Clearly our company is in that microcap area and understands the pains of compliance with Sarbanes-Oxley. Let me talk about three or four things. I have filed a written statement, and so for those of you that want to see a little bit more background in detail, certainly it is there and available for you. But I understand that I was looking forward today from people like me who are testifying is what issues, what are the most pressing issues that smaller public companies, in our case very small public companies are dealing with. And does the cost of compliance with Sarbanes-Oxley, is there a cost benefit in the relationship.

At German American Bankcorp clearly we believe given our shareholder base and given the cost which was about $850,000 for us in 2004. And given the fact that we are in a regulated industry that has historically had a very good track record in terms of internal controls. Our company I'm proud to say likewise has had a very good record of internal controls.

The extra layering of the regulatory burden and the cost of that regulatory burden has not had a significant benefit for our shareholders. And to that extent at the most recent shareholder meeting I discussed that with the shareholders. And I can tell you that our shareholders, every one that I have spoken to, part of the reason they bought our stock initially was because they know us, they can touch us, they can feel us, and they can assess management. Part of it we are in a regulated industry and they know that we have those internal controls. They likewise don't see a lot of increased benefit in Sarbanes-Oxley.

But what I would like to focus on really four areas in answering which of, as a CEO of a small public company, what are the four areas that probably have created the most difficulty for us and what is our recommendation as to what the SEC and the PCAOB could do in terms of helping us work through those issues. Those four issues are: the lack of external auditor guidance because of the new regulations; the scope 404 compliance, both in documentation and assessment; the frequency of the internal control certification and attestation process; and last being the banking industry, and something I'm sure you've heard from others in the banking industry, duplication of federal agency regulatory oversight by multiple government agencies.

Let me start with the external auditor guidance and also kind of splash over into this scope with the 404 compliance. With due respect to all of the audit firms represented here, I think the fundamental issue in both of these cases is that our audit firms have become paranoid, rightfully so, I might add, but they've became paranoid in terms of -- as a small company we have historically outsourced to our attorneys and our accountants those technical parts of whether it's regulatory, accounting, legal issues. Our external auditor has always been an important part of that group, an important part to make certain our SEC filings are complete and they were accurate.

In today's world where every auditor I think believes in every conversation with every audit client they're putting their firm at risk, they're no longer willing to provide that guidance. And I do understand that the PCAOB has issued a statement basically saying to the audit firms you perhaps have gone bit too far here, you can provide some guidance and some direction in this more than you have in the past. But yet I have acquaintances in the accounting industry that have told me that that's a bit of a mixed signal, because that may be what they're hearing but when they have field examiners come in to do their firm audit they're hearing something else.

Along those same lines, the scope of 404. Going through the first year of 404 in terms of documentation and in terms of testing the internal control systems, again being in the banking industry we have never had a major issue. We have never had any type of restatement issues. The federal banking examiners have scrutinized our internal control system time after time, both in financial reporting and operating controls, no major issues. But yet when we go through this process, the level of depth that we had to go to, the level of documentation that we had to do was very, very burdensome, and quite honestly to some extent almost unbelievable.

Made a comment to some of the other people when we were talking earlier, that as part of this process our management team, myself, CFO, the internal auditor, and with our external auditor there as an observer, early in the process looking through our internal control system. In one day we added additional layers of checks and balances that as I was leaving the meeting I told the group my fear is that we have put things in place that will continue to give us an excess overhead burden much beyond what we need, well beyond the time I'm no longer with this company.

And again I think that and the guidance situation is driven because our audit firms, not just our audit firm, but all audit firms are somewhat paranoid and rightfully so. The SEC and the PCAOB needs to go further in providing very clear guidelines for audit firms as to what they can do and what they can't do. I would also suggest that in order to have those firms again become an asset to help the companies comply with their SEC reporting there needs to be some type of limitation on what their penalty is, if they would make an inadvertent error. Right now, in our small firm, our auditor firm I firmly believe feels very strongly that a mistake that they would make in our case has the same level of severity as if they were auditing Enron.

There has to be some type of proportionality in the issue. And one of the ways to do that would be to take some multiple of the fees that they receive from us and at least set a ceiling on, okay, if you make an inadvertent error as auditor on German American Bankcorp, yes, it's going to hurt you, yes you are going to be fined, but the fine is not going to be the, your entire firm at risk. It's going to be some proportionality of the fees that you earned from that client. That would be my recommendation.

The other two items that I want to talk to, and this one in particular, I think affects not only those of us in banking but it affects every small company. As a small company our internal control systems and risks don't change dramatically from year to year. If we have a good internal control system in place and we go through 404 compliance, we go through the documentation, we go through the testing, we go through the attestation process and get a clean opinion, one of things that the SEC can do that would greatly help smaller firms in covering the overhead cost or the regulatory burden, is don't ask us to do that process from scratch every year. Being in the banking industry, coming from the bias of the risk-based approach that federal banking regulators and examiners routinely take. Under that risk-based approach for smaller banks, they come in and do an audit, an exam, and it's clean, they won't be back for an extended period of time. On the other hand, if they come in and they find things that aren't the way that they should be, they accelerate that process.

The frequency of the certification process 404 and the attestation process and the documentation process, my recommendation would be for those smaller public companies that have a clean opinion from auditors on their internal control system, go to a three year cycle. Instead of a quarterly certification by the CEO and CFO, for those low risk smaller public companies go to an annual certification. Should as part of the three year cycle on the attestation, a smaller public company does not receive a clean opinion, then go back to annual attestation and quarterly certifications until they again have a low risk profile and clean opinions.

For our company, because we do out-source so much the process that we go through, we're faced with one of two challenges. If we stay on an annual cycle, one, we can gear up our staff certainly, to do this on an annual basis. But our costs, that $850,000 that I mentioned that we spend both external about $600,000 external costs and about $250,000 internal cost that we spent in 2004, we expect will drop but only moderately to about $600,000 this year.

As a small company $600,000 dollars is not an annual expense that we can readily absorb year in and year out. If, however, it was a once every three year cycle, we could marshal our resources, and on that every third year process we could effectively manage the process that way. But if in fact we have to retain it on an annual basis, there's no way that we can reallocate resources and manage that cost on a cost effective basis. So I would ask that the SEC consider a risk-based approach to the frequency and also the level of scope that we have to go through and our external auditors have to go through.

The fourth and final item that I would like to mention is the duplication of federal agency oversight. Again, I think this is perhaps I think somewhat unique in the banking industry, but talking with Mr. Jaffee before the session I understand that sometimes you have banking regulators and sometimes you have environmental issues that you're dealing with.

But let me give you a good example. German American Bancorp, as I mentioned, is a bank holding company. We have five small community banks as part of our group. Every quarter we issue to the FDIC, who is our primary federal banking regulator, five call reports. At the federal reserve level we issue a parent company only financials, we issue consolidated financials, and we have a second to your holding company so we issue financials on those. That's on top of our 10-Q and our certification process that we go through there. We certify to the FDIC, we certify to the Federal Reserve, and we certify to the SEC. And all of that information is publicly available. It's all available on the Internet. There has to be some method by which, for smaller banking companies there can be some method of which rather than duplicate filings we could file with one federal agency instead of three federal agencies.

Again, I thank you for the opportunity to speak today. As a small public company this is critically important to our company and to our shareholders. With 3200 registered shareholders and with the commitment we made to our shareholders to give them the liquidity of traded securities we have, don't have the option of going dark and bringing our number back under that level to go dark. We're in this for the long haul, and in some manner or fashion our only choice is find a way to comply cost effectively or partner with someone through a merger transaction to who has that economies of scale.

And I guess my comment there would be I think clearly that Representative Oxley and Senator Sarbanes surely did not have the intent when this law was passed to take small microcap companies, community folks such as German American, and put them in a position where eventually that's the decision. Not that the cost of Sarbanes-Oxley in and of itself would be the issue that would have to drive our company to have to consider that type of sale or merger transaction, but it's one more layer of regulatory burden on top of an another layer on top another layer that eventually comes to that situation. Thank you.

MR. WANDER: Thank you. I'll just start off with hopefully a simple question. What was your net income last year?

MR. SCHROEDER: Net income last year, bit of a down year, right at 6 million dollars.

MR. WANDER: Are there any other -- yes, Janet.

MS. DOLAN: Thank you very much for your testimony, Mr. Schroeder.

MR. SCHROEDER: Thank you.

MS. DOLAN: One of the schools of thought with regard to the cost of Sarbanes-Oxley is that it was a big cost the first year because most companies didn't have processes and they didn't document it so they had a lot of work to do. You come from a different environment because you already had at least two levels of scrutiny of your processes, so I'm just curious if you could give us a little more detail on why it ended up costing you so much. And I have a couple -- is it that the 404 went into controls that the other two agencies didn't and therefore you had to do some new documentation, or is it that they went into a lot of the same controls but they went to the nth degree much deeper? I'm just curious first of all what caused the additional effort and the additional external costs.

MR. SCHROEDER: The additional costs was really related to two primary areas. First of all we've had a very effective internal control system. That internal control system has been tested by the federal banking regulators, but it has not -- we did not have the level of documentation of that control. We've got policies, we've got procedures, but not necessarily to the nth degree on the documentation side. And secondly, the cost of testing that system.

The level at which we needed to test the scope of that testing, and I've heard this from banking acquaintances throughout the Midwest, from various auditors, so it's not just our audit firm that's an issue, but very much detailed documentation followed by detailed testing. Additionally, because we have outsourced so much of our audit work in the past, we've managed the process with our own personnel but tended to out-source the testing, we didn't have the resources internally to gear up for this. So we did have to contract with our -- another audit firm, other than our external audit firm obviously, to do a good deal of that testing.

MS. DOLAN: Follow-up question. One of the concerns that we're hearing a lot in testimony from a lot of issuers, is that the outside auditors could not or would not rely on any of the internal testing and work that was done. That would be particularly interesting for me when you are a regulated issuer. Was there any opportunity for the external auditors who were doing the 404 audit to rely on some of the work of the FDIC or the state banking work that was done, or did you feel that there was real duplication of effort?

MR. SCHROEDER: There was no reliance on that work that was done from the banking agencies. Clearly they did look at what our own internal management testing was done, but no, which was not even considered.

MS. DOLAN: Then my last part of this question is: You know none of us wants to reinvent the wheel, so we've had some suggestion that we should look at other industries and maybe get some better practices from them. Is there anything you can tell us about the way the FDIC regulates you that you would say look, they have a better risk approach than at least the current 404 audit implementation as it's currently implemented, or anything else that they do that you say why don't you look at this, it might be helpful in terms of trying to bring a -- more of a risk-based approach to 404?

MR. SCHROEDER: Clearly the whole approach from a federal banking regulatory perspective is risk-based, they do monitor the risk profile from the quarterly reports that we file and also come on-site. But the risk-based approach in terms of scope, for example, they will come in when, they looked at our loan portfolio from an asset quality perspective and our credits. They know that's where the risk is. And the whole approach of the banking regulators take, nothing I guess is going that I could state specifically, but the whole approach is a risk-based approach. The other piece of this they also recognize that there is a difference from small banks and large banks. Very large banking organizations, they have federal regulators on-site every day of the year as part of the process.

For us as a small banking operation we may have regulators in-house once every eighteen months, once every three years under certain circumstances. So they recognize the complexity, which is another item that the federal reserve looks at and what the other banking regulators, and they look at our organization and say is this a complex organization? Do they have a lot of activities that are unusual for organizations of this size and adjust then their review based on complex non-complex, large versus small, and what's the quality of their systems and the quality of their management.

MS. DOLAN: Okay. Thank you.

MR. WANDER: Leroy?

MR. DENNIS: Leroy Dennis. Thank you. Mark, Leroy Dennis. I chair the subcommittee for the accounting, so I'm interested in your comment about the relationship with the auditors. And I really have two questions for you. One, is have you seen any difference in the relationship with your auditors since the guidance issued by the PCAOB? And secondly, you mentioned that there should be some recommendations or some guidance -- some further guidance issued by the SEC. Have you had any thoughts about what that relationship should be, what kind of recommendations you would make?

MR. SCHROEDER: I think we have seen some willingness -- to some level of willingness to engage in a discussion with management on certain accounting issues not from just a guidance and advice perspective. Still I think a fearful participation, but somewhat of a participation. Prior to that literally on our tax side of the house is the one example I can think of, not only did our external auditors tell us we can't help you with that, but don't ask you us because if you do, that in and of itself is admission that you may have an internal control weakness in that area. So I think in terms of what level of guidance and assistance can they give us, and I then I think tax is a good example.

Being a small company we don't have resident tax experts. We have people that do a good job for us. Our CFO has some people that work for him that do an exceptionally good job. But we have to rely on outside advice and counsel for our tax filings, for tax footnote of our financials flows off of that. And we're not asking -- we understand the external auditors can't do the work, but they can certainly point us in the right direction so that we can do the work. And I think that the clarity which the SEC needs to provide to these audit firms is where is that line? Because now it's a gray and murky area. So when in doubt as an audit firm they take the safe route and do nothing.

MR. WANDER: Did you have any further questions, Leroy?

MR. DENNIS: No, not at this time.

MR. JAFFEE: Thank you, Mark. I thought your testimony was very interesting. I've got two questions -- I'm sorry. Dick Jaffee. I thought your testimony was very interesting and right to the point. I've got two questions, and I'll probably ask this to everybody who talks about 404. We're able to identify, and there have been a lot of survey data, we've read a lot of it, about increased audit fees and costs of compliance with 404. Have you been able to, and I'm sure this would be anecdotal or episodic, identify in your own organization other costs, let's say lost opportunity costs that you think are excessive for people focused on this as opposed to focused on your business?

MR. SCHROEDER: We have not tried to quantify that component of it. We will tell you some of this again was because of the late start because of lack of clarity of direction as to where we go on 404, but I can tell you during the month of this year, during November and most of December, our entire staff was focused on 404 compliance. We were not calling any customers, our lending people weren't focusing on that because my instructions to them were we can't afford to fail on this, all hands on deck. And that will get better, obviously, in future years. But no we've not -- we've done a rough quantification, but when I talked to $850,000, $250,000 in total costs, that's our accounting people, our auditing people, some of our management people, but it's not necessarily throughout the organization where it was during November and December it was our entire focus, and thankfully we did come out with a clean opinion.

MR. JAFFEE: The other question I have is, do you see any benefit from 404? Can you identify anything when you say, "I'm glad we did"?

MR. SCHROEDER: Corporate governance. There are some governance issues in terms of independence of directors, but as a banking company we've always focused on independence of directors. Code of business conduct. There's nothing in our code of business conduct that wasn't our standard approach, but we have put it in written form, our employees understand it, the whistleblower features that we've now put in place that was relative to the corporate -- so the corporate governance piece of it I think certainly had some very good attributes in it.

In banking it was a matter of perhaps documents, what was already in place. But that has been very good. 404, as much as I hate to say it before this group, I can see -- for our shareholders I can see absolutely no quantifiable value that came from the 404 process.

MR. JAFFEE: Thank you.

MR. WANDER: Kurt?

MR. SCHACHT: I'm Kurt Schacht. Thank you for your testimony. I want to ask you about auditor's paranoia, because I'm from New York and everybody is paranoid in New York. So when you say auditors are paranoid and rightfully so, and then I think you said that inadvertent mistakes have Enron consequences. I'm not sure what you mean by that, whether you have any basis for that?

MR. SCHROEDER: Kurt, probably more of a feel. The feel that I have in working with our auditors is that, as I said during my initial comments, that it seems that in every conversation with us there is an underlying concern that if they cross some line, will they cross over and they are advising and counseling and helping management rather than auditing the process that they are at risk in an upcoming review that, by the PCAOB, that their firm would be criticized for that process. I think it has something to do with if I'm the partner in charge of that audit, particularly because we're the "second tier" firm, I don't want to be the partner whose audit client resulted in that happening. And from the firm's prospective, I think that there's a fear in every conversation if they cross that line, they're putting their whole firm at risk. That's just my perception of the process.

MR. SCHACHT: Do you expect your costs to go down this second cycle?

MR. SCHROEDER: They will go down some. We had, as I said, about $600,000 in hard dollar costs the first cycle, but hard dollar costs will only drop to $400,000 in the second cycle. If there is a third cycle, which unfortunately there probably will be, we expect further reduction, but probably not a significant reduction at this point. We have factored in and said this is going to be a half a million dollar a year cost for us between internal and external or dollar costs as the law is now interpreted and applied. And we will do -- as a small company I will tell you that we scrounge very hard for $50,000 or $100,000 dollars, and a half a million dollars is real money from our shareholders' perspective.

MR. WANDER: Yes, sure.

MR. CONNOLLY: Actually I was born in New York too and I'm always paranoid. Drew Connolly. Coming at from that half million dollar cost and really quantifying that in terms of what it means to your stock and therefore to your

investors is what I'm interested in. What kind of
price/earnings multiple is your stock trading for?

MR. SCHROEDER: We're trading currently for, on a
run rate, about 14, on a trailing twelve months about 20.

MR. CONNOLLY: So splitting the difference, and say
at 16, on a half a million dollars.

MR. SCHROEDER: About a half a million dollars, or
about five cents a share.

MR. CONNOLLY: So you're taking eighty cents of
share worth of market value away from your equity at 16 P/E
at a nickel cost that would otherwise go the other way -- what's your stock
going for,
sir?

MR. SCHROEDER: Stocks selling at about 14 dollars
per share.

MR. CONNOLLY: So somewhere near a dollar hit to
earnings is what that true cost of that audit looks like, if
it's a half million dollars, and a 16 P/E.

MR. SCHROEDER: Multiplied by on a price
perspective.

MR. CONNOLLY: So, in effect a dollar a share --
and how many shares outstanding, just as an example?

MR. SCHROEDER: Just under eleven million.

MR. CONNOLLY: So eleven million dollars has disappeared out of your investors' wealth, whether it's a real number or non-real number because of that half million dollar annualized cost.

MR. SCHROEDER: Yes, I think that's fair.

MR. CONNOLLY: Thank you.

MR. WANDER: Rusty?

MR. CLOUTIER: Mark, great testimony. I will admit that Mark and I are very dear friends. Jim knows that I knew his predecessor George very well and Helen.

I wanted to ask you a couple of questions just to kind of clarify a little bit. We had a very unique period. On June 30th you closed your quarter end, and I would assume that as every bank in America on July the 30th you filed your call reports, because there is not any leeway in filing that call report. I think you would agree and I know Dave would agree -- we have two bankers on the panel -- that it's not up to you to actually extension on a call report, you file it. You have not filed your 10-Q yet because I would imagine it's not filed yet. It is --

MR. SCHROEDER: We actually did file our 10-Q a couple days ago.

MR. CLOUTIER: Okay. So you have filed it. But you didn't have to file it. You could still be in a period of waiting. My question to you is: Do you understand, and do you think all your fellow bankers understand, that when you file your call report, that if you've made any mistakes you have a very serious problem and that the OCC or the FDIC or the Fed has all the powers it needs to take you out of office as quickly as they care to at German American as President of the bank?

MR. SCHROEDER: It's been that way for many, many years, certainly my whole banking career. And yes, I think certainly CEO's -- bank CEO's clearly understand when that when they sign a certification on call report, they are putting their -- certainly their reputation and their career, and in some cases, it would be blatant, their very freedom at risk. We've always had it that way on the banking side.

MR. CLOUTIER: So once you sign the call report, you have attested that all your financial information is correct. And the fact of the matter is, and I don't mean to make light of this, but when you sign your 10-Q, it's kind of an after event -- you've already been over your books and already asked all the important questions and make sure those call reports were right when you signed them. Would that be a correct statement?

MR. SCHROEDER: That's correct.

MR. CLOUTIER: Let me switch to another area which I think is very interesting. You stated that you were very concerned about the cost of the people you were having to hire to continue to meet all these requirements, and that it was taking away quite a bit from your company. Is it a fair statement that you maybe as a president and CEO have spent more time worrying about Sarbanes-Oxley and putting new people in to check the checkers, as we like to say sometimes, than you have maybe on hiring loan officers and try to grow your business and grow the economy in the areas you serve?

MR. SCHROEDER: Certainly that was the case in 2004, which was the first year of implementation, admittedly, but yes.

MR. CLOUTIER: Mark, last question. You and Jim know each other, both from the same hometown, both from somewhat of the Midwest. As you know, there's a lot of concerns about the Midwest economically, and I was very concerned in your comment that if there's not some relief coming, German American Bankcorp may have to consider selling itself as one of the opportunity to a larger company.

Would it not be that if that came about, other bank holding companies in the Midwest in Iowa, Nebraska, in other parts of the country, in Illinois, where there's more community banks than anywhere except in the state of Texas, all reach the same conclusion that it is not good for rural America that there is much loan considerations from you being there than there is from one of the major, and forgive me to my good friends in New York, one of the major New York city banks, running a branch in your hometown?

MR. SCHROEDER: Rusty, you're -- obviously those in community banking, as you are, understand well that one of the attributes of community banking is that we recycle funds in our own community. That deposits are made from our community and the loans are made back into our community. One of the strengths of this small town that Jim and I are from is that with a strong German heritage our ancestors invested in local companies. And there is a lot of wealth in our community because the dollar stayed there and the profits that were made stayed there. That's what makes community banking work. And if small community banks, public company community banks, wither up and go away, there will be a detrimental impact on rural America and the communities that they serve.

MR. CLOUTIER: Thank you very much.

MR. WANDER: I think we ought to move on unless there's some other questions.

Mark, why don't -- since you're sitting next to the person, proceed.

MR. SPEARS: My name is Mark Spears. I'm the CFO of LKQ Corporation, and I will take a second to tell you what that is. We are in the recycled after market parts business. We sell to mechanical repair shops, and deliver parts that are to be recycled, automobile parts or after market parts, which is basically engineering type parts. The company was founded in 1998. We went public in the fourth quarter of 2003. At the time we had a little over three hundred million dollars in revenue, about three hundred million in market cap after we went public. Today we're a little over six hundred million market cap and just a little bit over five hundred million dollars in revenue. So we've had a pretty good growth trajectory there, really from day one.

We're considered within the small business range that I believe this Committee is looking at. We may be close to getting over that in the near future. But I thought it would be worth kind of hearing about some of the pains we went through in 2004. As I said, we went public in the fourth quarter of 2003. This 404 compliance testing that we jumped into right away. You know, as probably everybody, we feel like we were lucky. We spent 1.2 million dollars despite having fee estimates of only six hundred thousand dollars, we felt lucky it almost doubled, from what everybody thought it was going to be including the people we hired to help us do that.

While we sound like a concise company, we don't -- our big thing is being a low cost provider of parts to help insurance companies save money. So we are a low cost provider and structured ourselves that way to stay that way to stay competitive. So we don't have a big corporate office, probably 25 people at the time in our corporate office and has all the disciplines from marketing to accounting to computer systems.

So as we went forward in the 2004 process of 404, we weren't really ready to -- we weren't expecting what would -- what really hit us there. We were not planning to use inside resources, we did not have an internal audit group at the time. Our plan was to get one at some point. We didn't have extra financial force sitting around. We were all working 40 hours a week. So we did use an outside firm to come in to do our management consultants, do a lot of our legwork, a lot of interviewing of people to do the documentation that the outside auditors wanted. And like I said all that was about 1.2 million dollars. Just for 404, not the fees to do the basic auditing.

I guess the biggest thing I wanted to leave with the Committee was what surprised me a lot was how much time is spent -- there's two levels testing, entity level controls, the higher level, general and financial reporting controls and the transaction controls. And I wasn't really surprised at the level of what's being done on those general financial reporting controls, the whole thing about policies, communications down in the organization, someone has a problem how do they report that up the chain of command, something they shouldn't be doing, accounting, who do they talk to about the ethics, those types of policies. You know, I think the governance -- I know you mentioned governance earlier, but that to me made a lot of sense since as we went through that.

We felt we were pretty well prepared for that. What was very surprising the amounts of time and money spent on what I would call the transaction controls especially for a company like us which we still consider a small business, and certainly would be considered a small cap for a long time on the transaction controls. You know, I think all businesses, including small businesses, feel like just to stay in business you have to have some good controls. You have to obviously collect your receivables. You obviously have to manage your billings to your customers, otherwise you really are not going to be in business very long. And we felt like we had really good controls.

The amount of time spent going through and documenting and testing and reviewing different locations throughout our company. We have over 50 locations. Our people really, you know, after an account's thirty days past due are they calling that customer, and are they then sending a letter out, even though it was in our procedures. And I've worked with larger companies and smaller companies before in my past history. And it kind of hit home, but especially a smaller business senior management is a lot closer to what's going on out there than perhaps a larger business; there's less layers between senior management and the field offices. Because of that I believe senior management spends more time with people out on the line making the sales, using the revenue, incurring the expenses, and it just came across as a lot of waste of resources, testing things that just didn't seem to matter because they're already in place, they have to be in place for a business to operate.

Maybe there's some things I'm over exaggerating on, that have to be looked at, but I know the Committee's looking at -- I don't believe you're looking at exempting completely from 404 small companies, but maybe every few years coming back and looking at things. You know, I feel like the governance, the ethics, the general financial controls are important for a public company. I think it helped us, actually, making the point of how serious this is being a public company, and how all the employees have a responsibility if they see something that's not right, to report that up. But I just felt like, and I would say out of the 1.2 million dollars, probably less than a third of the effort was doing those higher level controls.

I'm not saying we should have done more, it was more than adequate to cover those. Where maybe the other two thirds was running around looking for receivable collection after its billing and things like that, that really a small business probably has a pretty good handle on just because the management team is out there. It doesn't have a lot of room to make mistakes when you're a small business. You have to manage your cash and your earnings as well to make sure you're making money from your products.

I think I guess maybe on that section I'm just not aware of a lot of big company failures that happened because of errors in the transaction controls. You know, most of them seem to take place at the higher levels in the corporate offices and some of the ethics and the controls in place.

A lot of attention has been made about gee, the auditor just did too much. I'm sure we all probably did too much that first year trying to understand, you know, how much work is needed, et cetera, but I know the auditors are asked to do an internal control opinion on the whole company and just -- you know, way back in my prior career I was an auditor too in public accounting, I was a CPA. And when you're signing your line there, there's a sense of being overly cautious. So I don't know if just telling the auditors to stop doing as much stuff is going to get anywhere. I think we have to really look at what kind of reports we want from them is a way to break that report up and maybe have different types of reports between size and company, small business versus large businesses. That's all I've got for this Committee. Thank you.

MR. WANDER: This is Herb Wander. Mark, could you -- you started to do that, give us a little of your background.

MR. SPEARS: Started with LKQ in 1999 as the chief financial officer. That's the first position I had as a financial officer. Prior to that at several companies I had been a chief accounting officer, with three different legal entities, three different public companies, and prior to that I spent about nine years in public accounting.

MR. WANDER: Have you estimated what you think your 404 cost will be this year?

MR. SPEARS: We think our external cost, which was about 1.2 million for '04, will probably be somewhere between eight or nine hundred thousand. And it's a little misleading because we have gone out and hired a director of internal audit, to kind of bring down some of that cost as well, so offsetting his salary and his benefits. And over time we'll bring in one or two auditors to work beneath him to try to reduce the fees that we're paying to an outside consultant.

MR. WANDER: Questions from the Advisory Committee?

MR. THYEN: Mark, this is Jim Thyen. Could you talk a little bit about how Sarbanes has changed your decision making process in the company, if it has, and maybe in terms of disclosure, governance, and oversight on how you make your decisions. Maybe to preface that to get a little context, tell us a little bit about who your customers are and how you serve your customers to provide value and then relate that back to decision making process changes. Thank you.

MR. SPEARS: Our direct customers who we sell to and collect receivables from would be repair shops, collision repair shops. If you have an accident and you car needs to be fixed that's who we sell our parts to. However, the person that pays that job is an insurance company, Allstate, State Farm, companies like that. So we really feel as our customer both those people, because insurance companies have very heavy influence on how the car is going to be repaired. I know -- I can't say that Sarbanes 404 has come in and made us do a lot of different things differently with our customers. We are -- we have put in more systems, we're looking for more systems to audit, to get better controls over that, but from a customer standpoint I can't -- I really don't see an impact of 404 on that.

MR. THYEN: Talk a little bit about your competitors and who they are. And if you had the decision to make again, would you go public?

MR. SPEARS: Our competitors -- is really anybody else that sells auto parts, and that includes the OEM Manufacturers, General Motors, Ford, those types, along with a lot of smaller competitors that sell recycled parts. There's six thousand automobile dismantlers out there in the

United States, fairly small companies that buy cars, wrecked cars, take them apart and then recycle certain of the auto parts from that. We also compete with bigger after market companies than us, that would be engineering from generic type parts, like if you need a fender, the insurance company -- if your car was old enough, it wouldn't get a General Motors fender, it would get a new fender made by another company, we call it a generic type part.

As far as going public, I think we still would have gone public even with 404. Would we have done it just a few months before 404 was effective? Maybe not. It was a lot of cost and planning that out a little better I think I would have at least tried to convince the board to maybe delay that another year. It was a lot to have your IPO and then immediately get thrown into that, and at the same time you're in a whole new area where you're dealing with the institutional investors, mutual funds, auditors that -- I think they audited with the same on the financial statements but charged a whole lot more. There's a whole different risk environment when you're public.

So that's probably -- I think we would have gone public, we wanted to for a lot of reasons. We felt like it was not just to raise capital, but it was needed to really be taken more seriously by the Allstates and State Farm companies where our financial is much more transparent than if we were privately held.

MR. THYEN: Thank you.

MR. WANDER: Janet?

MS. DOLAN: Mark, thank you for your testimony. You're in a very unique position having been an auditor and now being on the inside as a CFO and gone through a 404 audit. I would like to ask you there seems to be a lot of wide-based consensus that we either have already a risk-based approach but it just isn't yet working its way down to the front lines as the framework that is being used, or we should at least get to one. And you mentioned entity controls but you also mentioned high level financial controls.

When you look at the way the auditor approached your audit, could you have designed a risk-based approach? Could you and the auditors have actually sat down and developed what you would consider a risk-based approach? It seems that everybody wants to do that but nobody wants to take the first step and figure out how to go about doing that. So you've been on both sides of the aisle -- well first of all, do you think that the auditors used a very good risk-based approach? And if not, could they have and how would you and the auditors have been able to get there?

MR. SPEARS: In our approach through '04 by the auditors, and by the consultant we hired as well, was more of a shotgun approach. It was kind of like let's hit everything. And even as the designing approach and going through the process, one of the things -- both the firm we hired and the auditors, I just don't want to dump on the auditors there, is another auditor firm we hired to be our consultant. But as the rules keep changing, we're trying to come up with where we're going to end up here.

It was like -- I mean it was almost comical except we were spending money so it wasn't, and it felt like -- in all fairness a lot was because it involved the first year. Everybody was doing it everywhere. Resources were short. Even the firm we hired had a hard time getting all the resources they needed. Everybody was doing it all at once with the calendar year ends. It was not -- it did not look very risk-based, you know, approach to me. I felt it could have been more risk side. But again, it was something new to us because it was an audit of internal controls, it was not an audit of financial statements. I think when they audit financial statements it is very risk oriented. The inventory, that's our largest asset, that's where they spend their time where the higher risk is on the financial statements.

MS. DOLAN: Just one follow up. Have you had any -- sat down with your auditors and done any kind of scoping out of year two audit? Can you tell yet whether post-May release from the PCAOB you're going to have any more risk-based approach?

MR. SPEARS: We talked about it more. I haven't seen any new programs so to speak. Probably more of our discussions have been on the side of the consultant we continue using and scaling it down and focus, as you said, on some of the bigger issues, using him there trying to cut back on the fees.

We had a discussion with our auditors shortly after I believe the SEC and the Oversight Board issued earlier in the year where they felt like the auditors have done too much and they were pretty open to sit down and talk. So I have -- I know -- I don't want to give the impression that I feel like our auditors ran out and tried to turn up the fees to maximize their profit. I don't think that was the case at all. Actually we sat down and had discussions. But in all honesty I think they were missing some things and have to cover everything. It was just a fear there of this new -- of this opinion they're about to give on internal controls that they really just had to cover all the bases.

MR. WANDER: Leroy?

MR. DENNIS: Mark, thank you. I have a couple of questions for you. You mentioned that we need to define what kind of report that we want the auditors to give on internal control. Are you proposing that that be different from say large companies?

MR. SPEARS: I think for about probably about a third of the cost, maybe 80 percent of the benefit if there was a way to -- and I haven't been out of auditing for a long time so I'm the not sure of the opinions firms can give anymore. But if you can give an opinion, what I would call the general entity control and the financial reporting controls, that would go a long way in really covering the major risk.

Personally I feel that way with larger companies too, but on a small based and the added value, it's given in control on the entire transaction flows of a company and transaction controls, there's some -- I don't want to say there's no value in that. There's some value there. There's probably a little less value for a smaller company than a bigger company, because how close management is to what's going on in small business. Management travels all the time out there in the face of the small business, they just don't have the layers between them.

MR. DENNIS: Could you also address Mr. Schroeder's comments about his relationship with the auditors and the -- whether you experienced the same thing as far as being able to go to your auditors for help and if that changed in May when the guidance got issued?

MR. SPEARS: I haven't really seen a change there. I know over the last two years the auditors have been so much -- management hasn't decided these things in the audit. We still do use our auditors for our tax work. That's about it. Our audit committee chairman really doesn't want to use them for certain due diligence items and acquisitions, so we pretty much split that. But when it comes to certain accounting issues, I kind of feel like they know a lot about us and they're probably the best ones that can provide certain accounting guidance. We're a little lucky because we have a chief accounting officer that's very knowledgeable and my prior experience as an accounting controller rather than a CFO, so it's kind of nice to have the two of us talk back and forth internally. A lot of small businesses they don't have that. They have one chief financial officer that's fairly skilled and his insight is talking to his auditors. To try to get another accounting firm to get opinions from accountants for certain complex transactions and then run that by the auditors, that's going to be pretty costly for a small business.

MR. WANDER: Alex?

MR. DAVERN: Yes, Alex Davern. I just wanted to confirm I understood you correctly to say that the cost in year one of 1.2 million and in year 2 it adds up to about a million dollars, is that correct?

MR. SPEARS: It's going to be about eight hundred -- well, probably about nine hundred thousand dollars plus I'll be adding other things on -- basically all that's dropping is, as of now anyway, is the large consulting firm that I hired. They're dropping their --

MR. DAVERN: So about 1.2 million to 1 million roughly, is that fair?

MR. SPEARS: We expect to get to around 900,000.

MR. DAVERN: That's fine. Secondly, I wanted to probe a little bit related to where in your transactional process a lot of the work got done that had the least amount of value. I specifically want to raise in my experience, the issue of IT-type controls and if you had any rough estimate of how much of the dollars spent were spent related to IT-type controls and your view on the effectiveness of that expenditure in terms of the material accuracy of your financial statements.

MR. SPEARS: I think it was fairly effective. It probably helps that primarily, because we've done about 30 acquisitions since we founded way back in '98, but we are all on the same basic sales, billing system, that type of thing. On the same general ledger system and same financial accounting package, so that helped a lot. People that I know who are the CFO's of companies having mixed systems said it was awful, different systems, platforms. I don't have a real handle on how much of the cost was that, just kind of seemed that people involved and hearing they're doing it. It may -- or maybe 20 percent, and that's a rough estimate on my part.

MR. COOLIDGE: Dave Coolidge. Could you describe to what extent the Sarbanes-Oxley issues, 404 or whatever, have come into play in your dialogue with your investors -- institutional investors when you were doing your initial public offering? How much concern did they evidence, how much since you have completed the 404 review, et cetera, how much of a focus has that been in your dialogue, and do you think it's made any impact on your stock or your stock performance?

MR. SPEARS: Well, the biggest thing with our investors was how much cost are you spending to do this. And then of course they always want to know how much it's going to be the next year, how much lower it will be the next year to try to look at your earnings. I think very few of them, if any of them, even asked how we thought the opinion was going to come out. They were all focused on the cost, how much is it going to cost.

We very much talked about that in our 10-Q filings, our MD&A discussion, how much it cost. Basically in our MD:A discussed it was going to cost and we very much talked about that in the 10-Q filing, how much the cost. And basically, you know, I mean as discussed in our MD&A we're not looking at a big drop going into the following year. A lot of this will be continual, there will be some drop. But very little really.

Any discussions there were here about it were well, how much does this cost. And a couple of comments would come back and say gee, that's not too bad compared to some companies. They were quite attuned to this large cost.

MR. WANDER: Mark -- Pastora.

MS. CAFFERTY: Mark can go and I will follow.

MR. JENSEN: I have a short question. If you assume for a moment that the auditors had, because most of your comments were about audit firms, if auditors had less involvement or possibly no involvement with the internal control structuring of the company or the auditing and internal controls but you were still required to file 404 certifications and make management's assertion, would you be comfortable selecting that without auditor involvement, and secondly, would your board be comfortable with that, and thirdly, would your CEO be comfortable with that?

MR. SPEARS: Yes, I think all three would be comfortable with that.

MR. WANDER: What about your investors?

MR. SPEARS: That's a tough question. I don't know.

MR. WANDER: Fair answer. Pastora?

MS. CAFFERTY: We've heard a great deal about concern about companies not going public or companies going dark because of the burden of SOX, in particular 404. I was particularly curious and would like to hear you talk more about -- when you said we would have gone public anyway because of the transparency. I guess what I would like you to focus on is the benefits of the, if any, that you have seen of the increased transparency offered by 404 to public companies and reassurance to your investors.

MR. SPEARS: Yeah, I think if we had not gone public we felt to get the size we wanted to get at to grow, we were going to have to attract talent to the company, we wanted to have a good relationship with insurance companies and make them understand we were a professional company. And quite frankly, we don't use this word at LKQ, but a lot of these that we buy, you know, consider themselves junkyards, so this is not -- it's not a bank. It's not a highly professional looking animal.

So we really wanted to show that. We also wanted to attract people into management, we really felt like -- that was kind of the goal from day one when LKQ was put together. We bought 30 businesses around the country in a two year period and then we didn't buy anybody for three years we didn't go public, that was planned not to do that until we adjust to all this. But in buying those companies to make sure they bought in as part of the group and it wasn't just an acquisition it was more of a merger. About two-thirds of our proceeds was cash, one-third was stock, on average, and we were privately held.

And so at some point in time putting this group together in centralizing it you had to have an exit plan at some point for their stocks. There's a lot of reasons we felt like to be a public company wasn't just to raise capital. In the whole financial reporting side as well you get a lot of information. I guess we could have published a booklet on that if it were privately held, but it was just a whole different level when you're a public company. I think people look at you more -- we actually -- last point on that.

We actually felt like that helped to go a long way. We have actually procurement contracts with some of the OEM manufacturers -- Daimler Chrysler, BMW, Honda. They give us those cars and we dismantle them for them and sell the parts off of them. We felt like in the past, you know, they'd never do that with automobile dismantlers in a big way. It was too much trouble. It was part of the background of used cars still under warranty and you get warranty claims on them. So that was a reason we felt like as well be able to grow the way we wanted to and have relations with them and customers we need to go public.

MS. CAFFERTY: I was particularly curious because you refer to the benefit of transparency in going public with the investors but also with customers. So I guess as follow-up, I'm sure you've given some thought to this since you've given so much thought to SOX as evidenced by your testimony today. Do you see additional advantages from the increased transparency provided by SOX and the increased governance to a small and particularly recent and public company.

MR. SPEARS: I do. I'm not sure how much the 404 section does kind of carving that out at this point. You know, I think people read the 404 report and say well that's nice and maybe it makes them feel good, but if you didn't have that in there I'm just not sure that's getting us any new brownie points with insurance companies in the -- you know, the full 404. I'm not saying throw it all out. I think the governance piece does give it some benefit. I'm just not sure on all the transactional flows how much benefit we get from that.

MR. WANDER: Rusty?

MR. CLOUTIER: Mark, Rusty Cloutier. Great testimony. I really wanted to follow-up with you on having gone public fairly recently. What percentage of your shares would you say are institutionally owned?

MR. SPEARS: I would say almost all the public shares are institutionally owned.

MR. CLOUTIER: So you have very little what they call would individual shareholders. Like in the state of Louisiana, you may not have any shareholder in my state.

MR. SPEARS: I would say we have 21 million shares outstanding. You know, we probably -- we have probably about eight million or so people that sold businesses to us, larger share investors. We really don't have any retail market right now.

MR. CLOUTIER: And following up on that, did you have any research at all done on your company, anybody that is calling to the retail market to sell stock in your company currently?

MR. SPEARS: We don't.

MR. CLOUTIER: Would you assume most of the institutional investors you have in your company are pretty sophisticated investors? I mean most of these people are representing trust funds or brokerage firms or mutual funds. Would you consider most of them pretty sophisticated investors?

MR. SPEARS: Yes.

MR. CLOUTIER: Would you make the assumption that the -- Mark, sitting next to you, made the statement he asked his shareholders, and they said they would prefer to have the money and kind of not do 404, and I believe you have not had an opportunity to ask your investors that. But to follow-up on an earlier question: Do you think most of your institutional investors would say give me the return as Drew pointed out, the price to earnings ratio maybe adding a buck a share to your stock, do you think there would be any preference to that?

MR. SPEARS: If there was an exclusion where a smaller company didn't have to do anything, no governance, et cetera, at this point I think they would have some issues with that. I think some -- the ISS and some of the orientations that follow governance, you know, you'd end up with a bad report, even if you were small. That's why I feel like get some benefit of the 404 on the governance side at least. It would be awful hard to throw the whole thing out for a small business.

MR. CLOUTIER: No, I understand that. I'm not talking about the governance part. I'm talking about the other part.

MR. SPEARS: I don't think -- I think to drop the fee two thirds, if that's the right number, I think they would be pleased with that on the earnings side. It's like three percent of our net income.

MR. CLOUTIER: So of all of these institutional investors who are very sophisticated, none of them really have called you up or sat down with you and really went over your 404 report or what wanted to ask you material weaknesses or really got into any great discussion with you on any of those discussions.

MR. SPEARS: That's correct.

MR. CLOUTIER: Thank you.

MR. WANDER: Dan.

MR. GOELZER: Mark, you have kind of a unique perspective, as you comment, a new public company that was thrown into 404 quite rapidly after having become public. Do you think your perspective on the benefits and the costs would be any different if there had been a much longer phase-in period or assessment for the year or two years or three years, would any of the work that was done would have been done anyway for business reasons?

MR. SPEARS: No, we would not have gone out and rushed into the first year after being public the type of things we did. I think over time, as I say, phase in. When you're phasing something in, obviously you're more efficient in the way to do it. In some respects I think it was a waste of money in some of the things that we did. So a phase in would be much more beneficial than just jump right into it.

I still struggle with the -- we always intend to put in, but I struggle, you know, spending the money we did to go out and send a lot of people all over the place. Quite frankly a lot of people who do that for you, in '04 there wasn't real experienced people. We had people supervising them, they were high rate people, hiring people, but they weren't real experienced. So phasing in certainly would benefit small business in a big way.

MR. WANDER: Yes, Drew?

MR. CONNOLLY: Drew Connolly. Thank you once again. Very clearheaded statement. It's interesting though that the number, and I apologize to Mr. Schroeder because the one calculus we didn't do was a pre-tax and a post-tax analysis. But your million two in true cost divided over the same 21 million shares is approximately a nickel a share as well. So since this whole process is about building market share, increasing wealth, and ramping sales, you're to be congratulated on those numbers in your short life as well. I guess I'd like to know what -- in a perfect world what would you do with that million two? Would you hire more people, would you build more plant and equipment, would you make more acquisitions? And finally, with the exception of estate planning, I think you listed every possible reason to go public as motivators for you, so congratulations on that as well.

MR. SPEARS: Yeah. I mean what would we do with the capital of 1.2 million we spent? We are continuing to grow. Not only are we doing acquisitions, we are adding facilities and plants, warehouses and that type of thing. I can't sit here and honestly say we wouldn't do any of that -- we'd do it faster because we saved the 1.2 million. I realize after taxes about seven hundred and so thousand dollars. But we are supposed to be earning money for the shareholders. And in the end here these types of things should be something that benefits the shareholders, and it's taking something like a nickel away from the shareholders at some point -- at some point we'll be in a dividend mode here. We're not now, we're still in the growth mode, but we should be returning that to the shareholders and --

MR. CONNOLLY: I'm also concerned about the stake holders, the employees, the potential acquired companies, the folks who were the prior earners, and the community that your, quote, "junkyards" are in -- and by the way, the U.S.'s largest export last year was in fact scrap. Thank you for taking your portion and keeping it home. Because the reworking in the metal bending industries which we've almost in the press, you know, given that up. That's something we don't do any more. We're right here in the heartland and I'm absolutely certain that there are folks who are working for you or working for some of the companies that you're doing business with, and those are jobs that are not going to come back. So that is a concern, and certainly that is one of the implications of regulatory costs on companies such as yours.

MR. SPEARS: Correct.

MR. WANDER: Any other questions?

MR. DENNIS: Could I ask one question?

MR. WANDER: Sure.

MR. DENNIS: Leroy Dennis. Mark, thank you again. Just curious if this Committee were to make a recommendation and the SEC were to adopt it, that substantially changed the rules for 404 so that there were -- was a big difference between smaller companies and larger companies, would you see that in your growth mode that you're in of hindrance for your ability to attract the institutional investors to your company? Or -- I'd like your comment on that.

MR. SPEARS: I really don't think -- let's say there was an exemption and we did not do 404 compliance in 2004 -- I don't think we would have had any less reception from the institutions, you know. It would have probably come up when we did the IPO roadshow and we were overbooked several times over. I think we still would have had that demand in the institutions whether the 404 would hit us in '04 or down the road.

I think what we're going to do 404 there is there will be concern by institutions that you don't, like, to fail the test and have a lot of significant material weaknesses. So I think it is important when you come to that point that the management has come through controls regardless because the -- the last thing you want to do is go out a with a material weakness that could affect your stock.

MR. DENNIS: We've some things in prior testimony about S-B regulated companies and how underwriters and investors really aren't interested in those S-B rules, that they suggest that people just go ahead and go public with -- under the regular S-X rules. And I'm curious whether the same thing would happen in 404.

MR. SPEARS: When we did the IPO we were probably too large to get a lot of the smaller exemptions I believe. 325 million in revenue. So, we really didn't get into that or look at that. Our chairman thinks we're going to grow to be huge, so he wasn't looking at the S-B rules too much.

MR. WANDER: If there are no other questions, why don't we move on to our next guest. David?

MR. BOCHNOWSKI: Thank you. I'm David Bochnowski and I'm Chairman and Chief Executive Officer --

MR. WANDER: Could you wait a minute? The court reporter is changing paper. Not a disk, I note, just paper. Okay. Thank you.

MR. BOCHNOWSKI: I'm chairman and CEO of North West Indiana Bancorp, a federal reserve chartered bank holding company for the --

MR. WANDER: Could you move the microphone closer.

MR. BOCHNOWSKI: Is that better? I'm the chairman and chief executive officer of the North West Indiana Bancorp, holding company for Peoples Bank. North West Indiana Bancorp is chartered by the Federal Reserve, and our operating unit Peoples Bank, a state-chartered bank located in Munster, Indiana. I am also a former chairman of America's Community Bankers, the trade association for over 1200 community banks and savings associations across the country.

Before I was a graying banker, 35 years ago, if I could tell a little bit of a personal story, I was a lieutenant in the United States Army serving in Vietnam, having gone through the shake and bake version of the special warfare school at Fort Bragg, and I found myself working in an advisory capacity at a Vietnamese fire base. I got a call on the radio one day that an "06" was coming in and wanted briefing on the intelligence situation in our area of operation. "06" is military talk for bird colonel. He jumped out of the bird and over the whirl of the aircraft, I said "Colonel, my name is Lieutenant Bochnowski and I'm here to give you your briefing on the intelligence situation in our area of operation." He looked at me and he said, "a Lieutenant with a last name like yours I'm not sure that's possible."

So here I find myself trying to follow-up on some incredible testimony that has been given about the issues of Sarbanes-Oxley, particularly those in the testimony of Mark Schroeder, which I'm not sure I can add to that. I do have a prepared statement which I submit for the record. But let me just give a brief overview and go from there.

People's Bank did a public offering back in 1984. We raised 3.1 million dollars, and at that time we had 157 million dollars in assets. Today we're nearly a 580 million dollar company, and we have 46 million dollars in equity capital. Back then we had 50 employees, right now we have 175. The compounded annual return for our investors since

1984 has been 23.2 percent as measured by the price appreciation and dividends paid on our stock. We currently have 440 shareholders and our stock is traded on OTC Bulletin Board. Average volume in the last three months has been about 325 shares.

We're very happy with our decision to have gone public. We have also announced in May of this last year that we were considering terminating our registration with the SEC, and that was not a step that we took lightly. In fact, as I think I will tell the story and hope explain it to you, our board of directors felt their fiduciary duty required them to look at that step under the circumstances that we think we face. We do have a special Committee that's currently reviewing the issues. If in fact that special Committee were to make a recommendation to the board to terminate and in fact the board were to adopt that recommendation, we have made the decision that our shareholders will have the final say and publicly announced that, this will go to a shareholder vote even though we're not required under Indiana law to do that. But I want to make it clear that those are all ifs and there's been no decisions made at this point.

Why did we take the step to review our options as far as an SEC de-registration was concerned? Plainly and simple, simply 404 and the impact upon us. We would like to remain a public company. We think it's been a fine existence. We like the fact that we publicly report. We like the fact that we can tell our story to our shareholders on a quarterly basis and on an annual basis. It's not our intention to go dark, that's not where we're coming from, when we looked at this issue.

We're not trying to push shareholders out; that's not a goal of ours. We came to this point because at the end of our meeting with our auditors when we got to the 2004 annual report, the question was asked by a member of the auditing Committee of the auditors, gee, next year under 404 we're facing additional costs, could you tell us what those were. Without blinking an eye the auditor said your costs will double. You'll go roughly up a hundred thousand dollars. That caused some internal discussion as to what the additional cost might be.

And we estimate that the soft cost would go from 75 thousand -- up roughly 75 thousand or a hundred thousand dollars, and that would include the need to hire additional personnel to track our compliance with 404. So when you're dealing with accompany that has had a consistent return of 20 percent plus to its shareholders, you're almost compelled to look at these issues, and that's why we are where we are.

I think the specifics that Mark raised, and I would second all that he said, but to give you some insight perhaps, to those things that we continue to look at and why we are where we are. Number one, is that we believe that this is an open ended commitment that we are making in terms of cost as a company of our size. And why do I say that? First there are very few audit companies that will audit our firm. The Big Four firms don't want us. Whenever we bid our job, they're always 50 to a hundred percent higher than the two who are capable of doing our audit. So there's really, at our size, only two firms that we think we're comfortable with. That doesn't mean there might not be others out there.

I can tell you I can think of at least one case of a billion dollar company that a Big Four firm has indicated they don't want to bid on. So part of what's happening with Sarbanes-Oxley is an oligopoly is being created or has been created with pricing power running one way and that's not towards those of us who would be doing the contracting. 404 creates a pass/fail system on internal controls at the end of the year. You either pass or you fail. It's at the end of the year.

What company in its right mind is going to go forward publicly and wait until the end of the year to find out whether you passed or failed. We concluded that we would have to hire another person to bring us to the point both as a board and as a management group where we would be comfortable with our progress on that particular issue so we wouldn't get to the end of the year and find out that gee, we didn't make it this year. Because there would be a lot of explaining to our shareholders and we didn't want to be put in that position.

There is an unknown factor in all of this and I will go back to something Mark said because it really plays strongly into our thinking on this issue. And it's simply this: If the current -- and we're not an accelerated filer, so we haven't faced 404 yet. But if we get into a situation where under 404 we're required to ask for advice as to how we handle a particular issue, and I'm not going to suggest we're a very complex company, because we're not, but just assuming that we would get there, and unlike in the past our auditor says gee, we can't give you that advice because it will taint our ultimate decision on your controls, you'll have to go somewhere else.

That means we have to have another audit firm that advises us on how we comply so that the audit firm that we have tells us whether or not we're complying. That's a hidden cost that we really don't know if it's out there, but I think that's one point that Mark was making, and I think it's important to us.

This leads me to, we talk a lot about Sarbanes-Oxley and what was the legislative intent. The legislative intent I believe was all of us as companies would publicly report so that our information would be transparent and would be known to the public, and we're fine with that. We don't want to change that. Our concern is that what's happening with Sarbanes-Oxley as it's being applied as we've come up with SHEWTA, the Shareholder Equity Wealth Transfer Act. Because that is exactly what will happen to us. If we use Jim's analysis, this is going to roughly cost us seven cents a share.

If we use his analysis and we apply that to our earnings multiple and take it forward this year but multiply it over the next 10 or 20 years based on the last 20 years we've just gone through, although past results are no predictions of future results, the numbers get a little mind-boggling. We think we're about building shareholder value and there will be, with 404 compliance issues that are going to take away from, a little bit Mr. Jaffee's comment, what are we about. We've been trying to figure out how get into this scheme.

And it's not a regulatory scheme and it's not even an SEC scheme, it's what the accounting industry in our opinion, through PCAOB, is telling us what we have to do. So we're not quite sure who is responsible for this. We only know that we have to figure out how to comply. And in a highly regulated industry, that's a real challenge.

Miss Dolan's comment about exams, and I would like to amplify a little bit of again what Mark talked about, the examiners when they come in, they come in roughly year to year and they're very interesting people. First of all, the examiners I know almost in my -- I've been doing this since 1981. I can say that there's very few of them I don't like personally. They're all wonderful people, great gals and great guys who have families and spend time away from their homes traveling to see our company.

But make no mistake about it. An examiner on a mission makes an internal revenue agent look like a friendly guy or gal. They come in knowing what the last exam said, because they've got their notes. And after you get through the niceties of life, they ask you about the things that went on last time just to see if you can remember what they remember and what you've done to correct those issues. And so when it comes to controls, there is no question that we all know what the game is, and that you better get it right the first time. And that gets back to Rusty's point of earlier, that when you sign your name onto something it has real meaning. And if there are issues that come up that need to be changed, you need to change them.

I would parenthetically say on this issue of building value, I know of at least one and perhaps other companies, smaller companies, certainly smaller than ourselves, that are going to merge because of the Sarbanes-Oxley cost, they can't absorb it. That leads to interesting questions, go back a little bit to what Rusty said about the direction of where we're going in America. Because we have had since the days of Hamilton-Burr, we've rejected the idea of a National Bank of America. We've had a system of debt distribution or at least consumer access to debt that's been widely dispersed across this great country of ours. We will diminish that and there will be unintended consequences if the results of Sarbanes-Oxley is that companies have to go out of business just because they can't absorb the costs. And I think there are examples of that

that are real.

So having said all that, what do we do? One thing that I think I would suggest is that at least as to smaller companies, please consider extending for one more year the right not to have to comply. And I say that for this reason: We know that you issued -- not you, but the SEC issued guidance in May. And we don't know how long it's going to take for that guidance to get through the system and whether or not there will be any changes as a result that guidance. But for all of us to have to incur this cost only to find out that some time from now we shouldn't have incurred the cost in the first place because there's going to be changes made, would suggest that we're all better off waiting.

I come from an industry that when, and only the bankers here perhaps can relate to this, but when you receive guidance from your friends at the federal government, it basically says you need to comply because otherwise they'll send some people to come to see you. The challenge here is that the SEC has issued guidance, but there's a whole industry that's ignored it as near as we can tell. I know that our audit firm has said it's caused no change in their approach. I think anecdotally I can report that from a wide cross section of bankers that I've had conversations with, they say the same thing. If that's true in our industry, if it's true across all the other industries. We have to wonder where these challenges will lead us.

Second, and this has been talked about, and it's in my testimony, the banking side both the FDIC and the banking regulators have said for companies at a billion and below, they're changing our reporting requirements so that we are not to face the strict side of the banking regs because they're recognizing where the risk is. They're saying that risk doesn't fall on smaller companies.

And then the last thing is that either terminate or at least review the attestation that we're asking auditors to make to internal controls. There's a part of me that I was trained as a lawyer and I clerked for a federal judge many, many years ago, and I always tell my friends that back in 1981 I stopped practicing law and went to make an honest living as a banker. But there's a part of me that says that when we ask auditors to attest to the efficacy of the internal controls and they say yes, they're okay, what risk position are they in when we find out that they weren't okay? And so I think that Mark's suggestion that there ought to be some guidance and some rules as to where the line is with respect to what auditors should be attesting to, that just makes a whole lot of sense for everybody. So I would be happy to take any questions you might have.

MR. WANDER: David, thank you very much. And you will be happy to learn that one of the items on our agenda for our public meeting tomorrow afternoon is to adopt a resolution recommending to the SEC that they continue the delay in implementing 404 for companies of your size. Rusty? You have quite a fraternity, Rusty.

MR. CLOUTIER: I know a lot of these people pretty well. Dave and I shared at the same time with two different trade associations as chairman and David has always made great testimony and he's always done a good job testifying on the Hill, and he's represented the American community bankers very well.

To kind of to set the tone for who he represents, of the 13 hundred banks, David, I would take that none of them has paid a two billion dollar fine recently that you know of.

MR. BOCHNOWSKI: Not to my knowledge.

MR. CLOUTIER: Yeah. Nor could they afford that. That's what I want to get. We talk about transparency every once in a while. If I was to hand you Mark's financial statement, either Marks' financial statement, small companies, being the banker you are, I would assume that you could read those statements and most probably within a reasonable period of time make some opinions of their credit worthiness because of the size of their firm and the complications of the business they're in. Would that be --

MR. BOCHNOWSKI: I think that's absolutely true. In fact it's easy because we can all go on the FDIC website and see that right after it's filed.

MR. CLOUTIER: Now if I was to hand you the statement of Citicorp or Chase with their options trading business and all the businesses they're in, and of course according to my record Chase is back in U.S.A. Today pleading guilty to some SEC charges this morning and of course paid the two billion dollar fine. They did it, Chase did it, Canadian Bank just did. It's up to seven billion now in the Enron scandals. Would you say their statements are very transparent, that any banker in America could look at them and determine exactly where they stand today?

MR. BOCHNOWSKI: Apparently not, the bankers could not do so but others couldn't either. But it goes, I think, to the complexity argument, that it's very clear that I am arguing and I believe Mark is and I believe everyone else is, is that because we're small business a different set of rules should apply, and that more complex rules should apply as you move up the chain.

MR. CLOUTIER: Right. In your statement on page six and I thought it was very well done, and I will read it because I thought it was so well stated. "In the end what our board was looking at was basically a wealth transfer from our shareholders to the public auditor with no compensating benefit to the company. This particularly is frustrating in that the catalyst for Sarbanes-Oxley was a rash of corporate scandals caused in large part by auditors and other gatekeepers not doing their jobs." Now I would only point out that with the complexity of Enron and WorldCom, which is very complex, and the trading which was led by the large companies in America which was very, very complex, that really at the end of the day in a Federal court the auditors were found not guilty. And so we are paying a very large penalty. And I loved your term transfer of wealth. From your shareholders, my shareholders and everyone else's shareholders to some third party when our statement's already very transparent. They're very, very transparent. I agree with you. I can go on the FDIC website and figure out your bank in ten minutes, Dave, and vice versa, and we're paying a large cost for this. Am I correct on this?

MR. BOCHNOWSKI: I think that's absolutely true.

MR. CLOUTIER: Last question. You come from pretty much just the suburbs just outside of Chicago, am I correct on that?

MR. BOCHNOWSKI: In fact from my office on a clear day you can see the Sears Tower.

MR. CLOUTIER: Would you say there's a great value to your company being out there and that if it was merged with a major bank, once again the same question I asked Mark, would there be some real loss to your community?

MR. BOCHNOWSKI: I think that's absolutely true. It seems to me that the community banks are thriving in some communities, that simply because a customer, and in our case it's the customer that's on the commercial side, it's one to six million dollars, it is small business, if they want to come in and see their banker, if they want to call, they see us. With the larger organizations that customer at that level is dealing remotely and really can't get to his or her decision maker. And I think there's a certain part of the American consuming public, especially at the small business level, that wants to have face to face meetings and conversations with their banker -- with their decision maker, not with their banker.

MR. WANDER: Yes, Richard.

MR. BROUNSTEIN: Hi, Rick Brounstein,. We've had a lot of testimony from the small community banks and it's compelling. I guess I'm going to probably pick on you for information because of your role in America's community bankers. You mentioned your current bank is maybe five hundred million to six hundred million in assets and you're a small business, you're non-accelerated, so your market cap is somewhere below 75 million.

MR. BOCHNOWSKI: Under all those rules, yes. Well actually the market cap is 97 million today, but because of the way that's held, we don't get past the 70 mark.

MR. BROUNSTEIN: At the prior meeting there was a lot of talk in terms of, you know, banks that had assets of a billion or less were really pretty small banks. Is there any way to sort of make a relationship on average between, you know, what's a six hundred million dollar bank or a billion dollar bank, market cap typically, are we talking about a hundred million or two hundred million or talking about some of these being much larger?

MR. BOCHNOWSKI: It would be hard to generalize on that simply because you have trading multiples and you have various levels of capital. I would think that if we're going to what's the appropriate size for a small business, I think I fall back -- I would myself, would fall back on the SEC's own study that says that markets to track and pay attention to companies that have seven hundred million dollars of capital. And that's I think where I would draw the line. And if that were true, you're probably talking about banks that are in the two or three million dollar, four million dollar --

MR. BROUNSTEIN: Billion.

MR. BOCHNOWSKI: Billion. I'm sorry.

MR. WANDER: Any other question? Yes, Al.

MR. DAVERN: One question. I think I heard you say that the banking regulators are looking at some different type of regulation based on size, around a billion dollars, correct?

MR. BOCHNOWSKI: Yes.

MR. DAVERN: Would you tell the Committee a little bit about what the difference will be in the regulatory process or burden between those below and above.

MR. BOCHNOWSKI: FIDICIA, which is the Financial Institutions Deposit Insurance Company Improvement Act, basically has been in place since '91 - '92, and it says that at five hundred million or above, you have to -- as an example, you must have on your board a CPA. You must attest separately, which is then reviewed by both your outside auditor and the examiners -- your control systems. And so that's going to move from the five hundred million to the billion dollar level. Again, because I think the banking regulators are looking at their own companies that they regulate and they're maybe falling back on some of the points that Rusty was making and suggesting that they're trying to be risk-based and they see that the risk is in some of the more complex organizations.

MR. WANDER: Thank you for being so patient, Don Perkins, but we would love to hear from you now.

MR. PERKINS: My name is Don Perkins, and Herb and I have done some other things together so he's taught me patience.

To anticipate his question, my background includes being the CEO of a fairly sizable retail business called then called Jewel, now called Jewel/Osco, in Chicago. I've served on 25 corporate boards in my lifetime, half of which at least of Fortune 500 companies. I'm now too old to do that so I work with some smaller companies, one of which is the reason I'm here today.

I'm the non-executive Chair of a company called

Nanophase Technologies. And with me is Jess Jankowski who is the chief financial officer. When I tell you about the size and nature of Nanophase, I think you will agree that it was absurd to apply Sarbanes-Oxley to a company like ours.

Nanophase produces nano-size materials measured in billionths of a meter for use in sun screen and other personal care applications, semiconductor wafer polishing, or to add to the wear-resistance of both paint and transparent coatings to name a few. If you want to know how big these are, if you stacked nano-crystals on top of each other and had one for every human being in the United States or three hundred million people, it would come to something like eleven inches high. So we're in the business of creating new chemicals.

Nanophase financed its early development by going public in 1997. Sales growth is slower than we expected, but we have great confidence from our investors.

Our stock multiple is what qualifies us for Sarbanes-Oxley. It has no reflection on the size or resources of the company. It is a high tech company in a high profile, in this case, nano technology business. Our market capitalization is 120 million dollars which represents twenty times sales. We have only 50 employees. Three of these are finance and accounting professionals who are responsible for everything from entering vouchers, billing, paying bills, cost accounting, SEC reporting, sales and franchise tax reporting, budgeting, forecasting, contract review, and investor relations, among other things.

In an environment as small as ours, redundant controls are inherently inefficient if not impossible. The CFO signs every check and approves every purchase order in excess of fifteen hundred dollars. The CEO signs every check over ten thousand dollars and approves every purchase order over five thousand. I or another board member signs off on any purchase of equipment which would be in this case 250 thousand dollars or more. We have a total of seven people responsible for the administration of the small company, but we may need to add somebody if we are to follow the pressures brought on to us by Sarbanes-Oxley.

Because of the one size fits all approach of SOX-404 requirements, an unwarranted and we believe unnecessary burden has been put on our small company. In 2004 we spent $259,000 on 404 specifically, and that's about five percent of our sales. Our projected -- Jess' projection for this year is that it will be two-thirds of that cost, although I need to look at Leroy Dennis up there and ask him because he's our auditor. In these numbers we have not included the tens of thousands dollars in additional annual and quarterly fees incurred with our auditors relating to the change in the general climate since 2001 and the specific enhancements previously required by other sections of Sarbanes-Oxley. We believe very strongly that our shareholders would be better served if those dollars and those hours were spent on revenue enhancement and new product development.

Since we disclosed, and this will answer the question you've been asking others. Since we've disclosed the results of our SOX-404 audit in March, not a single one of our investors, many of whom are in weekly contact with the company, has made even a passing comment regarding the completion of our 2004 SOX-404 audit, and we had no findings of material weaknesses, thank goodness.

It seems us that small companies have investors who understand many of the risks involved and do not expect Fortune 500 level internal control systems to be in place.

Since we operate at a loss, you can't -- I don't know what multiple losses we would get, Drew, at your question -- we operate at a loss. We could have spent 259 thousand dollars on product development and enhanced our revenue line which is really important to us. But the past is the past. We spent the money, I'm unhappy about that, frustrated about that. But in terms of the future, we have four suggestions, and some of them are the same, but maybe my words will be just a shade different.

The first suggestion for the future is to use a revenue test as well as a market capitalization test for requiring SOX-404 compliance. Even a 50 million dollar revenue requirement would help companies like Nanophase avoid spending such a high percentage of sales on accounting. As an alternative, others have suggested a more limited set of requirements for a small company. I don't know how many of you have seen the books that are prepared to have all the boxes to be checked for 404. I'm on two publicly traded companies, it doesn't make any difference what the size was, in each case I'd say it's about six inches high, the paperwork that is created to do this.

Second suggestion, permit, or better yet, Leroy, require audit firms to do all of the work for small companies, to complete whatever is required of them under SOX-404. One-fourth of our expense last year was required because our audit firm, McGladrey & Pullen, told us that their interpretation of their role under PCAOB prohibited them from doing this work so we had to go hire somebody else.

We believe the total auditing bill would have been less expensive if they had done -- if McGladrey & Pullen had done all of the SOX-404 work. We had to contract with an outside firm to complete it. The complications and expense within the company and two outside firms to do this was inefficient to say the least.

The third suggestion, and this one will help us now, all the things I'm going to suggest, but this is the one I wish you would put at the top of your list. Do not require an annual reaffirmation of the internal controls of a small company like Nanophase. Let us revisit the effort every three years or so. That's the same suggestion that was made by my banking associate down the table. We as directors of Nanophase will make sure that we keep track of whatever might be changing the business, but to go back and do this work and spend another few hundred thousand dollars this year and have to do this on an annual basis seems to us to be both unnecessary and unwise.

And our fourth suggestion is to redefine the IT expectations for small companies. The IT portion of SOX-404 project is probably designed by technicians who have spent much of their careers working with banks and other institutions that have long been subject to strict control standards. We operate on an off the shelf software package. And because of that the value clashes with our auditors were apparent immediately. After many meetings they did revise what they thought ought to be done, but we still have unresolved issues because we're a very small company operating with very few people.

Thank you members of the commission for listening to our expression of frustration. We would be very pleased if you would find some way to have a more reasonable challenge for us as a very small, hi-tech, hopefully growing, hopefully surviving company in an unusual world. All of the money that was raised in 1997 to take Nanophase public has been reinvested in the business. This was not somebody selling out and making a lot of money off it. This has been a project which incidentally was started at the University of Chicago, with inventions there about how you could produce nano-size crystals. It's been a long, tough road. It hasn't been helped at all by Sarbanes-Oxley, and our shareholders have not expressed one concern, or -- we don't even get a compliment for having no material weaknesses.

MR. WANDER: Thank you, Don, very much. Members of the Advisory Committee, any questions? Mark?

MR. JENSEN: Mark Jensen. Thank you for your testimony. I just have some questions about the companies just so we can frame, maybe a little bit of fill in some of the blanks -- when you went public in '97 how much did it raise?

MR. PERKINS: 32 million.

MR. JENSEN: Has it raised any capital since then?

MR. JANKOWSKI: I --

MR. WANDER: Could you speak into the microphone?

MR. JANKOWSKI: About twenty million since then but it probably totaled probably 30 million prior to that through VC funding.

MR. JENSEN: What you got was --

MR. JANKOWSKI: I really don't know. I'm sure a couple of thousand for the most part. Certain shareholders own about 18 million shares outstanding, several shareholders own or control five hundred to a million shares of stock.

MR. JENSEN: What's the trading activity?

MR. JANKOWSKI: About a hundred thousand shares a day.

MR. JENSEN: It trades fairly. I just was curious with the number of shares trading every day you have new shareholders coming in, what their expectations are for the company in terms of --

MR. JANKOWSKI: We think that those shares get worn out -- because we have a series of shareholders that have been sitting on the stock and we have day trading and other things -- that's a whole separate SEC discussion. But with respect to this, nobody really seems to care, and that's been frustrating because it's been a large commitment of resources. Three of us probably put a thousand hours in the last four months of the year on top of this ongoing load, and that takes away from costing and lots of other things including traveling and talking to the investors coast to coast.

MR. JENSEN: So shareholders, would they obviously ask for an audit and --

MR. JANKOWSKI: Our board we have several members that are not as experienced as Don, but Fortune 500 level executives retired, and we adopted the blue ribbon panel requirements for audit committees back in '99. And we run our company -- essentially we took what was an informal process, I signed every check that the company issues and we codified it and just put layers and layers of people around so if we wanted to do something, run around, have many people chasing me saying things all the time now, that had I not signed it today I would have signed it in 40 days when I write the check and in either event I would see it. But now everybody's concerned about a control total efficiency percolating upwards.

MR. JENSEN: Just one last comment. Is there a difference in your -- perspective on shareholder interest in auditing financial statements versus your internal reports, or are you able to distinguish between the to where their interest really lies -- or do they just assume it's all one package and therefore available to them?

MR. JANKOWSKI: We've received notes --

MR. JENSEN: I'm not trying to be --

MR. JANKOWSKI: Generally the bulk of our investors are concerned with revenue growth. So we get beat up every quarter if the revenue doesn't grow. And when we talk about the bottom line and the continual loss, it's shrinking but it's a loss, everybody says that's important, cash flow is important, and that's our -- our quarterly conference call is five minutes of me going through the math and 25 minutes of going through what's happening on the revenue growth side of the company.

MR. JENSEN: Okay.

MR. WANDER: Yes, Rusty?

MR. CLOUTIER: Don, I kind of wanted to ask you a little bit more of a personal question. Most of us that have testified or sat on these panels are CEOs, and it's good to have a person who has sat on several boards. As you heard me say a minute ago, I think in a very small company like the one you are here representing today, it's very transparent as you said, you know, when the CEO signing the checks of ten thousand or under and CEO 15 hundred and under. But of course you've also served on some very large boards. I would ask you the question: Do you see a difference in transparency as a board member when you serve on a small company that you feel you can get your hands around it much easier and know what's going on versus a very large public company? Is it much more difficult to get transparency even from a board member sitting in there making decisions that is affecting the shareholders. Do you find a difference or there is none?

MR. PERKINS: Of course we're much closer to what's going on in this business than I was in the Fortune 500 companies which I served. But I think it's important to add that my philosophy of serving on boards and I've, done as much of that as most people you will meet, has been that -- when I join a board, I put my reputation in the hands of the

CEO. And if I'm ever uncomfortable about that, one of us is going to go. So I've had my board life determined more by my judgment of people in their quality and their integrity than by verifying every number in the business. And I have the same concern with a small company as I do with a large company. I have great confidence in Jess.

MR. CLOUTIER: So I guess what I could reason this and I agree with you, is it really comes down to the honor and integrity of the people running the company. Forget about all the checks and balances. If you've got a dishonest person, they most probably are going to do dishonest acts.

MR. PERKINS: I've also been a strong advocate of governance reform, as Herb knows. In fact, Don Jacobs, recent dean of Kellogg, and I have put on governance conferences for 15 years and Pastora has been at some of them. And I can say as much as I'm happy to see the corporate governance recommendations of Sarbanes-Oxley, there's not a recommendation there that wasn't part of what we've been proposing for many years before Sarbanes-Oxley. Because it makes good sense, and there are many things today in corporate governance I would change beyond what Sarbanes-Oxley requires or recommends.

MR. CLOUTIER: What would be some of those things?

MR. PERKINS: To me the weakest part of corporate governance today is the fact that directors are re-slated without being really truly evaluated by their boards. My statement is that I think it's intellectually dishonest to re-slate a director who has not been put through some kind of evaluation process by his or her peers on the board. That's not required by Sarbanes-Oxley, and yet I think it's highly important. There's an expectation of board members that they will be re-slated until they reach a retirement age or until something very unfortunate or unpredictable happens.

MR. WANDER: Pastora?

MS. CAFFERTY: Thank you so much for joining us today. I'd like you to discuss this more, because some of the -- you can't hear? Sorry. I'll speak even louder. One of the issues that has been raised is the question of the burden of having independent directors, a preponderance of independent directors, a majority of independent directors, for small public companies. Some of the governance costs have been questioned, and I would like to hear you speak about that.

MR. PERKINS: Back when I first started serving on boards I didn't realize that most boards back then were predominantly inside directors. In fact it wasn't until the

New York Stock Exchange required audit committees of the three independent directors that such famous companies as Exxon, Johnson and Johnson, and Time, Incorporated had to put outside directors on so they could get an audit. And that goes back to probably the early '70s. It wasn't that far in the past. I can't imagine anybody going on a board today that was not predominantly outside. That has been something I've felt strongly about for a long time, but that's not really much of an issue today, I don't think. And I think the cost of -- if that was the nature of the question, Pastora, the cost of outsiders is very small in relation to the benefit that comes from it. In fact in Nanophase one of the benefits of the board we put together is to open doors to -- for a company that's introducing chemicals that are not very well understood in the world. It's how we locate the market for such unusual items as the ones that we produce.

MS. CAFFERTY: Let me pursue this because again I think drawing on your experience and your leadership on corporate governance. What I would like to hear you talk about a little bit is the benefits of the corporate governance in Sarbanes. And I believe that Sarbanes does not go as far as we would have maybe the boards go and as we have discussed in the past, so I would like you to talk about that because the other issue that has come up, the benefit that would be to smaller public companies, perhaps to all companies, if all the regulatory agencies and the regulatory bodies, the NYSE, the SEC, and so on, had similar rules, that we were not responding to slightly different rules with each agency.

MR. PERKINS: It's like several other questions I've heard here today. The answer's of course. It has bothered me because I've spent so much time on corporate governance that Sarbanes-Oxley is looked at as having changed things. I don't think -- I think it has codified good corporate governance rules, and hooray for that. And certainly boards are more alert today thanks to the disasters of the Enron and MCI. I spent some time serving on the ATT board back before -- back when it was the largest company in the country, and it's amazing to see what's happened to that company in recent years. But one of the things that happened was they were competing with a company that was falsifying its results. And the chairman, specifically Mike Armstrong, will tell you that he ran that business differently because he was trying to figure out how they were so inefficient in relation to what MCI was reporting. And much of the damage that's been done to ATT was done by a competitor in their dishonest reporting. So the implications of these disasters are to me terrible. But do we carry that all the way down to the Nanophase and have them spend money that we ought to be spending on our product development to -- how often can we -- can we check on poor Jess here and the two people he has working for him?

MR. WANDER: Janet?

MS. DOLAN: I want to thank you for your getting us off on a discussion of governance which I think for many of us I believe is probably much more critical to the solving the true problems that we solve. But I would like to get back to your recommendations because we -- first of all, we appreciate people who come in with recommendations. We hear a lot of horror stories, but the real question is what do we do about it.

Your suggestion of requiring 404 attestation maybe once every three years, I think Mr. Schroeder had the same one. That's a bright line, it's easy to administer, it's got a lot going for it. But it still requires that you're going through a complete 404 certification as it's currently implemented, maybe it will get better. And I have a question for you which is, even if you had to do it once every three years, do you think it brings value or do you think a better approach, if it could be done, would be to try to figure out a risk-based approach or a more defined risk-based approach where you only are certifying or testing and certifying the most critical controls? Do you have an opinion -- are you saying do it every three years just because you assume we're going to have to do it anyway, let's make it less onerous, or do you have another idea of how to do it in a way that really might bring value to your shareholders.

MR. PERKINS: Clearly, as far as I'm concerned, there is no benefit whatsoever in doing it every three years or any one year. I would support doing it more simply in which case I would give the microphone to Jess to tell you what more simply means.

MR. JANKOWSKI: To put it in context, one thing to remember is our auditors -- we have a good relationship with our auditors. And one of the things was we had to establish, well if we have an error, what does that mean? Well we determined if we took 90 samples, one error, there was a reasonable margin of error. If we had two, that would be potentially bubbling up to material weakness, certainly material deficiency. We don't have 90 samples. We don't have 90 big deposits.

In a quarter we certainly don't have it, so we were doing 60 back to 30, and you look at it, it's almost cartoon relative to our business. The bright line is drawn by having so much oversight. You know, I don't see the advantage to much of it because the areas -- I mean a traditional way to look at financial reporting, you know we have a lot of capitalized IP. Some of that IP is a -- from years ago was a four hundred dollar trademark application that's going to last 15 years. Well, this year we had error in the way we calculated IP. It wasn't spread over -- over the right amount of years it was so immaterial -- it was material in light of SOX-404. It was material to me.

I was annoyed that my people -- or my two people and I didn't catch the error. But the reality was there was a time when that would just be so immaterial to our six million dollar loss, to our five million dollars in revenue, to whatever expenses accumulated and you just would ignore that. And to focus resources on that takes us away from looking at the big things which are things like revenue recognition, handling of deposits and cash. Inventory -- in our case we have inventory that's not saleable to anybody except to a company that wants Nano materials. So there's really not a huge risk there. Our fixed assets are almost all manufactured, hand built by us, and have no resale value.

So you look at all of these things of our company. To me, you can look at four items and give yourself comfort that the company's doing things properly, that there's no either tacit or directly complicit cheating going on, there's no collusion. And I would like to see something -- an approach like that, a risk-based approach that ignores some of the standard -- if there's ten standards, there's all kinds of internal control standards we all learned in school that we live by.

Some of them are so irrelevant to a five million dollar company with one location with three products with three customers making up 90 percent of their sales, that the auditors have to have the flexibility to look right back and see say well, hey, we have a 60 percent revenue customer, you have a 20 percent revenue customer. Why are we going through this whole process? They -- very few people choose to pay more than they normally would for items. We went and vouched it all, and confirmed all of it. We're just looking through samples. It's an exercise in tedium for the most part.

MR. WANDER: Alex, and then Rick.

MR. DAVERN: One question relative to the cost and effectiveness of the different versions of Sarbanes-Oxley on preventing corporate fraud, obviously this was passed in the environment of post-Enron, post-WorldCom. So I'm curious if you take all the governance aspects, were to rate their effectiveness, perhaps, at preventing fraud in public companies and their relative cost and then compare that with the relative cost, and in your mind of effectiveness of 404 for preventing fraud among senior officers in companies of your size and with your complexity, is it effective in preventing fraud under those circumstances?

MR. PERKINS: I've had trouble finding any rationale that tells me that any part of 404 has been effective. Period.

MR. DAVERN: I was --

MR. PERKINS: I didn't hear your question. I'm sorry.

MR. DAVERN: I was just wondering if, Mark, you would want to comment as well.

MR. SCHROEDER: In terms of detecting fraud, I think the corporate governance issues, as this other gentleman has indicated, it's codified with what good companies had in place for governance, and certainly from a corporate perspective, the underlying culture, the underlying climate, is the best method for detecting fraud. And I think the formalization of whistle blowing for a company our size adds value to that process because employees know that they have an anonymous way to do what they should do in those situations and report it and know that it's going to be acted upon.

So you can't measure how much that's helped, but it certainly has helped set the climate that our board wants to have in place as far as code of business ethics and things of that sort. But I also agree that -- I see that outside of 404. Because the 404 side of things and the checking of mundane little silly items is -- doesn't add to anything new to the mix. Our CFO I was interested -- the gentleman we have talked about initially, the CFO after we went through the 404 process basically said "I now initial the wall when I turn my light off in my office."

So I think you've got to separate these two. Sarbanes-Oxley, corporate governance issues for our company is a good thing. 404, no value.

MR. WANDER: Did you want to comment, the other Mark?

MR. SPEARS: I agree with Mark. I think the little -- all the work that's done on these little things it's not -- if you're trying to keep corporate fraud out you're not going to catch it in that small amount of internal audit type work or transactions, that's not where it occurs.

MR. WANDER: Any -- yes, I'm sorry, Rick.

MR. BROUNSTEIN: Something that I want to come back -- this is Rick Brounstein. I want to pick on or take advantage I guess of something that Mark Spears added, and now that we have more another CFO here. And that is everybody's talked about corporate governance and tone at the top and entity, and I think that's a pretty foregone conclusion and everyone's sort of trashed 404. But within there Mark said something that stuck to me and that is there is a piece of -- it may be nothing to do with fraud but has to do with getting it right and that's the financial reporting controls. And I'm not sure -- as a smaller company, how did you address that? Was there some value there, anything you might talk about that specific area of 404?

MR. JANKOWSKI: I think there was some value there in a procedural sense, however, the value to us was check lists. But the check lists that we were given as an example, and a good check list to go through had hundreds of items. When you look at it you end up having to determine which of these items are germane and which are not germane. And at that point you're making it -- you're making a judgment that's subjective which I think the standard is trying to avoid, subjective judgments and have an objective cloaks over the whole process. I think from the reporting side our reporting was always strong. I think your company is small enough that the auditors understand very well what the in's and out's are in our financials.

So again, I guess I would say there may have been some advantages to it, but it was kind of swatting flies with a sledge hammer. You know what we have to do now disclosure controls is the next one that's going to perk up, is another big item to -- if you follow that to the letter there's almost a Committee meeting every time you do anything. And it's unrealistic when I see everybody in the company that's going to test the disclosure control at the coffee pot every day it doesn't seem to be germane to us.

I'm not saying one of the businesses, Mark the CFO here, had discussed is a complicated -- you have many -- lots of communications, and lots of locations, so you have some pretty old fashioned internal control issues. Our business is so simple relatively speaking that I don't know that the financial reporting disclosures have been all that, the processes suggested with were all that strong. I think we were already there before we started.

MR. WANDER: Yes, Drew?

MR. CONNOLLY: My name is Drew Connolly. Mr. Perkins, thank you very much for that testimony. As someone who spends his career hoping to help finance small companies, knowing that there are gentlemen and women of your stature, commitment and integrity level available to small companies, could we see each other after the hearing? I think I have a few other posts that need to be filled. But --

MR. PERKINS: You might be interested that on the board I have the retired chairman of Cummins Engine, the retired chairman of Zenith, and one of the senior officers of FMC, a major chemical company. All of them bring to this little business talent that wouldn't be available except that most large companies have retirement ages for directors.

MR. CONNOLLY: Playing golf isn't all it's cracked up to be after retirement, I take it. But in candor I believe I've actually seen a presentation, perhaps this company presented maybe at a National Investment Bankers' Conference. Is your stock symbol NAPT?

MR. PERKINS: NAMX.

MR. WANDER: Excuse me. Where is this stock trading on, NASDAQ?

MR. PERKINS: Yes.

MR. WANDER: And do you have any research covering it?

MR. PERKINS: Three institutional analysts, so we have no retail analyst coverage, but we have three actually, all within the last six months probably do a -- we're happy to capitalize on it.

MR. CONNOLLY: Actually that's where I was also going to go. There's been a lot said about how you did a PIPE financing, VC funding, sophisticated investors. The average investors are often not able to access that institutional research, except indirectly or occasionally and possibly through their brokers. The ability to find solidly managed growth stories, good investments, need to be obviously finding companies that need investors and investors that need good companies is the ultimate objective, I suspect. Do you have any thoughts for the Committee, not limited to Sarbanes-Oxley on how companies such as your could access capital markets, could benefit within the framework of regulation?

MR. JANKOWSKI: Well I think as it stands now it's going to discourage -- I mean typically private equity money is not as free flowing as public capital because it's not liquid. And with the -- as Mark said, Mark the CFO said --

I'm Jess Jankowski by the way. Talking about going public at 325 million dollars, that is the sort of thing we're hearing from people in New York and San Francisco. These companies need to be 75 to a hundred million to go public. Part of it is you have this hurdle on regulation. And the reality from my perspective is that lots of companies that were -- that we were what you called a "story deal" in 1997, we wouldn't be public in today's environment.

We wouldn't have been able to invest 60 million dollars in getting to the point that we got to. And I think that's going to limit the most entrepreneurial, probably the high failure rate, high success rate companies from going out, take Yahoo and take Amgens, none of those companies went public with a hundred or three hundred million dollars of revenue. They all went public in a garage with some bright eyed people that were excited about an idea that couldn't get VC funding because VCs typically are much more conservative than that. It's not just the entire Sarbanes-Oxley. But we probably spent a million and a half being public. So we're spending thirty percent of our revenue every year being public counting, you know, my salary which has -- that escalated nicely thanks to SOX-404 and I do appreciate that.

MR. CONNOLLY: It's nice to know we did fine with something.

MR. JANKOWSKI: We've got that. We've got lots of lawyering. We've got lots of systems. And I think that in terms of advice where to go, I think people are going to consolidate probably around public companies, probably going to start doing rollups where if you have enough money you just say okay, I have the public already, I'll start buying technologies and look at a lower multiple and probably be more conservative.

MR. CONNOLLY: Finally --

MR. PERKINS: We're not going to get money future money from the capital markets -- if I could wave a magic wand and make Nanophase private, I would do it immediately, because we're going to get our money in our future from our customers who see what we're doing as a less expensive way to do R&D and to find their growth items through what we're doing. This is where our last major influx of capital has come from. And they found us, a German company, that I'm embarrassed to say I've never heard of.

MR. CONNOLLY: Sir, I appreciate that, I am concerned with it, it is a specter that overhangs our capital markets in a very serious fashion. Companies that are managing for the future that are good governed at the top, that are aware contributors to a boom tech growth, new technologies, new job creation orientation, making statements such as that need to be cautionary to all of us and certainly the regulators in the room and the regulators who may review this transcript because that is ultimately what's at stake.

And thank you also for making my larger point when talking about having a negative price earnings multiple because I assure you, sir, you are at least one of several hundred, possibly a couple of thousand minor micro public companies. Certainly not all of them with market caps of 120 million dollars, and that's to your credit as well, but there are a lot of folks below that number where that Sarbanes-Oxley compliance number is the difference between a positive P/E and a going concern conceivable letter --

MR. WANDER: I think we've run over about fifteen minutes, but I think the discussion was well worthwhile. And before we close I'd like to offer an opportunity to any of our guests to make any final remarks they might have.

MR. SCHROEDER: One remark really a response to Miss Dolan's question to Mr. Perkins I believe. The question of the frequency of the testing process. I think it requires both. I think it requires a risk-based approach to make certain that whenever you do it, be that annually, be that every three years, be that every five years, that common sense is applied to the process. But I also agree with what the other gentlemen have said here today in that it doesn't -- we have a 94 percent retail shareholder base. It's obviously not important to the institutional shareholders. I can assure you it's not important to the retail shareholders. And the best solution would be to exempt smaller companies in the process completely, but I'm also a realist and I know that's not likely to happen. Alternatively, a risk-based approach every three years is much better for us marshaling our limited resources and focusing on it once every three years rather than a yearly basis.

MR. PERKINS: Hear, hear, a banker I can agree with.

MR. WANDER: Any other final comments? If not, why don't we resume at quarter to 4:00 for our next panel, and thank all of you very much.

(A brief recess was taken.)

MR. WANDER: I've been directed to make sure that everybody speaks into the microphone because the webcast is not picking up everybody, and all of those out in etherland are going to be upset.

I'd like to welcome our next panel, and I think maybe I'll do something a little differently. I'll start from my right and your left. So Bill, would you like to begin and introduce yourself?

MR. TRAVIS: Sure. My name is Bill Travis. I'm managing partner of McGladrey & Pullen, a national CPA firm focused on mid-sized businesses.

MR. MOLITOR: My name is Michael Molitor. I'm Assistant Professor at Thomas Cooley Law School in Lansing and Grand Rapids, Michigan.

MR. STIEVEN: Hi, my name is Joe Stieven. I'm Director of Financial Institutions Research at Stifel Nicolaus. I'm actually also leaving in the next month going to form my own company called Stieven Capital Advisors, but I can't go into any great detail on that on the advice of counsel. No business cards yet.

MR. HICKEY: I'm Jim Hickey, I'm a principal at William Blair & Company in Chicago.

MR. WANDER: You watched, all of you, the format that we followed. We would like to continue to follow the same format, and call on you, Bill, to open the session with your remarks please.

MR. TRAVIS: Thank you. Co-Chairmen Jim Thyen and

Herb Wander and members of the Advisory Committee, thank you for the opportunity to talk to you on behalf of McGladrey & Pullen, and hopefully the smaller public companies that we represent.

As you know, small and mid-sized businesses represent a significant and important part of the U.S. economy in their sheer numbers, their employee base and their impact on job creation and innovation. We're very pleased that the SEC has taken an interest in considering the impact of the Sarbanes-Oxley Act on current and future smaller public companies.

In the last few years many smaller public companies have been unable to raise needed capital through an IPO or even a secondary offering process. Additionally, many smaller public companies have been orphaned, strapped with the costs of being a public company while receiving few of the benefits that go along with it. Some of these companies have been fortunate enough to go private, but I'm not sure that going private is necessarily the best answer for the U.S. economy. Hopefully the SEC's process will address the capital formation issue facing us all in mid-sized businesses along with the cost benefit analysis relating to the Act.

Some of the benefits. The enactment of the

Sarbanes-Oxley Act in our view has certainly resulted in many positive changes and enhanced investor confidence, including, one, there's an increased awareness within the reporting companies and audit firms of the importance of a proper tone at the top and of the personal responsibility to do the right thing.

Secondly, there's an increased emphasis in companies and audit firms on the importance of effective and efficient internal controls and reliable and transparent financial information.

Thirdly, there's an increased emphasis on stronger corporate governance including enhancements in business ethics policies and training, and stronger and more active audit committees. We as external auditors are certainly much more active and engaged with the audit committees today.

Fourth, there an increased recognition in the -- there's an increased recognition of the importance of auditing to the capital markets. The audit profession is again important to the public, to students on the university campuses and within the audit firms themselves. However, these benefits certainly have come at a cost perhaps at a disproportionate level for smaller public companies. To further enhance the benefits of the Sarbanes-Oxley Act, we fully support a careful and thoughtful evaluation of the benefits and costs for smaller public companies.

To that end, we suggest and consider the following six items: One, as you know, smaller companies -- smaller public companies have different resources, capabilities and investor bases than large cap companies. As a result we believe the SEC registration and filing process and requirements should be scaled to fit the resource limitations of these smaller companies, while being attentive to the needs of the investors in these companies and to the public at large. We believe additional research may be required to better understand exactly what information investors in smaller companies really want and really need.

Second, we support establishing a definition for a smaller public company that significantly increases the number of registrants that fall below the large company or accelerated filer requirements. We believe the Committee should consider raising the public float threshold to 700 million from the current level of 75 million. And the Committee may also want to consider whether certain qualitative criteria should be considered or established as well. We further recommend that consideration be given to separating smaller public companies into both micro-caps and mid-caps with differing requirements for each of these groups.

Third, while we recognize it is easy to recommend and much more difficult to design, we believe the internal control requirements should be modified for smaller public companies to simplify the requirements and to reduce the associated costs. Obviously any such changes would need to be consistent with the needs and wants of investors. Areas for consideration include the adoption of a more risk-based approach that would allow the utilization of prior knowledge gained by the auditor and the spreading of certain required procedures for process controls over a multiple year period.

Number four, we'd like to allow adequate time to consider the input received by the Committee we recommend extending a Section 404 compliance date for non-accelerated filers which I heard earlier today that would be your recommendation.

Number five, we suggest that the Committee consider whether the accelerated filing deadlines should be further extended for smaller public companies, perhaps permanently. As you know, these dates are scheduled to be reduced to 60 days after year end for fiscal years ending on or after

December 15, 2005. We believe that smaller companies need additional time in order to implement the processes necessary to successfully meet these shortened timelines. Additionally, we have some question whether a shorter time frame is cost beneficial for the investors in the smallest of public companies, many of which may have very limited or inactive public float.

Lastly, we recommend that thorough guidance be provided regarding the SOX 404 requirement of smaller public companies and their auditors. This type of guidance will minimize uncertainties and better align the deliverables around the expectations of the PCAOB and their inspection teams.

This concludes my prepared remarks. I want to thank you for allowing me the opportunity to provide input to the important work of the Committee. I would be happy to address any questions that the Committee may have for me. Please be assured that McGladrey & Pullen is very supportive of your effort and would be willing to assist in any way which we can. Thank you.

MR. WANDER: You've already demonstrated assistance by giving us Leroy who has been a very valuable member of the Advisory Committee. Dick?

MR. JAFFEE: Dick Jaffee. We're going to talk size and the definition that's going to come of -- come out of our size Committee tomorrow. But you raised an issue and I would like to explore with you a little bit, and I think you're in a good position to comment. Total capitalization is a pretty simple calculation. Number of shares outstanding times stock pricing on some given day. The public float calculation gets a little more complex, but as we get into this definition of size and thinking about the closely held owner operators and so forth when they're excluded when you get to public float calculation, you begin to see that there are differences between the two. How do you feel about it? Is it tough as an auditor to make a good judgment on the public float calculation? Is that a complex calculation?

MR. TRAVIS: I don't see that as a complex calculation.

MR. JAFFEE: How do you go about doing that? What's the definition or the difference between the two?

MR. TRAVIS: In simple overly simple terms you have affiliates and non-affiliates. People who are not affiliated with the organization make up the public float calculation. That's oversimplified.

MR. JAFFEE: But your recommendation, if I heard you correctly was, that above seven hundred million public float as opposed to total capitalization would be what you would recommend.

MR. TRAVIS: Yes.

MR. WANDER: Jan.

MS. DOLAN: I want to thank you for the specificity of your recommendations, and I'd just like to ask you for a little more drill down on a couple of them.

MR. TRAVIS: Sure.

MS. DOLAN: Spreading the financial and the impact and just the cost of 404 is obviously one way to reduce the burden, annual burden, you know last panel we heard a recommendation possibly only do the whole thing, but do it every three years. Spreading it across the three year period is yet another way to try to divide it. We have run into -- we have been exploring that concept with different stakeholders but certainly some of them have been with other audit firms. And there seems to be a concern about how would you -- the mechanics of how would you actually do that.

I mean how would you determine what could be done in any one year? Would you test it only a third of this year, but certify them at the end? How do you decouple this concept of point in time that everything has to be all done and certified at a certain point in time. How do you start decoupling that and spreading it out over, say, some controls over year, over a three year period, or even everything gets done over a year but doesn't all have to be done as part of the end of the year activity. Tell me some of the mechanics of how you could go about doing that.

MR. TRAVIS: Well it's a great question. I think the answer depends on how descriptive you really want to be. From my simple point of view, the users of the financial information, investors, management, and others, are making an assumption that the internal control system is working day in and day out. And so from my point of view when you look at tone at the top and culture and things like that, do we have competent people in the organization, that's something that you would assess annually. Are there really significant changes.

Beyond that, for smaller public companies I would look to where are the significant risks in the business and what are the significant changes and use that to determine using judgment between perhaps dialogue between the auditor and the audit committee, where should we focus our efforts this year and let's make sure that over a period of time, and perhaps it's a three year period that we looked at all major areas of the control systems for the business, but it's really a facts and circumstances driven question because as businesses evolve and change, the risks in that business evolve and change, so spending the time in the right areas is absolutely essential as opposed as beating on all areas every year.

MS. DOLAN: I want to follow up. I -- again I think there's a lot of consensus from the various players in the whole 404 area that this would be a good idea. How do we customize this? How do we get it back in the hands of the auditors and the audit Committee and the company management to triangulate about what's really important and let's tailor it to every company. And yet we don't seem to be able to get there. So my question is: What needs to be done? I mean you mentioned that PCAOB perhaps has to give clear guidance. How do we get there? What are the steps to getting to the point where you and the audit committee and the management of the company feel that you have what you need to actually customize 404 for a particular company?

MR. TRAVIS: Well I think to a large degree we have to move towards more of a principles based and a judgment based approach so that we have competent people on the audit committees and there's competent people in management positions and there's competent people in the audit firms, they can work together and use their intellect as well as their knowledge of the business and their judgments to figure out where to spend the time each and every year. If you begin to get too prescriptive, then you get exactly the situation we have with smaller companies which is one size does not fit all situations. So I think the only way, as far as I'm convinced, as far as I'm concerned or at least the best way is we have to move back to some degree to giving the experts the judgments to do the right things.

MS. DOLAN: Okay. We started with AS 2, then we got to the interpretations and other frequently asked questions disclosure from PCAOB that came out on May 16, and now we're here. And we have some people who think we are there, enough latitude has been given because the term "use good judgment," and "don't over audit," "use a risk-based approach" has already been laid out as the standard, and yet we have others who come it's still not clear enough that we don't have enough latitude to take that approach you're suggesting, so what does it take, what more would it take as you're the head of an audit firm? What more would it take from the PCAOB or the SEC to give you the confidence that you're in that kind of environment where you can use that professional judgment?

MR. TRAVIS: Well, I think, first of all, the work of this Committee is absolutely part of that process where you begin to recognize that the needs and the resources available for General Motors is a lot different than the needs and resources that Don Perkins talked about. And so you really can't have the same requirements because investors in smaller public companies and the smaller public companies themselves can't deliver all of those requirements year in and year out.

If you're the head of an audit committee of a company that has a 2000 subsidiaries worldwide, you probably need some very sophisticated controls and business processes to make sure that you're getting good information, not only do your job in the audit committee chair, but also that the CEO and CFO has good information to manage the business. A smaller public company can't really afford all of that stuff and doesn't necessarily need all of that information because the audit committee folks and the board folks and the CEO are much more knowledgeable of all the activities going around in the business. So Janet, it's a great question, but I think really having different sets of rules and guidelines for the two types of entities or the three types of entities if you want to get into micro caps, I think is the starting point. Let's not have AS2 apply to everybody. Let's have a different set of rules for the smaller public companies.

MS. DOLAN: I just want to close with saying -- I just want an answer. Do you feel that right now with the interpretation you have from PCAOB you have the latitude with your smaller customers, your smaller company clients to bring the kind of judgment to bear that you would like to?

MR. TRAVIS: I think there's still some question about the level of judgment that is available. There is -- obviously when the Act was enacted, there was a lot of uncertainly around what the requirements really were. Over time that as people are implementing the Act uncertainty is diminishing. But there's a very significant hangover yet which is the uncertainty of what happens when there's a major failure, and what is going to be the expectations of the company and the audit company and the auditor once there is a major failure reported in the system. And so it's great to say we have all the guidance on judgment, but until we see the results of a mistake somewhere, and I'm talking about an unintentional mistake, I think we're going to have conservatism in audit firms, you're going to have some conservatism in management teams, and if audit committees are relatively smart, you'll have some conservatism in the audit committees.

MR. WANDER: Yes, Rusty?

MR. CLOUTIER: I want to ask you a question. In the last panel we talked quite about transparency, and this is something I think that that Sarbanes-Oxley really brings up. And I think it is very interesting we're meeting right next to the Chicago Board of Trade, because when we came in here earlier today, I don't think Alan Greenspan had raised rates, but I think he was planning on it at 2:15 this afternoon. And God only knows what the price oil is at this moment. My question is on transparency. We're trying to do things -- let me just give you a story and let me ask you how you deal with this as an auditor. I have a friend runs a small oil company, and he was CFO there. He just retired. He said Sarbanes-Oxley did him in, because he says he's always trying to guess how many barrels of oil he has in the ground and what it's worth.

No matter when he makes that guess he's wrong everyday. Of course you know you've got FASB -- he's doing a great job by trying to get it right. There's just so many variables. Goodwill accounting rules have changed. You know some companies don't have goodwill and others do, just the same type of transaction, depending on what year they did it. Now they're talking about mark-to-market. My question to you is: Is it ever going to be possible to have real transparency on financial statements or do we live in a world that moves so fast that by the time you print a financial statement -- you could print a financial statement of a healthy corporation today, and 60 days later it couldn't be healthy just due to the changes that have happened in the marketplace out there?

MR. TRAVIS: Well Rusty, I don't think we'll ever get to a situation where there is exactness in financial statements. There are so many estimates involved in developing the financial numbers, that reasonable people can differ on how to make those estimates, whether it's the number of barrels of oil in the ground or it's even the value of inventories. Most people don't realize that the valuation set for inventories is standard cost systems or estimates.

And so there are many numbers in financial information on financial statements on a specific point in time that are estimate based. As it relates to transparency, I think the key for sophisticated companies is to provide enough information for the users of that information to understand how those estimates are being put together.

Smaller companies have much simpler financial statements and much simpler transactions, so transparency hopefully should be easier to accomplish, but we'll never get to exactness in financials. And I think one of the key issues is what are the expectations of investors and users of financial information as relates to exactness.

MR. CLOUTIER: Could you tell -- let me ask you this question. Sarbanes-Oxley kind of gives a feeling that, well, as long as everybody is doing everything right in the company, nothing really can go wrong, and if you got a good audit committee, good external auditors and you got this and got that. The fact of the matter is, you could have great auditors of financial statements, you could be running an excellent company, and a lot can still go wrong on a given day.

MR. TRAVIS: A lot of things can change on any one day. That's part of the risk of investing. Giving transparency to what you do know is important. But guessing what might happen tomorrow is another challenge. Businesses go out of business all the time because of bad strategies. I think what Sarbanes-Oxley tries to do is try to make sure that the numbers are correct. The question is what's the definition of correct, and how reasonable are the numbers, not how exact are the numbers.

MR. THYEN: Jim Thyen. I would like to have a little more clarification or get your viewpoint building off of Dick Jaffee's comments on capitalization versus float. And help me understand why affiliated capital is not float.

MR. TRAVIS: Well I didn't make the rules, so you're asking the wrong guy.

MR. THYEN: I mean just at a high level I'm really trying to understand in a common sense way why affiliated capital would not be float.

MR. TRAVIS: Well I think -- let me give you an extreme example where a family or an individual owns 75 percent of a small public company. That individual probably will not only have control but they certainly understand every little piece of what's going on in that business or the ability to understand a real piece of what's going on in the business. So my belief is that the focus around float has to do with an investor like me in General Motors. I don't know about you, but I can't walk into the CEO's office and ask a lot of questions about how the business it doing or where it's headed. I think it's really trying to define who is a sophisticated inside investor versus who is not. That would be my perspective on the difference.

MR. THYEN: And I guess relating that to myself and my company, I would be an affiliated shareholder, so I would be in that category. Yet I don't consider myself as a holder of long term debt. I consider myself an investor in the equity, but I know that there are restrictions on my equity. I can't just go right out and sell it like a non-affiliated holder of equity. And I guess I'm asking for some help. But it seems to me affiliated and non-affiliated are just different kinds of float but they all are part of capital, otherwise it would be debt.

MR. TRAVIS: We're not debating the accounting characteristics of your equity versus the equity of third parties. What we're trying to get at with our recommendation is if you have a company that is all venture capital owned, those folks are sophisticated investors and have the ability to ask whatever questions they want. What we're trying to get at is identify the companies that have significant external and third party investors who really rely on the publicly available information to make their investment decisions.

So whether it's float or some other definition, what we're really trying to get at is those companies with significant external investors who can't go into the CEO's office and say, hey, I'm your grandma and I would like to know what the heck's going on.

MR. THYEN: That helps me a great deal. Thank you.

MR. WANDER: Dan?

MR. GOELZER: Dan Goelzer. Thank you for your testimony, Richard. It's very interesting and helpful. I just wanted to follow-up on two things that you had discussed with Janet Dolan. First, what do you see to be the aspects of Auditing Standard No. 2 as it exists today that prevents you from planning and conducting a risk-based audit, particularly of a smaller company?

MR. TRAVIS: Dan, I think the major issues have to do with the interpretations of the intent, and I think that each time an issue is raised about what's the intent and the PCAOB provides further guidance, it increases clarification. So without getting into a lot of details, I think we're narrowing the expectation gap on what you really want and what you really expect. And frankly, one of our biggest concerns one of our biggest challenges, shall I say, was the rule was written. The rules were written, great commentary coming out of your office in Washington, D.C., but then when the inspectors come out there seems to be different levels of expectations on what the rules really mean.

There's the first round of inspections, -- our experience and the communications we had with other major firms that went through the inspections was: what did you learn from the process? A lot more auditing. That was what came out in the process. So again there's a little bit of an expectation gap, nobody wants to get beat up and be the first pelt hung on the wall so to speak. And so being very conservative, we're probably all trying to do the right thing but we're probably all being fairly conservative and to some degree I don't know fearful is the right word, but we're probably spending a lot of time doing things that judgment would -- better judgment would give us a better answer. So I don't know if that helps you.

MR. GOELZER: It really anticipates the second question of mine was -- is part of the problem or is the problem that you feel you're getting a different message from our inspection staff from the words of the --

MR. TRAVIS: I would say our first year experience was yes. And believe me, as you know you have very talented, very dedicated people, but we felt like there was a gap between what we were hearing, what we were seeing, and then what was happening in the inspections. And frankly that's fairly normal in a new rule and a new process. It doesn't help matters, but it's part of the process implementing something that's brand new, is to narrow that expectation gap.

MR. GOELZER: The other thing I wanted to ask, if I understood correctly, I thought you suggested that perhaps Auditing Standard Number 2 shouldn't apply to smaller companies. There should be a different standard for their internal -- if that's what you were suggesting. How do you see that whole alternative standard as different?

MR. TRAVIS: What I think at the minimum what I think we need to have is clear guidance on if you're General Motors, what does it mean? If you are the small company that Don Perkins had, what does that really mean in terms of applying the standard? I'm not necessarily saying we need to rewrite the standard, but guidance on how to apply the standard I think would be very, very helpful. You're smarter than I am, you might know what -- you might have a different view of whether we need to rewrite another standard. Fewer standards would be good.

MR. WANDER: Kurt?

MR. SCHACHT: Nice to hear your testimony. Just a quick question for you in terms of trying to reduce costs by increasing competition in the auditing world, getting more of the smaller firms involved so it's not just the Big Four or Big Six. Is there a way to do that that would reduce costs in your view?

MR. TRAVIS: Well first of all, I think as you know, the Big Four are very, very talented and expertised firms. I think our firm and many others also have a level of expertise that can certainly serve the needs of public companies, especially smaller public companies. Every business has to have a focus. Our focus is on mid-sized businesses and we price according to the resources that they need, the resources we have, and I do believe that there would be some cost benefit if more companies, more audit firms could compete successfully for public company audits.

It's not the audit firms that are in the way, it's better awareness of the capabilities of the audit firms to do the job. And frankly the willingness of audit committees and investment banking firms to recommend someone other than a Big Four firm. What I am told time and time again is if I'm on -- if Joe or Suzie is on an audit committee or in an investment banking firm, there is no down side to recommending the Big Four. That's kind of an interesting way of looking at things. To see what you ought to is match the right needs with the right resources.

MR. SCHACHT: It's not probably as simple as telling issuers they need to shop around for these services a little more, or is it that simple?

MR. TRAVIS: I don't think -- I wish it was that simple. We've tried that method. I think there needs to be an education process, but certainly the firms like ours need to be part of, I think getting us involved, getting firms like us act more active with the organizations like the PCAOB, and the SEC, and others to build awareness of the capabilities that we truly have.

But the bottom line is are the audit committees and the investment bankers going to be willing to take -- to give the advice to choose somebody else. Now fortunately market conditions are really driving some change out of necessity. Big Four have limited resources and they're allocating those resources to wherever the highest and best use of what those resources are which the major clients that they serve, the major clients that they focus on. Firms like ours are benefiting from that indirectly in that the very high quality companies have to go find other audit firms and we're receiving many inquiries whether we're capable of doing the work and we're winning the work along with I think others including Grant Thornton or BDO are having the same sort of success. So the market conditions are doing a lot more than any marketing communications that any us could have done in the past.

MR. WANDER: Yes, Drew.

MR. CONNOLLY: Sir, this is a very irreverent question, but I've often wondered why if we have moved from the Big Eight to what is now the Big Four and, God willing, remains Big Four I guess, given the concerns there for one of the four, why you just wouldn't move up the next four and continue the Big Eight with the next four as part of that. And I mean there's a seriousness behind that question a little bit in that so many public companies are actually, and I don't mean to say this inaccurately, but have been intimidated into having a Big Four accountant because the perception is the institutional investors require it.

And I have been with -- involved with companies that have had Big Four auditors. I remember Peat Marwick very fondly. And I've worked with companies that are dealing with second tier and some small slightly peer reviewed accountants because that's what they can afford. So I guess my question is, from a self involved marketing standpoint you're obviously making that case in the marketplace everyday, but the patina of specialty by size of the Big

Four, is there -- other than the fact that they are the Big Four and have gotten the bulk of the 98 percent of the Fortune 500, how do you in fact break through that ceiling and become part of the newly constituted Big Eight?

MR. TRAVIS: My answer is five cents a share. I think the reality is enormous global companies require massive auditing resources to get the job done. And only collective organizations, because there really isn't a global audit firm, even the Big Four are conglomerations of firms located in a variety of countries, rather. Being able to put together that resource base is required to audit a company with 2000 subsidiaries located across the world.

So just by definition, many, many firms are just not qualified. I think many of the so-called second tier firms certainly have the capabilities to serve the needs of very large mid-market companies with global facilities around the world. If they had 2000 subsidiaries around the world, I'm not sure that's a true statement. So I think matching up expertise and matching up resources to the needs of the companies is the way I would answer your question. I don't think we're a legitimate competitor for General Motors. I don't think -- I don't see that client in our portfolio anytime soon and wouldn't recommend it to the audit committee.

But a five hundred million or a billion dollar manufacturer with a manufacturing plant in Germany and one in the U.K., there is no reason in the world we can't do that work because we all have foreign affiliates using the same methodology having all the communication capabilities, et cetera, et cetera to get the job done. So the resource capabilities are there to do a lot bigger percentage of publicly-traded companies especially those who we're talking about with smaller mid -- smaller public companies. And I think market conditions are helping and hopefully increased awareness and education will help too.

MR. WANDER: Alex?

MR. DAVERN: I wanted to make an observation from personal experience and see if you can confirm it or not -- my perception had been going beyond the Big Four would result in a lower quoted audit fee, and our company went through the process this year post-404, did refer to the non Big Four, inquired of two of them, got a formal quote from one along with three Big Four and, my experience with that is that the audit fee was right in the middle of a Big Four audit fee. There was no differential in price and was made very clear to me by Grant Thornton that their competitive advantages they saw was better service, more attentiveness to their customers, not lower fees. So I just wanted to make sure, ask your opinion. My perception is that moving to a non Big Four does not necessarily result in a significant change in cost. I'm just asking you to comment on that, if that's your experience or not.

MR. TRAVIS: I would say that certainly I've heard that situation in the past, but I would also say that number one, I think that if you're a public company, if you want better service and you want better attention, you should go to a firm where you are important to them. As it relates to price, I think if you look at one bid at one point in time, you can get all kinds of goofy answers. I think the realities are if you look at the cost structures of the Big Four, where are their offices, what's the partner compensation level, what kind of resource capabilities do they have, and you compare it to a mid-tier firm, obviously the cost structures are going to be a lot different. Pricing decisions are a whole 'nother issue, and -- but my point I'm trying to make is that over time for the services you buy I think you would see a difference in cost.

MR. DAVERN: Would you have any rule of thumb that you would share the with committee as to what that would likely be, so we have an accurate perception of the difference?

MR. TRAVIS: We used to believe that in the normal market, that certainly doesn't exist today because of supply and demand issues, that our rates were in the 85 percent mark of the Big Four and local firms were 85 percent of ours, and that is really a broad-based rule of thumb. And I don't think it's true anymore today.

MR. DAVERN: I assume from your comment that the likelihood is closer to a hundred percent than it used to be.

MR. TRAVIS: I don't believe that's the case. I think again, if you have a variety of competitors for your business, if there are enough of them, somebody wants that business bad enough, that they will price it accordingly regardless of what their cost structure is. You really need to look at it if you buy other services over a period of time, what's the collective rate going to be.

MR. WANDER: Bob?

MR. ROBOTTI: Bob Robotti. It seems to me that Nanophase's testimony in my mind is really interesting and unfortunately since you're the auditors you have to do the work that really is important too. It seems that the process and the execution process of 404 is fundamentally flawed.

And it's not a design problem in the law necessarily. It seems as if it's the rules themselves. I am struck by the fact that a company with nine million in cash with 120 million dollar market cap is paying $259,000 internal costs to do its internal control process. The cost benefit in that situation is clearly out of line, not when you've got a Big Four auditing firm that's concerned about it. So it's not a Big Four auditing issue. It really is the process. The process is fundamentally flawed.

If you stole the nine million dollars from Nanophase, the market cap would be unaffected by it. So the cost here is dramatic. And the fact is it's just plain and obvious. A lot of other things, it gets more nebulous; this is a dramatic situation. So therefore I'm asking you, how is it that the rules are such, because I can't understand it. One time way back when I was an auditor myself. I can't understand how there's any logic to the process, of how this is being implemented and what rules you feel as you have to do this work and have to force the company to do work that clearly, clearly is out of line. Everybody else the range of how out of line it is and how reasonable it is becomes probably less dramatic.

But in this case we know it is dramatic and obvious that anybody and how big that is just to kind of narrow it down to everybody else. It's clearly a problem, and it's in the implementations, it's not in the law. Which is also helpful which means we can make a change here. How did that work? Did they have to spend that kind of money? And I guess part of it PCAOB and everybody else in the process, that's my confusion. I can't understand how it works.

MR. TRAVIS: Well I can't comment specifically on what Nano -- what the company spent or who they pay, but what I will tell you is there a big difference between General Motors and that company is that General Motor probably already had very detailed processes and systems and documentation in place, and small companies aren't starting from that point of view. They have tone at the top, they have a few controls and documentation's pretty minimal.

So to get them from ground zero in year one to being in the ballpark of complying with the PCAOB's rules and expectations and being able to issue a clean opinion on the quality of their controls, management's assessment of the quality controls, and to avoid being the first pelt on the wall of coming up with, we have a material weakness, that takes a lot of time and dollars and hours to get the right answer. And I would guess, and I can't say about this company, as I said before, I would say I guess there was some excessive work done by the company, some excessive work done by the auditors, and some excessive work done by the consultants.

But you have this massive expectation gap between what was the intention of the rules and how is it going to be enforced. And there's a period of time, I believe, where people are doing a lot of work to make sure that they're meeting with this spirit and the details of the rules and not enough judgment is being applied. Let me give you an example which I just find amazing and this isn't necessarily the SOX-404 issue, but the fact that firms were having trouble talking to clients about accounting issues, things we've done for years and were fearful of doing that, that was driven by some sort of uncertainly and fear, but it made so sense whatsoever. The one thing that we've always known about auditing smaller public companies is you not only have to do the audit work but you have to add value because they have limited resources and they need your help and advice.

They don't have five thousand people on executive row. They don't have a lot of excess cash to do unnecessary things. So the point I'm trying to make is the start up to get a small public company from where they were to what the perceived expectations of the rules were and what the enforcement was going to be, is very, very expensive. And I think what we're learning is well intended people spent a lot of time and effort doing things that probably didn't need to be done to get good answers. Learning, more judgment, some clarification on expectations, some consistency involved around what the inspection teams are asking for versus what the PCAOB really wants, all of that's going to take some time. And the faster it gets ferreted out the better and sooner we'll get the good answers.

MR. WANDER: Janet?

MS. DOLAN: I have one follow-up point. From the testimony that we heard at other -- the New York hearing and here, if you really listen, what people were saying is not only was it not a good idea to take the 404 structure for transactional auditing and apply it to small companies. But small companies actually have the reverse of what big companies have in terms of real risk. If you're really looking of what creates risk for the shareholder, it kind of flips.

It's really done at the top and it's really the controlled environment and the entity controls. If you really wanted to say our real goal is match what we ought to be asking auditors to certify to what the real risk is, that risk is greater there, not transactional. And it sort of flips when you get to bigger companies. As you look at what we have in place for auditing for tone at the top and entity controls, is it very good? Would you recommend that we actually do something different? Is there a role -- a greater role that auditors can play in actually going after what apparently is the biggest risk for the smaller companies which is entity controls and tone at the top?

MR. TRAVIS: Well that's a terrific observation. I long believed in smaller companies because the transactions are less complex usually, and less volume of them, the tone at the top, the culture, those sorts of things, the competency of the people are really the guiding lights.

So I think one of the problems, Janet, is if you ask auditors to report on something that creates a whole level of activity and documentation, that may not always be cost beneficial for the value that the investors are getting. So the real key question -- the number one question for me would be, do the investors really even care if the auditors opine on management's assertion about internal controls.

The way the auditors and the audit committee have to get at the issue is by -- for auditors it's the client acceptance and reevaluation process. Do they have a good culture? Do they have competent people? Are they making good decisions? And the audit committee has to kind of do the same thing. I think as Don said earlier, they either do it right or he's gone. And so I think -- is the reporting of the quality of the internal control system, is the reporting by auditors on management's assessment really valuable to investors given the nature of small company businesses?

So I don't know that -- I don't know that you want auditors -- you need auditors to report on tone at the top. I don't know that you need auditors to report on competency of people. That's the role of the audit committee as far as I'm concerned. Auditors need to make sure those things fit the profile for responsible public companies before they do the work.

MS. DOLAN: Thank you.

MR. WANDER: I think we ought to move along. Michael, would you like to address the Advisory Committee please.

MR. MOLITOR: Thank you. My name is Mike Molitor. As I mentioned before, I'm a professor at Cooley Law School. Let me first say thank you very much, Committee members, for inviting me to testify today here. I am greatly honored to do so. I promise I won't say anything about Section 404 in any of my remarks.

What I would like to talk about today is the Pink Sheets. Now your Committee's mission has to do with smaller public companies. And largely what I'm talking about today the public in the true sense of the word. They're non-reporting companies, they're not subject to Section 12 of the Exchange Act. So it's not necessarily right down the center of what you're considering by and large. You did mention in item 5.7 of your agenda, also at the last meeting you heard Cromwell Coulson at the Pink Sheets give a lot of testimony that I'd like to expand on today.

I did submit a written letter. It was dated June 29 -- I'm sorry, July 29th. And what I'll talk about today is largely to amplify on that so I'll keep my comments brief. Now as I mentioned, I am a professor but only been doing that for a year and a half now. Before that I was in a large law firm in Grand Rapids, Michigan for about nine and a half years and I did a lot of Exchange Act work, I helped the companies file 10-K's, their proxy statements and did a number of securities offerings. And the thing that got me interested in the problem with the Pink Sheets is that I had a client that decided after Sarbanes-Oxley, enough of this.

404, all the other requirements of Sarbanes-Oxley, this client said this is ridiculous, we're going to go dark. That client had about 230 record shareholders.

And so as a result of this very easily was able to simply go off to the exchange that it was on and go dark, and all perfectly above board. And as we've seen from comments that other people have made very common as well. But that left a bit of a bad taste in my mouth. I thought we have shareholders in these companies that are doing this. They're going from this nice position of having great information about the company and they're getting 10-K every year or at least having access to it, 10-Q's every quarter, there's a nice proxy statement that comes out once a year. All of a sudden the shareholders go from tons of information to "poof," to basically nothing. So it got me thinking about this.

Another thing that got me thinking about this, I had friend who actually was a bit of a Pink Sheets investor, a Pink Sheets gambler. A friend of his taken a little bit of money and turned it into 50 thousand dollars in the Pink Sheets without really understanding why. He just got lucky. So this seems to me a lot of people are viewing Pink Sheets as more like a casino than a stock market.

So this led me into this topic. What did I find? Well, we've heard a lot of anecdotal stories of companies that have decided to go dark in response to Sarbanes-Oxley. They are able to do that because, and I guess this is a bit of a strong term, but there's a loophole in the 1934 Act that says that if you have fewer than three hundred record shareholders, you can decide not to be a public company anymore. This was adopted in late 1963. The Commission promulgated rules 12g5-1 in 1964 and the definition of a record shareholder by and large means somebody that has an actual stock certificate. That's really pretty rare today. And so a lot of these companies that are able to exploit this loophole and go dark like this, even though they have fewer than three hundred record shareholders, probably have hundreds or thousands of beneficial shareholders, who just like my former client have gone from this position of having great information to having very little now. So what should we do about this?

It seems to me that there's two goals that we should have. And I guess just to back up a little bit here I forgot to mention the eligibility rule. Back in 1999 the NASD passed a rule that said that all securities that are listed on the Over the Counter Bulletin Board basically need to be Section 12 registrants with a few exceptions for banking companies and insurance companies. This basically led to a mass exodus from the Over the Counter Bulletin Board. About three thousand companies took a look at the Exchange Act, and this is before Sarbanes-Oxley was even thought of, and said "we're not going to do that".

Where did these companies end up? They ended up on the Pink Sheets. Sometime before 1999 there were about a thousand securities or so that were listed on the Pink Sheets. How many are there today? There's more than seven thousand securities that are listed on the Pink Sheets. 4600 of those are exclusively, and when I say listed, what I mean is quoted on the Pink Sheets, 4600 of those are exclusively quoted on the Pink Sheets. So we've seen a massive population increase in the Pink Sheets. It also appears that trading volume in terms of dollars is increasing at the same time. And so again, what should we do with this?

It seems to me that we have two basic goals that we should be looking at here. We should be giving investors in these companies information. Obviously that's the whole goal of the Exchange Act. If you are an investor, you should look at a company, you should do some research on it before you decide to invest. The Exchange Act, the whole point of it is to give you the tools to it that.

And at the same time, even though we should be giving investors information about the company, I don't think that we should go too far in doing that. We've seen a lot of companies fleeing the Exchange Act after Sarbanes-Oxley, we've seen a lot of companies fleeing the Exchange Act even before Sarbanes-Oxley. So I think the two guiding principles that we should be thinking about when deciding what to do about these thousands of companies that have securities, traded in the Pink Sheets without publicly available information -- let's balance these two competing goals. So there have been a couple of other suggestions that have been made toward this end.

The first was a 2003 rulemaking petition that was filed by a group of institutional investors. They also sent the committee a letter concerning some of the same points that they raised in that letter. What they were suggesting in that letter was, well, let's change the definition of holders of record. If the Exchange Act says that you have to have fewer than three hundred holders of record, and the Exchange Act gives the Commission to define that term "holders of record," which it does, then why don't we just have the Commission change it to say we're not looking with people with actual physical stock certificates, we're looking at beneficial or street name holders. Well, this sounds like a fine solution, but the problem I see with it is that Sarbanes-Oxley, the Exchange Act, despite the good work that this Committee is doing, despite the ongoing efforts of the Commission, still is by and large one size fits all. And so if we were to take all of these companies who are able to avoid the Exchange Act and suddenly subject them to the Exchange Act overnight by simply changing the definition of holders of record, I think that's a bit much to ask of these companies.

Many of them were never publicly traded to begin with. Many of them decided to go private due to legitimate concerns like Sarbanes-Oxley. So what could we do to create a bit more of a tempered approach to this? Another suggestion that was made by Mr. Coulson when he testified to you in June, and what Mr. Coulson's main point was, well, we should require companies -- non-reporting companies who are traded on the Pink Sheets to make public disclosures in two situations. First situation is where its insiders are buying and selling its securities. The second situation is where the issuer is undertaking some sort of promotional activities that are designed to encourage other people to trade its securities.

Now this also sounds fine when you first thing about. We would at least have these companies going about making some publicly available information in some situations, but I think that we can do better than that. I think what we should do, like what the Exchange Act does is, is make disclosures continuous. If you are a Pink Sheet company, not an Exchange Act registrant, but you've taken some steps to become a Pink Sheet company, you've taken some steps to facilitate a trading market for your stock, it seems only fair to me we should require you to disclose some modicum of information, not full-blown Exchange Act Reporting status, but what I would suggest is that the Commission or this Committee recommend to the Commission that we explore some sort of what I'll call a "minor league disclosure regime" for companies that are traded on the Pink Sheets.

I've written a law review article on this. I write in the article and I won't bore you with all the details on this, but I looked at a number of possible disclosure models. The Pink Sheets itself has a disclosure policy. There's Regulation A under the Securities Act which is where securities offerings of five million dollars or less. There is the small corporate offering registration form which is promulgated by NASAA, which is for small securities offerings. Each of these forms has a number of ideas that we can look at to create the regime that gets investors important information -- financial statements, something resembling an MD&A Section, good information concerning the issuer’s business and its management. I mean without going too far overboard, these issuers, many of which are quite small.

The current regulation I don't believe does the job. It's Rule 15c2-11. Mr. Coulson talked about that in his letter to you and in his testimony to you. But basically the current rule that we have is that if a broker-dealer wants to go about entering a quotation in the Pink Sheets, the broker-dealer has to go about gathering issuer information. So the rule that we have now imposes the duty on the broker-dealer. The end result of this rule is that information rarely gets into the hands of investors. It's riddled with exceptions, what they call the "piggy back exception", the "unsolicited quotation exception". So I think that what we should do is change the definition Rule 12g5-1 to come up with a two-tier approach. What I think, and I do believe that the statute, if you look at Section 12g5 in the Exchange Act, gives the Commission the power to define the term "holders of record" as it deems necessary in the public interest.

What I would like to see the Commission do is adopt a two-tier approach. What I think should be done is to say well, if you are a company that's listed on something like an exchange, the New York Stock Exchange, AMEX, or traded on something like NASDAQ, something that requires you to be a Section 12(g) registrant, well then we'll continue to hope to count simply your traditional holders of record. But if you are listed on -- listed is the wrong word -- I should say quoted on the Pink Sheets, and you've taken some steps to facilitate that market, well here's what we're going to do. We're going to change the definition of holders of records to count your street name holders. And if you have more than five hundred street name holders, well guess what? You're going to be a Section 12 registrant. But hold on, we'll cut you a break. If you comply with this minor league disclosure regime that the Commission should design, we will continue only to count your holders of record. This way you would have people voluntarily complying with this disclosure regime that's much less onerous than the Exchange Act for fear that if they don't they will be stuck with the Exchange Act.

I guess I'll make a couple of last points before I conclude my comments here. One thing that I talked about in my letter, okay, well if we do this, where should this information be available? Right now, as I mentioned Rule 15c2-11, the information largely ends up in a broker-dealer's files without reaching the investor. The one thing that you might think of off the top of your head, is just make them file it on the EDGAR System. What I would suggest on that end, is let's take a look at the system that they have in Canada which is called SEDAR.

EDGAR, as some of you who are small business owners know, is not very simple. You just can't simply push a button and convert your nice Microsoft word document and nice spread sheets into EDGAR format. You by and large have to go to a financial printer to do this. With SEDAR what they allow you to do is essentially take all of these documents that you've done, turn them into a PDF, and post them on the website for nominal fees, and there you go. Much easier than doing EDGAR and much less costly than doing that.

The last observation I would like to make about this issue with the Pink Sheets is, if we do adopt some sort of disclosure regime for these non-Section 12 registrants, we should be sure to couple it with investor warnings. You may have an investor out there who sees something that superficially resembles a 10-K or superficially resembles a 10-Q and may think, well my Pink Sheet investment, well it's a publicly traded company. It's subject to all the protections that Sarbanes-Oxley gave me. One thing that we should think about is to make it clear in whatever disclosure documents that are required of these companies, the many differences between those companies and full fledged Exchange Act registrants. Again, the goal here should be to get critical information to investors, financials, something along the lines of MD&A, but not go too far. So I guess that's all I am would like to talk about today. That concludes my remarks. I'll be happy to answer any questions.

MR. WANDER: Mike, thank you very much. I did read a letter that you submitted, and I would hope that you would send us a copy of your article that's going to be published I guess in the Indiana Law Journal where you elaborate a little bit more on your what you call minor league disclosure, which would be disclosure for these companies. Let me ask you, we are going to consider tomorrow a working definition for smaller public companies, and it will be probably, if adopted, a two-tier situation where there will be companies up to 600 million, 700 hundred million in size, market cap -- total market cap, which will be essentially smaller public companies, and then companies with below let's say a hundred million would be in effect micro-cap companies. Do you think it would be appropriate to adopt your minor league disclosure for either of those two kinds of entities?

MR. MOLITOR: By and large the companies that are traded on the Pink Sheets are micro-cap companies. So by and large many of them would fall within in the definition to begin with. The thing that I looked at in my research is more along the lines of the numbers of shareholders rather than the market cap. But I think off the top of my head it sounds like a promising idea.

MR. WANDER: And do you think investors would be well served with that or that there are other additional items that they might need?

MR. MOLITOR: Well served by some sort of reduced reporting obligation?

MR. WANDER: Yes.

MR. MOLITOR: I guess what I was trying to accomplish with my comments is something is better than nothing. Right now we have essentially nothing for these Pink Sheet companies other than Rule 15c2-11 which doesn't particularly work very well. So I think that anything that we can do to give investors information would be a step in the right direction because they don't really have that now.

MR. WANDER: But I think your put your finger on the question maybe. I'll put it as you have done. The non-reporting Pink Sheet companies give us nothing, so anything is better. But now let's say these companies at a hundred million that are public or full -- they're not S-B companies, so they're fully complying with the Exchange Act disclosure rules. Would it be appropriate or in the public interest to downgrade them to something like your minor league disclosure system?

MR. MOLITOR: It would be in the public interest to the extent that it reduces the burden on those companies. That's obviously one of the main issues that you're looking at them with this Committee. I would think that it would not be in the public interest to the extent it reduces information to investors. Where you balance those two things is obviously one of the things that you're looking at with this Committee.

MR. WANDER: Well I would hope that once we adopt our size definition that we'll send it to you and you think about it and think about how your minor league disclosure might be helpful to us in calibrating the disclosures for these companies.

Any other questions? Drew.

MR. CONNOLLY: This is Drew Connolly. Professor Molitor, thank you very much for focusing this Committee's attention on an area of the marketplace that is particularly near and dear to me, and a place where I do whatever minimal magic in the corporate finance world I do. I'm very supportive of certainly the first part of the beneficial owners versus the record holders, that's an obsolete, archaic rule when everybody held their shares prior to DTC and prior to stock loan being the second largest profit center of the investment banking community, by lending those shares that are no longer physically in their position to facilitate short sales.

The concern I have is really a public interest question here. And it's really broader than do we put up the warning signs to the investors? As much as -- and I am deeply consumed with the idea, how do we get some more investors? Because I'm finding that investor confidence, and I'm really speaking of perhaps less sophisticated, but retail investors, not the outback riverboat gamblers who have to sign that penny stock letter, which by the way is another part of what I would like to hear your thoughts on. Because in the regime of the penny stock world, the definition of a stock is a penny stock, is on one level, is anything trading for under five dollars. Well that now encompasses large parts of the American Stock Exchange and some parts of the New York.

But given the strictures, and I speak as a former broker, if I were to effect a customer transaction in a, quote, "penny stock", prior to effecting that transaction, I would have to have a signed back penny stock letter that basically swore that my investor was completely aware of all risks, a riverboat gambler, totally prepared to lose every dime he made as an investor. And I'm not sure that we have perhaps not taken investor protection mandates on -- and this is a strange thing to say in an era of WorldCom, Enron, but if we have not taken some of that too far down the road such that small companies, reporting non-reporting, many of whom were in fact thrown into the Pink Sheets by that eligibility rule, the enforcement overnight of that eligibility rule, do we not create a scenario where we're creating not just a farm team or a minor league, but essentially a ghetto?

And I think my colleague Mark in our first meeting talked about his fear of creating regulatory schemes that would forever create that ghetto. So we have this -- the series of Pink Sheet rules, Pink Sheet penny stock rules, we have a trading venue which is now -- Mr. Coulson has done an inordinately good job in creating transparency. Those quotes are available to me on any computer system in the world. Previously I had to be a subscriber to the National Quotation Bureau and get my quotes once a week.

So the information, at least in terms of pricing information, is certainly available. The 15c material, as I think we talked about in June, is traditionally resident in a brokerage file, but it's also true that the NASD has a rule that a broker is supposed to maintain reasonably current financial information.

MR. MOLITOR: Yes.

MR. CONNOLLY: I think we'll hear, either by letter or perhaps by testimony, that there's an organization, MOBIUS, who absolutely for several years attempted to get the NASD to publish that data. They themselves -- the broker gets it and the NASD get it when it's filed. The NASD, and I believe I tried to have Mr. Knight talk about, is refusing to release that information to data purveyors who would make it publicly available, and I can only assume because they are in violation of their own rules, not keeping it current. So there is a format for that information to be available without too much more regulatory oversight. The rules exist.

They need to be enforced. And my hope is that as we look to layer on additional strictures on these small little -- the smallest of the small, that we look to simultaneously increasing their viability to attract investor capital.

MR. WANDER: I think we're going to move on. It's already 5:00 o'clock. We're going to terminate at 5:30, but since I took some of your time, we'll stay to hear our final two speakers. We're ready.

MR. BROUNSTEIN: Hi. Rick Brounstein. Just maybe a quick clarification on this minor league disclosure, and that is -- is it something that is less than full GAAP disclosure?

MR. MOLITOR: No, I would suggest that GAAP is something that is needed. Audited financial statements, I'm not sure that we can go that far. 15c2-11 just says, give us your most recent balance sheet and profit and loss statement, it doesn't say anything about GAAP at all right now.

MR. WANDER: Okay. Joe, would you like to continue please?

MR. STIEVEN: Sure. Thank you. Before I get started I would like to thank Rusty Cloutier for providing my name to Gerald Laporte regarding the impact of Sarbanes-Oxley on the banking industry. As said previously, I am with the

Stifel Nicolaus Financial Institutions Research Group. I have been there over twenty years. In investment banking terms is sort of like dog years, it's a long time. But we've been slowly focused on analyzing small to mid-sized financial institutions.

When they asked me to provide some thoughts, there were three areas that I wanted to talk about. The first was the impact of Sarbanes-Oxley on small banks. I'll do that very briefly.

Number two, what is then the impact that those have had on small banks in dealing with the customers. And finally third, which is not directly related to Sarbanes-Oxley, what is happening to the research coverage of small and mid-sized corporations out there? A little bit related to a previous speaker.

First is me drafting up some new documents. I wrote a piece of research three years ago which I think Sarbanes-Oxley came about really. There was an article in The Wall Street Journal, not that the journal is ever trying to be a little flamboyant, it said "Where's the Next Enron?". I took this to heart because somebody who has looked at the banking industry so long, and prior to coming to Steven Nichols, I was an examiner with the Federal Reserve. So I've been on both sides of the table.

We've responded with an editorial comment that said it's not in the regional banking sector, and we tried to, without making any recommendations, talk about it. And I'm just going to briefly very quickly read some comments. I know I'm competing with a warm dinner, so I will be brief.

Setting the banking industry apart from all other industries is that there is a truly independent set of extra eyes out there. The watchdog groups is comprised of various banking regulatory agencies that look at banks on a daily basis. In most cases the average regional banking institution has at least two regulators looking at it; there's three separate agencies, Federal Reserve, the FDIC, the Office of the Comptroller and Currency. In general banking regulators are trained to spot problems before they become big. And are they perfect? Of course not. Do they make mistakes? Of course. But in general the regulators have been phenomenal. In fact, a common line that I put out is I defy anyone in this room to name five major non-bank corporate failures in the United States. It would be WorldCom, Enron, Adelphia, easy. But if I challenged anybody to name the last major bank failure in the United States, my guess is that I'd probably clean up all the money. Most people can't. Bank of New England, 1989.

So my point is let's talk about this for two minutes. The FDIC recently put out data that the banking industry is again as profitable as ever. If you look at this, most experts now agree. But when you look down to the facts at why is it so healthy, the banking regulators have been the police of the banking highway. But more importantly why are the small banks the most profitable? I tell people it's because the regulators are tougher on the small banks. Why are they tougher on the small banks? Look around the room and say that does anybody here have a small little brother or little sister? Do you ever pick on them? It's the same thing in the regulatory environment. It's the exact same thing. You pick on who you can.

And my bank CEOs that I've worked with for that last 20 years, they never complain. They don't. The truth of the matter is we actually thank them -- they have kept the regional banking industry as healthy as it's ever been, and it's so important for our economy because the small banks are the ones providing the capital for the small businesses that are out there. You need these small banks out there. So my point, to try to sum it up quickly, is that the banking industry a lot of Sarbanes-Oxley is already covered by the banking regulations. They've done a phenomenal job. I'm not just saying it because I was one; I was there twenty years ago. They've done great job. A lot of it is just redundant. What is the average cost for a bank right now, under a billion dollars. We've done our own internal but we've seen other reports. The average bank they say is spending somewhere if you're under a billion dollars -- five percent of the profits on Sarbanes-Oxley.

What happens though, which leads to point number two. What happens? Or do they just eat that or pass it along? Of course they pass it along. That's how things work in America.

But the third point was with Sarbanes-Oxley costs that companies are now trying to de-list, it really presents a situation that I think is unhealthy, is that you got companies who want to delist. You've got fewer companies who want to provide research on small companies because you've got a smaller base out there. And I think it could potentially threaten the formation for small companies and the capital that goes into those companies. So I was asked to talk about my three comments. I tried to keep my comments very brief because I assume we still have one other speaker. I provided a copy of my speech to, I think, Kevin earlier.

And again, since the time I'll try to open it up for questions.

MR. WANDER: Mark?

MR. JENSEN: I was just going to try to make a point. I'm hiring Rusty as my adviser. It's an inside joke. Everybody from the community banks has said -- and I'm going to say this in a flip way but it's a serious question. But I want to make a point. Most of the banks have said it's redundant, that Sarbanes-Oxley is redundant on top of things you're already doing. If it is truly redundant, why is it causing any cost?

MR. STIEVEN: Well, most of the banks -- one of the reasons is you're having to hire additional professionals to re-package a lot of the information that was already provided. We've got some very noteworthy accountants, representatives of the accounting firms here, because of the liability attached to anything that comes from a professional provider, nothing is free.

MR. JENSEN: Most of -- most of the firms use what we learned, I can't say it's FDICIA, right, what we've learned to do in terms of internal control audit. We had experts who had done that, that used the framework similar to the internal controls structure, and then we used -- we just leveraged that knowledge down into the company. So it's really kind of modeled after the same thing. So I was just curious. Thanks for clearing that up. That does make it a little more understandable.

MR. STIEVEN: I can go on the FDIC website and pull down the vast majority of the data I need. That -- unfortunately that gets reformatted time and time and time again into other documents.

MR. JENSEN: There is no question. If you got to report once about the same thing, it should look the same every time every time you report it.

MR. STIEVEN: But it doesn't.

MR. WANDER: Janet?

MS. DOLAN: We've heard from Mr. Travis and others from the accounting industry that maybe the problem with 404 is that it's just so new. If we go along further we'll get a little more clarity, and the clarity will eventually get us to a stage where it's a more workable implementation process. If you're very familiar with the FDIC, what can PCAOB -- I'm sorry, -- PCAOB learn, why do we have to reinvent the wheel? What is it about -- what does the FDIC do that the PCAOB isn't doing? To either set the standards or make it clear or how do they create a risk-based approach to the auditing of banks that the community bank representatives who come here say they aren't getting with their Sarbanes-Oxley 404 approach? So there's a disconnect here somewhere. They're being asked to do a lot of stuff they don't have to do for the FDIC. So what could one agency learn from the other?

MR. STIEVEN: That's a very encompassing question. I would guess I'm going to answer your question with another question. There are a lot of things that are required of these small banks with some of these new rules and regulations. I guess the question is, who is it benefiting? Because the industry's obviously exceptionally healthy. We just had our test on bank failures, and that went over. So the question is who benefits from these additional regulations? And my point is we've had a lot of people do very bad things with regulations and need to try to stop that. And so I actually -- as somebody who was on the regulatory side, I understand it. But I think the issue is that the small companies don't have the resources, or if they do want to incur the costs, the percentage incurred by them is so much higher compared to somebody 10 or 20 times their size. And the final question is, who does it benefit? I don't know who it really benefits.

MS. DOLE: Well that wasn't my question. I think there's a lot of alignment around your conclusion that it isn't providing enough benefit. That's a separate issue. But if 404 is requiring too much audit activity on things that don't make -- that are inconsequential, and you don't have that situation when you have the FDIC doing the same kind of thing, which is audit to prevent -- I'm trying to get at what is different about the way the FDIC is choosing, is implementing their audit requirements from what PCAOB is doing?

We're getting back a lot of feedback that we need more clarity in the 404 arena in order to get away from this one size fits all. We have to figure out how to get there. So since the FDIC has been doing this a lot longer. What have they finally gotten to in terms of providing a message to the examiners? You were an examiner for 20 years. What do they do that gives the message to you to use a more rational, reasonable approach than apparently the examiners, so far at least, are given to the audit firms? Because audit firms are saying they're not getting that message yet on 404. What kind of message, what do they do to make it work in the banking arena that isn't being done in this corporate arena yet?

MR. STIEVEN: I think banking regulators have an unfair advantage in getting responses from corporations, both the Federal Reserve, the OCC and the FDIC. When they go into a bank, as Rusty can attest, they have the utmost attention of the people involved. And basically what they ask for has to be provided. You cannot get out using a shield of public information. You have to provide it. And if you do not there are very serious consequences. So I would say that structure for all of the public companies, I think would be virtually impossible. And I think the reason that you have the banking regulators who have that ability was all related to the deposit insurance reforms, et cetera, from the early or the mid 1900's.

MR. CONNOLLY: Sir, you're the Director of Research for regional banks at a major regional investment banking firm?

MR. STIEVEN: Yes.

MR. CONNOLLY: For a regional banking firm? Thank you very much. Do you have a position on sponsored research in terms of its availability to cover the vast majority of public companies that are not covered how the money would be able if it's not sponsored by the company as long as it's credible and some form of standard?

MR. STIEVEN: When you say sponsored research, can you define that for me?

MR. CONNOLLY: Where the company or one of its shareholders on a completely disclosed basis would hire a CFA or an independent research firm to provide standards-based CFA quality research. A major regional investment banking firm is not going to do a research report on a 20 million dollar micro cap that trades on the Bulletin Board. But their investors need that research nonetheless.

MR. STIEVEN: I would have a hard time thinking any research could be considered independent if you're paying somebody to provide it. I would think that would be more called public relations. So I would --

MR. CONNOLLY: How is that different from paying for an independent attorney, or an independent auditor, are they not all professional?

MR. STIEVEN: I guess the difference is that your accounting firm is saying that what you have done in the past -- for the past twelve months or whatever, those statements are accurate. Okay? Your attorney is saying that what you have done in the past is "legal" but you're asking someone else to make a prediction about the future. And I would say that is totally different than asking someone to certify the past was accurate. I would say then -- then you're getting into somewhat something that can be promotional. I would find a conflict in paying somebody to "paint a picture of the future".

MR. CONNOLLY: And that would be different than an a investment banker doing the same thing.

MR. STIEVEN: I would think it would be.

MR. WANDER: Okay. Sure Rusty.

MR. CLOUTIER: Believe me this is not a banking question, but I asked Joe to come for one reason. Joe is, and he will not say this, is considered one of the most if not the premier analyst on the street for financial institutions, he's one of the best. He is leaving the business. And I would like for him to talk about that for just a moment. But the other thing I would like Joe to talk about in just a moment is the impossibility that's coming. Forget banks, talk about any company, technology company, medical company, any small company, it is getting almost impossible to get coverage, to get research due to that you've just got to have tremendous size to get that out there and to get some firm to sell your stock retail-wise. I mean MidSouth Bancorp or anything else, it's getting more and more difficult for any company to go out there. You've been in the business twenty years. You and I have talked about this.

I would like you to give the Committee a little insight of what all this stuff has brought about as far as the coverage of research and why firms are nervous about doing that.

MR. STIEVEN: Sure. I'll answer Rusty's second question. In general there is diminishing research on smaller companies out there. And there are several facts. Some of them, not caused by Sarbanes-Oxley, some of them related to Sarbanes-Oxley. But when you have smaller companies trying to de-list, if an analyst is out there working with these companies and all of a sudden they de-list, you have invested time with these companies, and all of a sudden they -- you have invested time notice companies, all of a sudden your investment is worthless. So you are watching street analysts move their coverage uptown to make sure they don't have that happen to them. That's number one.

Number two, is that there have been numerous changes in the investment banking business that have caused people on what we call the sell side of the street, the research side to leave because of very complex regulations, and those regulations came about by the sins some of the investment banks committed, the bigger ones, and it's called the global settlement, over the last number of years. Again I've told this to people. They've said you're leaving. Are you bitter that you're leaving? I said no, I'm not bitter. I was a regulator. Regulations happen when people lie, cheat and steal, and there were people lying, cheating and stealing. But it is causing -- not commenting on myself what people would say -- is causing the brightest and the best to leave the street, to get into other businesses. And I think that's a challenge for small companies like Rusty's, et cetera, you want coverage on these companies out there, because if you look at where the economy gets fueled, it's fueled by the small corporations.

MR. WANDER: Do you have any suggestions on what we could advise or recommend to increase the research coverage? Or at least stem the flow of it?

MR. STIEVEN: I think there are regulations not related to Sarbanes-Oxley that have been detrimental to the securities industry and that's, again, not something that's involved in Sarbanes-Oxley. Michael had some great thoughts regarding some of the small companies. I think investors -- I don't care if there's 150 investors in a company, I think they deserve more information. In the age that we are in today, investors deserve more information, not less information. So I think we would like to try to encourage companies to keep their shares on exchanges, or at least quoted, and give information to people. And I think the fine line that we all have to walk is making sure that the burden is not excessive.

You cannot expect a company with a hundred million dollars of revenues to have the same resources as a company with ten billion dollars in revenues. That's obvious. You have to have a tiering structure. What I think is very right that you were talking about are setting levels for market capitalizations, and I think you talked about a three-tiered level somewhere around six or seven hundred. I fully endorse that. I would actually like to see it a little bit higher, but that would be a great start.

But I do think companies that are even under two hundred million dollars need a different level. I think they need an even reduced level. Because I forgot what speaker said this, but to comply when you are small, you still probably have to have the same amount of resources as somebody five and ten times your size, but you don't have the revenues to take care of that.

MR. WANDER: Okay. Thank you. Any other questions? If not, our last speaker is an old friend of mine, Jim Hickey.

MR. HICKEY: Good afternoon, everyone. As I said originally, I'm A principal of William Blair & Company which is a Chicago-based investment banking and investment management firm. For 70 years William Blair & Company has provided capital market services and advice to small and medium-sized growth companies and to new investors seeking opportunities to such businesses. I've been at Blair for 22 years, first as an equity research analyst, covering the technology sector for 11 years, and then as an investment banker focused on technology companies since then.

I appreciate the opportunity to appear before you this afternoon to talk about the impact of Sarbanes-Oxley compliance on small businesses. I believe it's clear that the Sarbanes-Oxley regulations have made an important positive contribution in restoring investor confidence in the integrity of financial reports by public companies after the disclosure of egregious misbehavior by several large high profile companies with very complex operations and capital structures. Regulations requiring more active involvement by more independent boards and audit committees, CEO and CFO certifications, expanded disclosures, and other actions that have improved the timeliness and transparency of financial information have had a good effect.

However, the zeal which attended the drafting of the legislation and subsequent rulemaking has just as clearly caused negative outcomes, particularly for smaller companies. The lack of distinction in the regulation for large and small enterprises is a fatal flaw, in my opinion, as is the apparent absence in practice of any consideration of the cost benefit trade-off in the new rules. Rather than making the capital formation process more efficient, Sarbanes-Oxley has made capital-raising much less sufficient and more difficult for smaller businesses. The managements and directors of my small and medium-sized company clients universally see Sarbanes-Oxley as a major cost burden that generates little or no benefit to them or their businesses.

My clients commonly cite the overall cost burden from the new regulations including out-of-pocket in lost productivity, the deterioration in their relationship with their outside auditors, the difficulty in recruiting independent directors, and the difficulty in obtaining research coverage as the main drawbacks of the new regulatory environment. I see firsthand how regulations interfere with the capital-raising process.

Examples include a local company I worked with for several years, that originally desired to go public to raise growth capital and provide liquidity for its owners.

Sarbanes-Oxley burdens were a major factor in its decision last year to sell the company rather than go public despite boasting strong growth and record results. A company we took public took several years ago decided to go private in 2002 due in part to the looming burdens of Sarbanes-Oxley compliance and difficulty in generating research coverage. Recently despite outstanding financial performance as a private entity, this client elected to sell control to a private equity firm instead of considering a public offering for the same reasons. The new owners contemplate an IPO in a couple of years, and as a result brought in a new CEO, and the CFO resigned because she did not want to have to deal with burdens of being a CFO in a small public company.

A local client that achieved strong sales and profit and clearly had the skill necessary to be a successful U.S. IPO candidate elected to go public earlier this year on the AIM exchange in the U.K, despite the fact that 95 percent of its business was generated in the United States, expressly to avoid the incremental costs and productivity burdens of Sarbanes-Oxley compliance which they estimated to be as much as an incremental two million dollars per year.

A venture-backed client that is in the midst of a self-imposed 12 to 18 month delay in its planned IPO to ensure its directors that it will be fully Sarbanes-Oxley compliant before it goes public even though it's not required currently under the Act.

Several public equity offering projects with which I've been involved, that experience unprecedented delays due to the inability or unwillingness of the auditors to provide timely responses during the registration process. Initially auditors can no longer be looked to for advice on how to handle various issues. It seems the response to almost every issue now needs to be "run through the national office". And those responses take weeks longer to be produced than was the case a couple of years ago. Such delays leave potential issuers to additional market risk that did not exist in the past.

My discussions with clients confirm the findings of the recent studies we heard talked about today that illustrate the costs of Sarbanes-Oxley compliance are falling disproportionately on smaller companies, particularly in terms of revenue and profits, and are increasing at a faster rate than they are for larger companies. Audit fees that have tripled, director fees that have increased 50 percent or more, and substantial increases in SEC-related legal fees are common experiences.

Furthermore, it is the least costly requirements, such as executive certifications, director independence, and enhanced disclosure that are perceived to have the most benefit to these companies, while the most expensive and time consuming requirements, such as section 404 requirements, are perceived to have the least benefit.

I understand that the Advisory Committee is considering establishing new definitions of small companies and recommend that Section 404 compliance with such a company be deferred for an additional year. I support this proposal, but believe that more relief is necessary. I urge you to consider establishing different standards for such companies. Standards which sustain the spirit of Sarbanes-Oxley but which better consider the cost benefit trade-off to small businesses. Such issuers should be required to work towards the standards of larger companies, but not necessarily meet every single requirement and perhaps have a more liberal materiality threshold apply.

I've heard talk today of a three-year cycle of Sarbanes-Oxley compliances requirements for such companies. That might be a benefit, but I see a situation where you'd have a furious effort every three years, a substantial incremental cost to these companies to jump through the hoop on that process. That to me seems to be a waste of time for these companies, a very inefficient way to go about it and likely to cause noticeable deviations in the results of these small businesses as they pay those costs every third year and suffer this. I think a better process would be to divide up the areas covered by Sarbanes-Oxley requirements for those companies who are required to a review a third of the requirements each year so that they have a steady expense and a steady process of going through it, and can still accomplish it all every three years.

One other point I would like to make, as someone who spent over a decade each as a research analyst and as an investment banker, is to urge the Advisory Committee to consider the effect of the regulations related to research analyst conflicts of interest are having on the capital-raising process. Certain of these rules are very beneficial, such as increased disclosure of conflicts, financial interests and compensation practices as well as prohibitions related to analyst supervision and promises of favorable research coverage connected with underwritings.

However, other rules clearly make the capital raising process less efficient. Two examples include the prohibition on communication between analysts, bankers and issuers, and on promising research coverage in connection with underwriting engagements. The communication restrictions simply make the process much more time consuming for everyone involved. Much less of that and much less productive for issuers by having effectively forced them to duplicate a substantial portion of their communication to bankers and analysts as part of their capital-raising process.

Furthermore, I believe an investment bank has an obligation to provide research coverage to its investor clients to whom it has sold securities in connection with an underwriting. While favorable coverage should not be promised, coverage itself should be part of the commitment that an investment bank makes to its clients, issuer and investor alike.

In closing I hope the analysis and recommendations of your Committee inject a greater degree of common sense and a consideration of the cost benefit trade off and regulations applicable to smaller companies, and contribute to restoring some of the efficiency that has been lost in our capital markets since the adoption of the Sarbanes-Oxley regulations. That's my statement, and I'd be happy to answer your questions.

MR. WANDER: And you're going to stand on it. Thanks very much, Jim.

MS. DOLAN: I too have a question. I've heard -- now not necessarily any testimony here, but I've heard anecdotally from companies that are getting ready to do an IPO, and they're trying to get their 404 compliance activities all lined up and ready; that they're being told by auditors who will be doing their 404 that they need to freeze their activities so that -- such as investing in new IT systems, acquisitions, anything that might be considered a new activity that will change the status of their control environment.

They were told originally 90 days and then 180 days. Are you hearing anything as you work with clients that -- these are the very clients who are generally investing and moving very quickly and investing and changing and, you know, maybe a freeze for them for 180 days is significant. Are you hearing that it's having that kind of chilling effect on what would be normal business activity that they would otherwise engage in just to make sure they're ready?

MR. HICKEY: Absolutely in the case of acquisitions. They could have gone through all the effort and pain to get themselves Sarbanes-Oxley compliant, but they go make an acquisition of a company and they have to start over with that entity. So it has absolutely stopped from considering that. I haven't heard as much on the system side, but that's not something we get exposed to in our normal services to the client.

MR. WANDER: Other? Yes, Rusty?

MR. CLOUTIER: I would just like to ask you one follow-up question from various testimony we heard today that Microsoft could never start under this environment and some of these companies would have had a real hard time. I guess my question is: Do you see it very difficult for technology companies to continue to evolve in the United States? And my second part of that question is: I recently had a visit from Chinese bankers, and last year from Russia bankers and both told me the same thing: it's a lot easier in their countries. They have less rules and regulations. Is that something we should be concerned about with technology coming out of India, China, Pakistan, young companies being formed? Is it something we should worry about? Have you all done any research on that?

MR. HICKEY: We haven't done any specific research on it. There's lots of technologies that will come out of those regions of the world, vis-a-vis Sarbanes-Oxley issues. Could a good company start today? Absolutely. There are hundreds of billions of dollars of committed capital into venture into private equity funds that are looking to be employed. When they can get through the door of going public is going to be later in their development, that will decrease their cost. At the margin you make the argument that it could reduce the internal return and put more power in the hands of private equity or capital venture funds.

But I don't think good ideas are going starving for investors here. Our firm has made an initiative over the last couple of years to develop business opportunities in Israel because it has been historically the aspiration of Israeli technology companies to go public on NASDAQ, and they were looking for U.S. firms that could help to provide that distribution. If you go over there today, they're all talking about going public on AIM. They're not talking about going public on NASDAQ.

They all view the Sarbanes-Oxley hurdles they have to jump through as an unreasonable burden compared to what the alternative market is for them is now. And that may not mean a lot to American jobs and American technology development, but it does mean something to American investment opportunities for investors in our country. They're not going to see these companies here because they're not going to be thinking about going over and trying to invest in the AIM market.

And the earlier question today about purchase research, the AIM market is entirely driven by purchased research; you get a nominee or a Nomad, where you pay 50 or a hundred thousand dollars to and he writes a report, puts your earnings estimates into it, and that is the basis he's the sponsor of that company. So I'm less opposed to the concept of paid research. The other question about how do you fix this in terms of research. That's her question. You've got to figure out how to have research paid for in our capital markets. You've taken away the link for investment banking activities.

The institutional investors are finding more efficient markets to do their trading that doesn't require the research connection. If you're not paying for it, it's going to disappear. And there was some analysis in the last two years, for companies between 10 and 50 million dollars at the end of '02 to the end of '04, companies with market cap to 10 to 50 million dollars seen on average, an 89 percent decrease in the number of research analysts that follow them.

Between 50 and 100 million it's a 76 percent decrease in the number of an analysts. One hundred to two hundred million it's a 50 percent decrease in the number of analysts. And that's partly the burdens, it's partly the inability to efficiently meet with these companies and have their firms get involved in the capital raising activities, and have that subsidize the research being paid.

It's a big problem, I think more than 404 compliance. It's being able to provide a way to have small firms sponsored in the market. People willing to go out on a limb, stake their reputation, credibility for their investment clients by making recommendations on these companies that's one of the biggest impediments.

MR. WANDER: Jim, could you provide us with those statistics?

MR. HICKEY: Yes.

MR. WANDER: Just get them to me. Did Alex have a question?

MR. DAVERN: I had an observation at the last Committee meeting. I qualified first as a chartered accountant in Ireland and the U.K. before becoming a CPA in Texas. The quantity of GAAP in the U.K. is physically, dramatically smaller, and the scale of regulation I think has significantly more common sense applied to it. My question is: Do you notice or are you aware in your experience any significant differential in the perception of investors about the quality of regulation and reporting in U.K. companies and valuations on the U.K. exchanges that are significantly different than those on the U.S. exchanges?

MR. HICKEY: It's hard to generalize on that. I think for many years the U.S. was perceived to have better financial reporting, more accurate financial reporting and generally at higher multiples for its companies. The events that gave rise to Sarbanes-Oxley substantially eroded that; these actions were necessary to restore that confidence. It has come back. I don't know that there's -- capital markets have become more efficient as well. Information flows, the internet, other things. There are things that help that.

I don't know that there is as dramatic a valuation difference geographically as there used to be. I'm not sure if that's because of the degree of confidence in the financial information today as it -- I think the level of most investors that I talk to, domestic and institutional, all viewed the degree of burdens put on small companies, the hurdles being made to jump through, as a waste of time. They do not derive incremental confidence by knowing that all these tests or transactions have been performed in the business and they understand the kind of risks that are there.

Smaller companies -- and someone earlier was talking about is it the culture at the top or the transaction testing at the bottom, and they want someone who can help them evaluate the culture at the top.

MR. WANDER: Anybody? Mark?

MR. JENSEN: A couple of things.

MR. WANDER: Could you speak into the mike?

MR. JENSEN: I'm sorry. The questions you gave in your comments said a lot about the reaction to compliance with Sarbanes-Oxley. I'm assuming what you really are meaning is 404 compliance more than anything else.

MR. HICKEY: It's actually everything. You'll hear the comments about everything. The least perceived value is the 404 components, but I would be lying if I didn't say there were a lot of small company managements who resent having to have independent boards. They have fully independent audit committees. That's probably something you can't back away from.

MR. JENSEN: This is kind of new testimony. I'm not sure we've heard that before, that everything is swept up in it. The question that I had about is there any research -- one comment, one question following. Is there any research available on the impact of Sarbanes on companies going public or companies being acquired that would quantify somehow the real impact to the American investing community of, say denied access to the opportunities -- investment opportunities and things like that?

MR. HICKEY: Not that I know of. There's the Foley study, the Foley and Lardner study that talks about the number of companies considering going private or who are not any longer considering going public.

MR. JENSEN: That's an issue we need to think about, opportunities denied to the American investment public. Obviously these are investment opportunities that suit the American investor very well. We just don't allow them to make any investments and their money will be safe. I'll guarantee.

The last question. This is this one. As an underwriter, if companies going public were allowed some kind of a phased in approach to 404 compliance, so whatever that might be, first year, maybe nothing, next year they get something, in a control environment. Next year they get maybe 404 audit, would that help companies go public and would you as an underwriter accept companies that would be phasing their way into 404 without it being able to prove that they were in compliance with 404?

MR. HICKEY: I think the answer is yes and yes. It would help companies go public because they would have less bureaucratic work to do as opposed to the development of their business with their products in the markets. Yes, we would be willing to take those kinds of company's public, if it wasn't a set of standards that said, the term that was used earlier, a ghetto, but it was a set of standards that reflected common sense application of where risk was to the scale of these businesses, because I believe investors in these kinds of companies are very comfortable that they are taking on incremental risk than they are if they are buying, say Coca-Cola -- and they're willing to live with that.

MR. JENSEN: The auditing profession gets to at the end of the day, whoever is looking at that, it would be looked at again in a courtroom later and judgment is called into question, that's where the auditors come from. It's not so much common sense today. It's the fact that five years from now we're going to be in a courtroom, and somebody's common sense is going to be applied to my common sense five years earlier.

MR. HICKEY: That came up earlier. Asking the auditors or the audit committees to use there judgment isn't going to happen because everybody's going to cover themselves for the fear of getting put out of business or sent to jail. So you need standards, explicit standards of what you have to cover and what you don't, what the materiality levels are. And those need to be developed with common sense by bodies such as yours that then can be applied universally to all companies of a given size.

MR. WANDER: Yes, Drew.

MR. CONNOLLY: At the risk of keeping anybody from a hot meal, I would like to just compliment you, Mr. Hickey. I find myself and also the Chair and the Co-Chairs, of selecting of witnesses on today's panel. I find myself wanting to invest in Nanophase. I want to have a community banker when I get home to New Jersey, and I'm going to really want to open a brokerage account at William Blair. The quality and caliber of the commentary -- I might even be willing to go back to school. But the truth is --

MR. TRAVIS: You need an auditor?

MR. CONNOLLY: The truth is your comments are incredibly well received. The research comment is one that I am personally and deeply concerned about. I have a relationship with an independent research provider who does do sponsored research. I'm very concerned about that. But also I want to make you aware that you're hitting it on the ground; that after last month's testimony we went down to Westminster Securities, a New York member firm, and got the following presentation document from the director of listing from the AIM, from the London Stock Exchange. Just so happens he was in New York on his rotation on his way to BIO 2005, which is the biotech conference with three hundred companies, where they were standing shoulder to shoulder with Archipelago and the American Stock Exchange looking for listings.

Now I brought this, but the fact of the matter is, that he sat there bald-facely and said, Sarbanes-Oxley is the best thing that ever happened to us, because they are getting companies from all over the world. Westminster was interested because they had various clients who were unwilling to list in the United States. And I am concerned about that both from the corporate finance stuff, which is what I do professionally, but I'm also as an investor, I don't want to be frozen out of the best deals. I want access to those deals. I'm not big enough to be a private equity firm, I'm just little old me. But my hope is that those private equity deals find their ways to the American investment public some day without being overburdened with regulations and precludes American investors from participating. So thank you for being here.

MR. WANDER: Actually our September meeting, maybe if we have enough time, we can take a half an hour and discuss -- Gerry and I did actually talk to some representatives from AIM. The difficulty -- and I'll tell you this that I see here, is the Nomads won't work in this country because of the liability which they don't have in the U.K. Any other questions for Jim or any of our other panelists?

(No response.)

Would any of our guests like to make some final concluding remarks?

(No response.)

If not, let me go through for the Advisory Committee just some housekeeping addendum items. You're finished.

(Whereupon, at approximately 5:00 p.m., the meeting was adjourned.)

* * * * *

24 CERTIFICATION

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

/s/ Herbert S. Wander______	October 28, 2005 ____________
Herbert S. Wander	Date
Committee Co-Chair	

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

Advisory Committee on Smaller Public Companies

1. Written Statements Received and Presentations Made

[Release Nos. 33-8560; 34-51417; File No. 265-23]

Aug. 10, 2005	Slide Presentation of Size Task Force, Alex Davern
Aug. 9, 2005	Bill Travis, Managing Partner, McGladery & Pullen LLP
Aug. 9, 2005	Donald S. Perkins, Chairman, Nanophase Technologies, Inc., Romeoville, Illinois
Aug. 9, 2005	David Bochnowski, Chairman and CEO, NorthWest Indiana Bancorp Munster, Indiana, and Member Government Affairs Steering Committee America's Community Bankers
Aug. 9, 2005	Joseph A. Stieven, Director, Stifel, Nicolaus & Company, Inc.
Aug. 9, 2005	James P. Hickey, CFR, Principal and Technology Group Head, William Blair & Company
Aug. 9, 2005	Charlotte M. Bahin, Senior Vice President, Regulatory Affairs, America's Community Bankers
Aug. 5, 2005	Cary J. Meer, Kirkpatrick & Lockhart Nicolson Graham LLP
Aug. 3, 2005	Charles J. Urstadt, CEO; Willing L. Biddle, COO and President; James R. Moore, CFO and Executive Vice President, Urstadt Biddle Properties Inc.
Aug. 3, 2005	Mark A. Schroeder, President & CEO, German American Bancorp

Aug. 2, 2005	Mark B. Barnes, Ice Miller, Indianapolis, Indiana
Aug. 2, 2005	James A. Clark, Chief Financial Officer, Critical Path, Inc.
Aug. 1, 2005	McAllister Consulting L.L.C.
Jul. 29, 2005	Vicki W. Li, Stevens & Lee, King of Prussia, Pennsylvania
Jul. 29, 2005	Michael K. Molitor, Assistant Professor, Thomas M. Cooley Law School, Grand Rapids, Michigan
Jul. 29, 2005	Geoffrey Grier, Senior Vice President, Marketing & Sales Proxy Service Division, Research Data Group, Inc.
Jul. 22, 2005	Benjamin Gettler, Chairman and CEO, Vulcan International Corp.
Jul. 19, 2005	Charlotte M. Bahin, Senior Vice President, Regulatory Affairs, America's Community Bankers
Jun. 30, 2005	Arnold Orlander
Jun. 29, 2005	Brian Small, Director of Finance, Amtech Systems, Inc.
Jun. 27, 2005	Merlin E. Zitzner, Chairman & CEO, The Baraboo Bancorporation, Inc.
Jun. 22, 2005	Gregory Pusey, President Advanced Nutraceuticals, Inc
Jun. 17, 2005	Professor William J. Carney; see also slide presentation
Jun. 17, 2005	Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, Inc.
Jun. 16, 2005	Murray S. Cohen, CEO, Epolin
Jun. 16, 2005	John P. O'Shea, President, Westminster Securities Corp.
Jun. 16, 2005	David L. Cox, Chairman, President and CEO, Emclaire Financial Corp., Farmers National Bank
Jun. 15, 2005	Opening Statement of David N. Feldman, Managing Partner, Feldman Weinstein LLP
Jun. 14, 2005	Gayle Essary, Managing Director, Investrend Research and CEO, Investrend Communications, Inc.
Jun. 13, 2005	Andrea Psoras, Principal, Strategic Advisory; Member, New York Society of Security Analysts
Jun. 12, 2005	Samuel J. Yake, Paoli, Pennsylvania
Jun. 10, 2005	R. Cromwell Coulson, Chief Executive Officer, Pink Sheets
Jun. 08, 2005	William (Bill) A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank on behalf of the Independent Community Bankers of America
Jun. 08, 2005	Stephen J. Nelson, The Nelson Law Firm LLC
Jun. 08, 2005	Philip V. Oppenheimer, Oppenheimer & Close, Inc.
Jun. 08, 2005	Steve Nagel, President, Kolorfusion International, Inc.
Jun. 08, 2005	Karl Kirwan
Jun. 08, 2005	Victoria Duff, CEO, Bold Ventures Group
Jun. 07, 2005	Michael Ramos, CPA
Jun. 07, 2005	Karl R. Barnickol, Barbara Blackford, Linda K. Wackwitz, Subcommittee on Smaller Public Companies, Securities Law Committee, Society of Corporate Secretaries & Governance Professionals
Jun. 06, 2005	Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial

	Executives International and Member of the SEC Advisory Committee on Smaller Public Companies
Jun. 06, 2005	Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial Executives International
Jun. 01, 2005	Deloitte & Touche LLP
May 31, 2005	Karen Kerrigan, President & CEO, Small Business & Entrepreneurship Council, Washington, District of Columbia
May 31, 2005	Robert J. Kueppers, Chair, Center for Public Company Audit Firms
May 31, 2005	Ernst & Young LLP
May 31, 2005	Charles W. Barkley, Attorney at Law, Charlotte, North Carolina
May 31, 2005	Ronald J. Simpson, Chief Financial Officer, Minefinders Corporation Ltd.
May 31, 2005	Debra Fiakas, CFA, Managing Director, Crystal Equity Research, New York, New York
May 31, 2005	Stephen M. Brock, CEO & President, Public Company Management Corporation, www.PublicCompanyManagement.com , www.PubcoWhitePapers.com
May 31, 2005	Joel Jameson, President, Silicon Economics, Inc., Cupertino, California
May 31, 2005	BDO Seidman, LLP
May 31, 2005	KPMG LLP
May 30, 2005	Michael T. Williams, Esq., Williams Law Group, P.A., Tampa, FL
May 30, 2005	David N. Feldman, Managing Partner, Feldman Weinstein LLP
May 26, 2005	Peter Chepucavage
May 26, 2005	Steven J. Sharp
May 26, 2005	Phillips W. Smith, Ph.D., Paradise Valley, Arizona
May 24, 2005	Kathryn Burns, Vice President and Director of Finance, Monroe Bank
May 24, 2005	John B. Williamson, III, Chairman, President and CEO of RGC Resources, Inc.: RGCO; Director and Audit Committee Chairman of Optical Cable Corporation: OCCF; Director and Audit Committee Chairman of Botetourt Bankshares Inc.: BORT.OB
May 24, 2005	Gayle Essary, Managing Director, Investrend Research (http://www.investrendresearch.com), CEO, Investrend Communications, Inc. (http://www.investrend.com)
May 24, 2005	Brad Smith, President, WBS&A, Ltd.
May 23, 2005	Scott Shaw
May 17, 2005	James A. Brodie, Managing Director, Carr Securities
May 11, 2005	Frederick D. Lipman, Blank Rome LLP, Philadelphia, Pennsylvania

Written Statements Regarding First Meeting

Apr. 12, 2005	James A. Brodie, Managing Director, Carr Securities Corporation, Port Washington, New York
Apr. 12, 2005	Catherine Connally, CIA, President, Issues Central Inc., Toronto, Canada
Apr. 08, 2005	Christopher Cole, Regulatory Counsel, Independent Community Bankers of America

Apr. 07, 2005	Richard D. Brounstein, Executive Vice President and Chief Financial Officer, Calypte Biomedical Corporation
Apr. 07, 2005	Nelson Obus, Wynnefield Capital, Inc.
Apr. 01, 2005	Financial Executives International
Mar. 31, 2005	Independent Community Bankers of America