23rd ANNUAL SEC GOVERNMENT-BUSINESS FORUM

ON SMALL BUSINESS CAPITAL FORMATION

SEC HEADQUARTERS
450 Fifth Street, N.W.
Washington, D.C. 20549

Monday, September 20, 2004

Diversified Reporting Services, Inc.
(202) 467-9200
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PANELISTS:

Brian Bussey
Gerald J. Laporte
Elizabeth G. Osterman
John D. Reynolds
MR. LAPORTE: If everybody could take their seat, that would be great. I'd like to call to order the 23rd Annual Government-Business Forum on Small Business Capital Formation, which we're holding this morning in accordance with Section 503 of the Omnibus Small Business Capital Formation Act of 1980.

First of all, I'd like to thank all the members of the -- all the people who helped to make this possible, especially the members of the planning committee and the people in the Office of Small Business Policy here at the SEC. All of them are listed in the binders that you got if you are a registered participant when you entered the room.

Before I introduce Commissioner Campos, I'd like to give the standard disclaimer, so that we don't have to repeat it throughout the day, which is that anything of substance that anyone from the SEC says here today represents his or her individual views only and doesn't necessarily represent the views of anyone else at the Commission or of the Commission itself.

To open the forum, I'd like to call upon SEC Commissioner Roel Campos. Commissioner Campos joined the SEC in August, 2002, less than a month after passage of the Sarbanes-Oxley Act, so he doesn't know what it was like to be here B-SOX, which in this building stands for before
Sarbanes-Oxley rather than the Boston Red Sox.

Before joining the Commission, Commissioner Campos co-founded El Dorado Communications, a radio broadcast company, so he has firsthand experience at what it's like to run a start-up company. He also had a distinguished career as an Air Force pilot, a federal prosecutor and a lawyer in private practice.

Since he's been here at the Commission, Commissioner Campos has been a friend of small business and entrepreneurship, and we're very glad to have him here today to officially open the forum. Commissioner Campos?

(Applause)

COMMISSIONER CAMPOS: Thank you, Gerry. It's great that you refer to me as a pilot, but you know, that was my dream when I went to the Air Force Academy, and my eyesight took a nose dive my last year, so I had to be a ground pounder, as they put it in the Air Force parlance. I only went through the first part of my Air Force training for a pilot.

But it's a pleasure to welcome all of you today to the 23rd Annual -- how about that, the 23rd Annual -- SEC Government-Business Forum on Small Business Capital Formation.

We've been conducting these meetings every year since Congress passed the Omnibus Small Business Capital Formation Act of 1980. That's a mouthful. But this year has
special significance as it's the first time -- I'm not sure why, but it's the first time this event has been held at our SEC headquarters.

So accordingly, I'm proud to welcome you, representatives of small business, to our home, the building and the very room where we pass all of these exciting rules that -- including the implementation of Sarbanes-Oxley -- that the newspaper writers and many of you who are interested in, come to see.

Gerry mentioned that I joined the Commission -- that's really that I took my oath a month or so after Sarbanes-Oxley was passed. In fact, four of the Commissioners were confirmed at the same time with Sarbanes-Oxley being passed on the floor of the Senate.

So I always tell people I feel like I'm the son or maybe the brother of Sarbanes-Oxley, in that all of us, at least that's the way I view it, came in together at the same time. And Gerry's quite right. I don't know a time when we didn't have the business of Sarbanes-Oxley to implement, and the rules, and dealing with all of the monumental issues of trying to balance the goals of Sarbanes-Oxley with the business community and making sure that the community at large can prosper, you know, in spite of the necessity to improve investor confidence in light of the scandals that occurred.
Gerry also mentioned that I founded with partners what amounted to a small business. And our particular business had to do with raising capital, venture capital and purchasing assets. In the case of my particular business, it was radio assets. And I used to tell people it was a little bit like having a mortgage that was due every three years.

And essentially, every three years or so, and you have to start thinking about it quite a bit in advance of your due dates, it was either time to refinance and pay back your investors and hope -- and not hopefully -- it required a return on their investment, or it was time to sell. And support profits and do that sort of thing.

It's a very difficult environment when you're in the start-up or early stage company, and I've lived it. I know what it's like to go to venture capitalists or angels, or others, and make a presentation. And unfortunately, most small businesses to get capital have to present a plan that creates a very high rate of return for that capital, or else no one is willing to take a risk at such an early stage.

So I personally have been very interested and it remains a passion of mine to figure out how government can facilitate this. We can't get into the business of capital raising. Obviously, we're -- you know, we're just government after all, and we're just regulators.

But I'm very keen on learning how we can facilitate
the access to capital by smaller businesses, and how we can essentially make appropriate accommodations in our regulations when required. All of us -- that's the whole Commission, the agency, believe that small business capital markets are integral to the health of the economy in general. I believe I've read recent studies that show that 60 to 70 percent, it depends on exactly the study, of new jobs created in America every year come from the small business sector. A significant percentage of the growth comes from the small business sector.

One of my privileges as an SEC Commissioner has been that my colleagues have allowed me to represent them with the International Organization of Securities Commissions, which is the international group where securities regulators meet and gather and talk about international issues.

And one of the things that I've noticed that's most evident that makes the U.S. economy different from the economies of other countries around the world is our small business sector and our venture capital. Frankly, I was in Europe last week -- the European model is essentially still a large company oriented partnership with government to create the objectives of growth.

And I maintain that this is a very difficult thing to do. We've seen the risks of central planning. We've seen
the risks of large companies that end up being essentially,
in many cases, very stuck to a government situation. And
again, I asked my colleagues in Europe, you know, what about
your risk capital. What about venture capital?

And it's an interesting observation that one of
them made. In fact, this was Commissioner Bolkestein who
is -- has been -- the Commissioner for Internal Markets for
the EU. And he said, "Well you know, that's a very good
point. You know, we never seem to have the entrepreneur
activity that you have in the U.S. There's something cultural
in Europe about that. You see, in Europe, if you attempt to
start a business and you fail, that's a taint on your life
for the rest of your life, and you can never get away from
that.

"In America, you know, you seem not to worry so much
about it, somebody trying to raise capital and then failing
the first time and maybe coming back the second or third time
and then being successful."

And I said, "Well, that is true. We certainly have
a great number of success stories of people being successful
only after they've had initial failures or just weren't
successful on their first or second times."

So maybe that's a blessing that we have. And that
unpredictable, unregulated energy that produces growth in the
small business sector, that creates new businesses and new
vitality is something that's part of the genius of America and our economy.

And today, we are open to listening to those of you, especially from the private sector, who have ideas and who understand the struggles that you have day to day, and understand where regulators like ourselves can do better.

We have tried, and I'll just quickly refer to my note here for a second.

We have tried to make significant accommodations to small business, but like anything else, this is a work in progress and I'm sure we can improve. And we're very open to your ideas and your input in this area.

In Regulation S-B for small businesses -- and in other small business initiatives -- we at the agency have created significant accommodations for small business. Small business issuers can file two years' worth of financial statements, rather than the three years' required for non-S-B issuers.

Well, we have created additional modifications for issuers that are unable to obtain two years' worth of financial statements. They can use shortened registration forms for securities offerings, while the Exchange Act reports have reduced narrative requirements.

In the context of exempt offerings, small business issuers have several means by which they can raise capital or
compensate employees with securities without triggering registration.

I believe that most would agree that these initiatives have significantly reduced the hurdles facing small business as they try to access the capital markets. The world today presents additional challenges for small business. In the wake of the significant upheaval of securities markets caused by the corporate scandals of 2001, and the sweeping reforms of Sarbanes-Oxley, the complexities of our rules and regulations have increased significantly.

The question is: How is this affecting small business? Are there new disclosure reforms and auditing standards that are too burdensome for small business? Is the cost of reporting becoming too costly for small business issuers? Are there special issues that new regulations pose for small business issuers that can be addressed without compromising investor protection?

Your input today, again, is so crucial. And I hope that you will not hold back and that you will hit us with your ideas and your thoughts. We have a very busy schedule today. I don't want to take too much time.

I will mention one positive thing that I saw recently. In a recent survey, the U.S. was second only to New Zealand in the ease of regulation for starting a new business. And that's actually quite amazing, considering the
size of our economy, the complexity and so on of our economy. And that is something that I take great pride in.

Now it doesn't mean that we're there, but it does at least give us a perspective. Europe, Asia and others -- there is much more paperwork to be done all around to start a business. So again, let me personally tell you how welcome you are, and I'm very pleased. On behalf of the Commission, there's two of my colleagues here today, Commissioner Goldschmid, Commissioner Glassman and others will be attending the sessions today during the different panels.

And again, let us have it. Thank you very much. (Applause)

MR. LAPORTE: Thanks, Commissioner Campos. I'd like to take a couple minutes to talk about housekeeping matters before we get into the roundtable discussions. We have two roundtable discussions today. The first one is on auditing matters and the second one is corporate disclosure, corporate governance and market regulation matters -- lot of things in the second roundtable.

The participants for these roundtables were chosen with the assistance of the members of the Planning Committee for the forum as directed by Congress. Most members of the Planning Committee represent professional and business organizations concerned with small business capital formation.
We solicited suggestions for topics to discuss from the general public, and we got a wide range of suggestions. We thank everyone who sent in suggested topics. We weren't all able to accommodate all suggestions. In some instances, we decided not to talk about a specific topic because we've covered that topic extensively in recent years at the forum.

This, for instance, was the case of the topic of general solicitation under Regulation D, which a lot of people want to talk about, but we spent a lot of time on in recent years.

But just because we haven't scheduled a specific topic for discussion doesn't mean that we don't think it's important for small business capital formation. It just means that we want to have some very focused discussions today.

It also, by the way, doesn't mean that it won't get discussed. All these people on the roundtable -- none of these people on the roundtable are wallflower types, and they can talk about anything they want to talk about. So if they want to talk about something that's not on the list of topics that we've raised, they can do so.

The roundtable format doesn't provide for direct audience participation, but we'll have a question and answer session after lunch where we will try to answer as many questions from the audience as we can. If you wish to submit
a question, there's a box out in the lobby there, with a slot on top.

You can write your question down on a piece of paper and drop it in the question box. There's also supposed to be some question cards, both at the question box and, I think, some at the end of the aisles. If you have any questions, if you're looking for a question card, you can ask any of the SEC people with a blue name tag, and they'll try to get you a question card. But you don't really need a question card. You can just write it on a slip of paper and drop it in the box.

In addition, after the question and answer period starting -- we're scheduled to start at 2:00, but we might change that around depending on how things go this morning, we have the breakout sessions at which all registered participants for the forum are entitled to submit recommendations for consideration by the final general session at 4:45 this afternoon.

Before I turn the program over to Alan Beller and Andy Bailey for the first roundtable, I'd like to remind the panelists that this program is being broadcast to an overflow audience in another room on this floor as well as being webcast. We hope that all speakers will use the microphones so that everybody who's listening can hear.

At Alan Beller's request, I'm also suggesting that
the panelists use the European system for being recognized, which means that if you want to be recognized to speak, you take your tent card and you turn it on end and you put it on the desk in front of you and you'll be recognized.

Finally, I'd like to note that Herb Wander has been added as a member of this first roundtable. He's also scheduled to be on the second roundtable. Herb is an expert on some auditing issues. We had a lot of difficulty getting lawyers who wanted to sit up here and talk about auditing issues, and Herb decided to do it. So we said if you want to do it, Herb, you're welcome to do so.

Alan and Andy, why don't you take over?

MR. BELLER: Gerry, thanks very much. On behalf of Andy Bailey who's sitting here on my left, for those of you who can't see, Andy is the Deputy Chief Accountant with particular responsibility for auditing here at the Commission. I'm the Director of the Division of Corporation Finance.

In light of the time, Gerry, unless you disagree, I don't think we want to shortchange the roundtable, so I would suggest we're going to go the full 90 minutes and take some time out of the breaks and do whatever else. But let's assume that this panel -- it's now 9:40. Let's assume this panel will run till something like 11:10.

I want to introduce the participants briefly going
from my left around. Commissioner Campos and Commissioner Glassman. Next is Herb Wander, whom Gerry already mentioned from Katten Muchin in Chicago. On Herb's left is Bruce Webb from McGladdrey and Pullen in Des Moines, Iowa. Is it a machine (Laughter)? Next to --

MR. WEBB: I'm not a machine.

MR. BELLER: -- him is Lawrence Moreau, who is a board member of IntermixMedia, Inc. in Los Angeles, California. Next to -- can't read my own handwriting. I'm sorry. Next to Lawrence is Mark Jensen who is a partner and National Director for Venture Capital Services for Deloitte in San Jose, California.

Next to Mark is Lynnette Fallon, who is the Senior Vice President and General Counsel of Axcelis Technologies in Beverly, Massachusetts. Next to Lynnette is Doug Carmichael, who is the Chief Auditor and the Director of Professional Standards at the PCAOB here in Washington.

Next to Doug is George Batavick, who is a member of the board of the FASB in Norwalk, Connecticut. And finally, William Balhoff, who is the director of Postlethwaite & Netterville in Baton Rouge, Louisiana. And on Mr. Balhoff's left is Commissioner Goldschmid.

Why don't I start off with a question? I guess it's certainly a question that's received a fair amount of attention. How do the -- let me start with somebody who's
inside a corporation and thinks about addressing these. So let me start with Ms. Fallon.

How do the costs of compliance with Sarbanes-Oxley Section 404, which is the section regarding assessment and attestation of internal control over financial reporting -- how do the costs of compliance with that section and with -- by your auditors with PCAOB Standard Number 2 compare with the benefits for smaller companies? How would you assess that?

MS. FALLON: Well first of all, I think both sides of the equation are unknown at this point. My company like many companies is still discussing with our auditors what 404 is going to cost us, and as you can imagine, the numbers keep increasing rather than decreasing.

I think, you know, there are internal costs and external costs as the auditor's fees. But there's also the pressure and stress that we're putting on our financial teams within the companies.

Our company has hired two new comptrollers and we are currently seeking to hire an internal -- someone who can specialize in internal audit, who can sort of support the 404 function, and haven't been able to find anyone in the work force.

It's a very difficult time both in terms of staffing internally and in terms of trying to predict what
your costs are going to be before we're done. I think on the
benefits side -- I think, you know, again are yet to be seen.
There are some operational efficiencies that companies will
receive as a result of doing all the internal control work.

But I think one of the significant aspects of 404
that Congress gave us is the concept that auditors need to
assess internal control. In other words, it would have been
one thing if 404 was just the first half, that management
needed to assess and attest as to internal control.

But having the auditors play that role means that
the internal control work that needs to be done to satisfy
404 is very focused on documentation. In other words, it's
not -- there's a lot of internal, informal controls that go
on within a company, but our auditors need to assume that the
control simply doesn't exist if the documentation doesn't
exist.

So there's a huge amount of documentation work that
companies are dealing with in order to create the paper trail
that the control exists, that really may not be bringing any
operational efficiencies to the company at the end of the
day, assuming that there were informal and documented
controls in place.

MR. BELLER : Mr. Moreau, do you have any --

MR. MOREAU: Yes, I do. I think there's a couple
things here. There's, first of all, the cost that everybody
talks about. That's the financial cost, the dollars and
cents.

But if you're a small company and one that's
growing, there's another huge cost and that is management time
and focus. You can quantify, although it's very, very
difficult at this point, how much dollars and cents are
going up. But in my experience, frankly, I spent a lot of
time in venture capital and investment banking by -- for
quite a few years.

My experience is that not only do the costs of the
internal control on the financial end, that being that you
have to hire more people, have to put in more regulations,
but also management. And by the way, I don't disagree with
some of this, because some these managements needed to
take a good, hard look at what was happening in their
organizations and become aware of their regulatory and, more
importantly, fiduciary duties to their stockholders.

But it is huge. Before I came here, I called up,
oh, maybe a dozen of my friends in D.C. in investment banking,
just kicked it around with them, and no one said they
thought the benefits were worth the costs, for whatever that's
worth.

So I think there's two important things that need
to be addressed here, and the benefits seem to be, at least to
me and some of the people I talked to, kind of hard to get
their hands around. The costs are there and they're growing. I think I saw a study that the cost went up better than 30 percent -- estimates from January to June of last year -- this year, I mean.

And we all know budgets -- you never come in under budgets. So I think they're going to be horrendous, both in dollars and in management and company focus time.

MR. BELLER: Anyone (inaudible) --

COMMISSIONER GLASSMAN: I have a question about the benefits. Is what's happening that there -- that controls exist -- effective controls exist, but they're informal. And so what the requirements are doing is making sure they're documented so that there's some institutional history of these controls? Or -- which means relatively fewer benefits than if the controls really don't exist and they're being created as well as documented.

Which of those two do you think is happening?

MS. FALLON: I think both are happening. I mean, it obviously depends on the company. There are companies with certainly things -- even big companies with situations where an internal control should exist and simply doesn't exist.

And therefore, as part of 404, that control would be brought into being. But there are -- though it's probably the minority situations in most -- most companies that are
reasonably well run that have gone through the public
offering process, that have a couple of years, at least, of
audited financial statements are going to have some controls
over probably material items that can materially impact their
financial statements.

One of the issues with 404 is that there doesn't
seem to be, and maybe someone can correct me if I'm wrong,
but there doesn't seem to really be a materiality
judgment going on about whether a particular control is
likely to have a material impact as opposed to a number of
small problems that could come together and become a
reportable event and, ultimately, a weakness.

So there are a lot of details. There really are.

There's a lot of time spent on a lot of details.

MR. MOREAU: Uh huh.

MR. BELLER: Mr. Moreau?

MR. MOREAU: Sure, should I do this?

MR. BELLER: Yes, that's fine.

MR. MOREAU: Okay. Also, let me say, getting the
formalities -- when you work with small companies, it's
mainly the management. I think I couldn't agree with more --
and it's coming up in the next round, that the internal
control was the governance, the independence, the having
somebody look over management's shoulders and overlook the
directors.
I think that's been the huge -- and I know for a fact improvement in internal controls, especially vis-a-vis outsiders. Now, when you get to a situation though, that you're looking for a process, maybe -- I'd say form over substance in a lot of cases -- that's where we run into real problems, like I said, both financially and also management time.

And I'm not sure what the benefits of writing it down are. For instance, my personal opinion is that a lot of the problems that we've had with these companies is that the persons at the top were crooks. I'll guarantee, they knew what was going on. Fastow knew what was going on; Sullivan knew what was going on. They had good internal controls, and they were crooks.

And internal control, when I was in auditing, never can control the top management. It's the board's responsibility to hold their feet to the fire, and it's management's responsibility signing off on these reports. That, I think -- I know three cases that all of a sudden, when the CEO had to sign and realized what he was signing criminal (sic) -- all of a sudden internal control and proof (inaudible).

MR. BELLER: Okay. We've got a number of cards up. I think I'm going to go with Mr. Balhoff, then Mr. Carmichael,
and then Mr. Webb.

MR. BALHOFF: Okay. I'll be quick. From a cost benefit perspective, we practice in Louisiana, and we have some clients that actually used to file with the SEC that delisted because of -- and from their perspective, their reasons were the cost of Sarbanes-Oxley, primarily the 404 reporting.

So from their perspective, they felt like it wasn't an actively traded stock. They had over 500 shareholders. They just had to buy down to 300. So these companies themselves, just in our practice, we saw that affect. And we --

MR. BELLER: Just out of curiosity, how many?

MR. BALHOFF: Two. But we don't -- I mean, we don't do that many public companies, either. And secondly, there are a number of clients of ours that were planning on going public, and they have put those plans on the back burner, definitely to address and see what some of the impact has been of Sarbanes-Oxley, and primarily their concerns are 404, also.

Not necessarily that having the controls and implementing the controls are inappropriate, because they certainly are not. It is absolutely appropriate. But the actual documentation, the testing and the paying people to come in.
And just one more quick point, because I think Lynnette made the comment about getting the staff. I think that we're finding a tightening market for staff right now, and it's for a lot of different reasons. But everybody talks about this being an employment act for accountants.

But the national firms are taking up staff. The clients need staff. As local firms, we need staff. It is across the board, creating maybe not a crisis, but a significant issue.

MR. BELLER: Okay, thanks very much. Mr. Carmichael?

MR. CARMICHAEL: I just wanted to point out some of the benefits -- when you look at the costs and benefits, the costs, of course, are immediate and out of pocket. The benefits are more intangible.

Before I started at the PCAOB, I did a study of the bank. It had experienced an $8 million defalcation. This bank had an average net income of $10 million. So it was a big hit.

Their insurance company wouldn't renew their fidelity insurance without an independent study of their controls, saying that they were good. The study we did of the bank disclosed a remarkable lack of ownership of controls in the departments doing operating and marketing.

They thought their job was to do those things, and
they didn't think they had any responsibility at all for controls. So one of the benefits that can come is from the operating people understanding their ownership of the controls in their area.

I think that ties in to the documentation as well. Unless those controls are documented, those people aren't going to realize their responsibilities, and they have a very good chance that they are going to see their main responsibilities as operating ones and not ones that require controls.

Also, I'd just point out that in the way of the -- a lot of the major frauds that occurred, they were done through journal entries. Management can always override the controls to get those unsupported journal entries made, but it is much more difficult to impose on an employee who has the direct responsibility for making the entries that charge to do it, if there are good documented controls saying that they should not do it.

Another intangible benefit, of course, is the ability to market securities and the effect that the knowledge of good controls may have on that market.

MR. BELLER: Mr. Webb?

MR. WEBB: Our firm audits a number of smaller issuers. As a matter of fact, of our slightly over a hundred issuer clients, we only have I think, 13 to 15 that are
accelerated filers. So they do tend to be smaller. We also are consulting with a number of issuers in -- audited by other auditors in implementing management's assessment of -- under 404.

I think what we're finding in both cases is that as clients are going through this assessment process, they are finding gaps, as Commissioner Glassman sort of suggested they might, and then are able to remediate those controls. So that definitely is a benefit of this.

On the other hand, the cost is very high, and I think it's proportionately higher for small issuers, both internally and externally. I think the smaller companies have less ability to complete the management assessment process internally, and therefore are having to outsource many of those services as well as seeing their audit fees perhaps as much as double, because of the audit of internal control.

And you do have to ask yourself whether the benefits to investors are as great when you're dealing with small cap or mid cap, lightly traded entities versus the larger highly traded companies.

MR. BELLER: Mr. Jensen?

MR. JENSEN: I was just going to try and give you a perspective from the venture capital community side, based on our conversations with them and how they see it. I would say
right now they don't see a cost benefit relationship in companies that they are behind or that they're investing in. And part of that is that, to some extent, venture capitalists don't like to be told what to do, so they're being told what do to here, so that's a bit of a problem in and of itself.

But if you put it aside for a minute, I think that in the early stage company, the early stage venture backed company, whose long term plan may be to approach the capital markets in one way or another, either through an IPO or being acquired, these rules really have to be applied in those companies long before they approach the capital markets.

Because they -- it's the way that internal control structures work; they have to be in place and they have to be operating effectively in order for an auditor to attest to them.

So what's happened through 404 as we've backed up into private companies, a lot of public company requirements. I think further, just to broaden this out a little bit -- most of -- I'm not an attorney, and so the attorneys on the panel can talk about this. But my view is, very quickly, Sarbanes is becoming the standard of due care in corporate governance today, whether you're public or private.

And we're seeing D&O insurance providers who
increasingly want to see the kinds of things that -- you know, 404 kinds of attestation reports. They want to see that in their companies that they insure today. We're seeing lenders who are starting to want that. And then we're starting to see -- you know, every state has standards of due care or of due diligence of board members.

And as Sarbanes continues to evolve, it quickly is going to become the standard of due care. And so I think we have to be cautious what our standards in small companies are, because I think it can become very difficult for small companies to comply with all these rules.

And if it truly becomes standard of due care in these companies, it's going to increase the cost for everybody. I guess my final comment on it is, I do believe there's benefits to these kind -- to 404 kinds of attestation -- in larger companies.

When you move into smaller companies, what really happens in the internal control environment, and especially in very small companies, but companies that are even of modest size, the CEO/CFO play an incredibly important role in the internal control structure in those companies, are involved in every major transaction. They authorize every major revenue contract.

They are basically involved in every major decision that is going on in the company, either formally or
informally. From an auditor's perspective, that's a very
good internal control in the sense that the CEO is involved
in it.

From the other side of the coin, it's not a control
you can rely on. So at the end of the day, you still have to
go back and pull all of that documentation, pull all the
information and satisfy yourself that the correct decision
was made.

So in some cases, we've put a lot of structure in
place, but it's not really operating the way we think it is.

MR. BELLER: I want to --

MR. WANDER: Can I make a comment?

MR. BELLER: Of course.

MR. WANDER: I just -- our experience has been that
the fees to the outside auditor are going to be 80 to
100 percent of the fees for the regular audit. And
that's for both large and small companies. The larger you
get, they maybe a little bit less, but they're very sizeable.

And that doesn't include the fees to the outside
consultants whom many people are bringing in, because you
can't rely on your regular auditor to establish these
practices and procedures. And that's also not including the
staff time that's devoted to this, which is, you can imagine,

enormous.

I do want to emphasize what a couple of other
people have said. That is, I think there is a growing crisis for qualified people in this area. I think you have a drain by all the big accounting firms hiring people here. The PCAOB is hiring people; that is taking away from firms. And there aren't that many qualified people.

And particularly if you're in a smaller community, where it's more difficult to attract somebody with an MBA or some other degree like that, it's going to be very hard to get them.

In terms of the benefits, I think it's too early to tell right now. I don't think we know what's going to happen at the end of this year, how many companies will not receive a favorable opinion, what that means in the marketplace, what it really means to the control environment. And I think it's going to take some time before everyone has an idea of whether the cost is really worth all the benefits that people perceive.

MR. BELLER: Okay. We've got a number of questions to cover. Mr. Batavick, I want to come back to you. But I'd like to throw another question on the table here, at least one more on this general subject, which is sort of in the area of: What, if anything, should we and others be doing?

The SEC, the Commission, in its adopting release and the Commission staff in its set of frequently asked questions about this subject of internal control, both
identified an acceptable framework for evaluating internal control as that developed by the committee of sponsoring organizations, or COSO, back in the early 90s. And also left open the possibility and, indeed, in the staff questions, provided a little encouragement to COSO or others to think about whether there is a more suitable evaluative framework for smaller companies, since that's really where the internal control exercise begins.

In addition to the other subjects we've been talking about in this area, does anyone want to take a shot at whether that's a sensible approach? Whether there's another sensible approach at addressing what kind of a framework there should be?

Mr. Jensen in his recent -- in his remarks a couple of minutes ago -- suggested that the structure of smaller companies, with CEOs and CFOs playing a large role, and almost everything, is kind of a little bit different structure than, or a very different structure than, larger companies. Any thoughts on that subject?

MR. JENSEN: Let me -- if I could just start it. I'll kick it off. If you look at the COSO framework, the comments on it when it was originally issued, there were a number of comments made to the committee at that time that they didn't feel that it was properly tuned to smaller and mid-sized companies.
As an accommodation to that comment, there was basically about three paragraphs put at the end of each section of the framework that talked about how it applied to small and mid-sized companies. And if you read those sections carefully, it basically says small and mid-sized companies' controls are entirely different than what's above here.

They felt that that was good enough and left it at that. The PCAOB, when they first issued their auditing standard, they too had a separate section on small businesses. Ultimately, that was not in the final rules, and they had indicated or put a small section in their report that said that they thought the COSO framework covered small businesses by these two or three paragraphs that I think were really probably put into the original framework as an afterthought, trying to accommodate a comment there.

A number of comments were made about how it may not be applicable to small businesses or mid-sized companies. I think the internal control structure of those companies is radically different, and the kinds of things you rely on are radically different.

And I think there probably needs to be more work done in that area. Now, whether it's within the COSO framework or not, I'll leave that for other people. But I think that, certainly, there's not enough in it right now to
help small business and mid-sized companies understand what
they need to do, and to help auditors understand.

MR. WEBB: I think I agree with Mark, that it
would be a worthwhile endeavor to revisit COSO and see if it
could be more tailored to smaller companies, and provide both
issuers and auditors better guidance in making the
assessment.

However, I would also observe that the components
of internal control described in COSO, as a control
environment, risk assessment, monitoring control activities,
information and communication, I do think apply across the
board. The financial statement assertions are the same
whether you're large or small. And the activities involved in
the various processes, that is authorization, initiation,
reporting of processing and reporting -- they're the same.

So the way in which those things are actually
implemented in small companies versus large companies are
dramatically different. And if COSO could sort of get focused
on the internal control for small companies, then I think
that would be helpful. But I think it would be a very
challenging assignment.

I think it would be -- I would be surprised if they
came back with a drastically different model.

MR. BAILEY: This is Andy Bailey. I'm going to
object. I was on the oversight task force, and I'll tell
you, we did take it seriously. What I'm wondering is, is this a problem with the concepts in the framework, or is this really a problem that has to do more with describing case situations where you might adapt the framework?

In other words, it's not in the framework so much as it is a series of case descriptions that deal with the specialized circumstances. Now, the problem we have when we start thinking about that is that there are an infinite number of these, and I'm a little bit concerned about how to approach that.

Anybody have any idea how COSO might approach this?

MR. JENSEN : I would agree with you. I think that having some case examples would be helpful. I agree with Bruce's comments. I don't think we need a new framework, but I think how it applies in small and mid-sized companies is not entirely clear.

I think it is going to be problematic for auditors when they -- when you start looking at internal controls in small companies that tend to be less formal. If you look at what the COSO rules, or what COSO says about small and mid-sized companies, a lot of these controls wouldn't need to be documented.

They basically say that they exist informally because of CEOs involved in many of -- you know -- in all important transactions and things like that. So they
actually -- if you took it literally, exactly the way it's written -- I'm not sure an auditor could audit it. And I'm sure they're not.

I'm sure they're telling people that doesn't fly. You've got to put this down. So I think we need -- I think it does need to be adjusted to -- and I think case examples would be an excellent way to do it.

MR. BAILEY: Mr. Carmichael?

MR. CARMICHAEL: I should say I'm here speaking for myself, not for the PCAOB or its staff members or the board members. But the board did remove the discussion of small business that was there, because it seemed to be causing some confusion. There were issues about whether we were attempting to change COSO, and some people thought we were being more restrictive.

Some people thought we were being less restrictive. So it seemed better just to rely on what was in COSO. But I think that the board did agree with the SEC, that it would be a good idea for a body to develop something more specific for small businesses.

In fact, in the process of preparing the standard in our discussions with the FEI, we did recommend to the FEI that they consider taking that under consideration. In the standard itself, we wanted to provide a standard that was not one size fits all, and that provided the flexibility in doing
the work to allow for differences.

   The thought was that a smaller business would be
less complex, and if it was less complex, that the controls
would be simpler, and therefore, the auditing would be easier
and the cost would be lower. And we tried to write the
standard in a way that would permit that flexibility to be
exercised.

   MR. BELLER: I think we should move on to the next
question, but I want to come back to Mr. Batavick whom I
didn't give the floor to a few minutes ago, to see if --

   MR. BATAVICK: What I wanted to do is just mention
a perspective from a standard setter, and we heard a lot of
comments this morning relative to the cost of implementation
of 404, et cetera. And although as a standard setter, we
don't really have hands on, not in companies we're not
auditing.

   And the actual experience that I can tell you over
the last year or so, based on all of our meetings -- I think
you're all familiar probably, with our due process, which
means that we are open to a lot of groups coming in and
speaking with us. Certainly, when we're looking at putting
out new standards or interpretations, we also have exposure
drafts to go out and get comments.

   And I can say over the last year, just about every
meeting we have, just about every time we put out something
for exposure, the comments that we get back are not only
comments on our specific standard, but they're also comments
about 404, saying the work is very difficult, our staff is
thin, et cetera.

So what we're seeing as a standard setter is
really a request to slow down in order to give people more
time to address the 404. So that's the -- just wanted to
give you the perspective from a standard setter, is that the
request that we kind of defer some of our work, we kind of
slow down some of our work to give companies more time to
implement 404.

MR. BELLER: Thank you very much. Shall we turn to
limits on non-audit services? And I'm going to turn this
over to Andy Bailey.

MR. BAILEY: Yes, there has been a great deal of
discussion, I think in the industry in general, but
specifically with respect to small businesses. In terms of
the independent --

MALE VOICE: Can't hear you.

MR. BAILEY: Can't hear me?

MALE VOICE: Is your mike on?

MR. BAILEY: I believe it's on. I wasn't talking
into it. I apologize. Been a good deal of discussion about
the independence rules, and the difficulties with complying
with the independence rules for everyone, including large
organizations, but small organizations in particular.

The question is, should further accommodation to
the Sarbanes-Oxley prohibitions on auditing firms providing
non-audit services to audit clients be made for smaller
companies. Now, just to set that up a little bit, issues
often arise with respect to secondments from the public
accounting firm to say, a smaller firm to perform certain
limited functions, bookkeeping services, systems development
that relates to financial statements, for example,
internal audit outsourcing issues, hiring audit staff,
et cetera. Are you encountering these problems in the
small businesses? And do you think that there should be
further accommodations?

MR. BAILEY: William Balhoff?

MR. BALHOFF: For the most part, my experience has
not been that those have been very onerous, the independence
issues. The concerns I have are if a signal gets sent, that
from small businesses, that the non-audit services that are
permitted are tainted in a sense, because you don't want to
use your auditor. It's going to affect their independence or
objectivity. That's a concern.

I have a concern to the extent that we not have
more services. I think it's appropriate, what we have
right now, but that we not try to bring more things under
the umbrella of what's not acceptable.
So I'm not seeing for our clients, or for the CPA firms that I've discussed it with, a lot of issues about independence and the pre-approval and the services that are prohibited right now. I don't think it's difficult for the issuers to find people to perform those services, particularly as it relates to bookkeeping and other things, the implementation of systems and design.

But I think if we start setting up a wall and essentially making it look like, or giving the impression that this -- not all services that are permitted right now are not -- basically, we ought to try to avoid them. I think that's the thing we would be most concerned about.

I don't think the small businesses will benefit from that exception.

MR. BAILEY: What other services do you have in mind here?

MR. BALHOFF: Basically to the extent of assisting the clients with implementation -- understanding the accounting standards, for instance, or not deciding exactly how that standard should be implemented, but helping the client understand.

Just generally, if a client has a -- we have clients that have tried or they were going to try to expand their business, and they'll have issues and questions about that, that would come to us for -- whereas for a small
business, they won't go find another provider that will help
them address all the different issues that they need to
address before they make that decision.

We don't make the decision for them and we don't
function as management. We're not auditing our own work, but
we actually are there on a consultative basis for the client.
Also, tax services, definitely. Probably for most of our
clients, we perform the tax services.

MR. BAILEY: Lynnette Fallon?

MS. FALLON: Yes, I don't know how you could have a
different standard on this issue for smaller public
companies. I mean, if the idea is that we're restricting non-
audit services because they either create a conflict of
interest, or I think there was one theory that -- which 404
seems to belie -- given that it's doubling what we're paying
our auditors.

But there was a theory that if companies simply
paid their auditors too much, then they were in their
pockets. And therefore, we want to reduce that to the
minimum, which is audit fees.

So I don't think you can have two standards here.

But, you know, a couple of observations on this point are that
first of all, you should know -- you know -- that the
institutional investor community is pushing public companies
way beyond what, you know, are on the no no list under
Sarbanes-Oxley in terms of non-audit services.

And most large institutional investors look at the disclosure and practice statements of audit fees and non-audit fees. And so even things that are permitted non-audit fees properly approved in advance by the audit committee are still subject to attack by institutional investors, because they are of the view that you should simply have either all or most of your fees on the audit and sometimes some say audit and tax side.

And so that's a pressure that exists in the world, regardless of what the regulations are.

MR. BAILEY: Mark Jensen?

MR. JENSEN: You know, I would -- I think I would agree with what was -- what's been said so far. I'm not sure that -- first of all, I don't think you want to have different standards and I'm not sure that the investing public or most companies would have a different standard anyway.

I think the one area in small businesses though, and mid-sized companies where I am seeing some real concern and some -- and we probably need to think about making some adjustments -- that is, the audit firms today have really gotten to the point where, you know, we audit what management tells us.

And in small companies, they typically don't have
the kind of resources a big company has. And so, in a lot of complicated transactions, they simply don't have the resources to determine how it should be accounted for and what the right disclosures around that particular transaction might be.

The auditors today would feel that we can't really advise a client on how to do that, and so then the client now has to go find another service provider who may know less about the business in order to have them come in and advise them about the accounting on the transaction, which increases the cost.

Then, when you're back in a small and mid-sized environment, you're actually back to where the auditor is going to go in and do that work again anyway, and has to, because there's just not enough control around those kinds of transactions in a small and mid-sized environment for the auditor to rely on it.

So you really are starting to duplicate some things there. I think that is an area where we could probably make some improvements, and I think companies would find some value in that.

MR. BAILEY: Herb Wander.

MR. WANDER: Yes, I agree wholeheartedly with most of the comments earlier that have been said. I think one standard is appropriate. I think the standards that we have
adopted all were needed, and so I wouldn't detract from them. And I don't find any of our clients, whether they be small, mid-sized or large cap, that really are looking for sources that aren't available.

There are a great many consulting firms who have grown up, and who, in fact, are looking to take away this business from what was a large -- the large accounting firms' business.

So I don't really see a need for this to help small business or any other business. I do think the accountants, as was just stated, are tending to shy away from providing advice in areas because they're very concerned that they will, in effect, find some fault and then some difficulty, some error that they find, the company didn't find, and therefore, may harm their ability to give a 404 opinion.

I think that's frankly a negative that probably should be avoided, but I don't think it applies just to small companies. I think it applies, frankly, to the larger companies who have more complicated issues who are finding their accounting firms a hesitant system in that.

MR. BAILEY: Bruce, and then we'll go with --

MR. WEBB: I guess I would have several observations, and I do mostly agree with the comments of the other panelists. I certainly agree that the current restrictions not on the services that are in the SEC's rules
are appropriate.

I also agree that some people are sort of getting paranoid, and, clearly, that's happening with the investor community and the people that claim to be their representatives or their watchdogs. I served on the roundtable discussion sponsored by the PCAOB on tax services, and it was very clear that many representatives there feel that auditors should not be able to provide any non-audit services to their clients.

I think the Sarbanes-Oxley Act and the SEC's rules have specific restrictions, but not overly broad restrictions. And I think it would be a shame if auditors were not -- or were afraid to or felt they were not -- permitted to advise their clients on the application of accounting principles, or to advise them on business consequences of proposed transactions and that sort of thing.

Our firm does not feel we're prohibited from doing those activities, and unless the rules would specifically prohibit it, we would intend to continue to do that on an advisory basis, recognizing that the issuer, of course, must ultimately make the management decisions and implement the actions.

MR. BAILEY: Doug Carmichael.

MR. CARMICHAEL: I have a comment and a question.

The comment relates to advising on accounting principles, and
certainly there isn't anything in our standard that I think should impede the ability to do that, although caution is necessary to make sure the auditor is not making management decisions in that area.

But we have a frequently asked question that makes some suggestions on how to do that. And then the PCAOB also adopted the interpretation of the Independent Standards Board that deals with giving implementation advice on FASB Statement 133, which is the example of the kind of complex accounting standard that companies probably would find valuable to consult with the auditor on.

So there are guidelines out there on how to do it, and 404 and our standards should not cut off giving that advice, provided it's done in accordance with those guidelines.

A question I had was on tax services. I wondered what companies find most valuable in the way of tax services and what your firm is providing. Is it just tax compliance or how far does it get into the tax planning and strategy area?

MR. BAILEY: Okay. Bill?

MR. BALHOFF: Well, we're a relatively small firm, and we have, I think, a pretty well developed tax area. But most of the work that we do for our audit clients would be more tax compliance, if they have questions about
it, you know, in terms of we don't sell tax shelters and we're not aggressive about that. So, primarily, there's some tax planning, but primarily it's tax compliance from our perspective. I don't know, Bruce, what is your all experience there? I called on you.

MR. WEBB: (Laughter) Thank you, Bill.

MR. BALHOFF: Sorry.

MR. WEBB: I think our firm's experience would be similar. We clearly do provide the tax compliance services, that is, preparation of tax returns for most of our audit clients, whether they're issuers or whether they're not issuers.

We also provide tax consultation or advisory services to those same clients. They're not highly structured, shrink wrapped tax solutions sorts of products, but rather advice on specific proposed or actual transactions or courses of action that the client may be considering.

MR. BAILEY: Lynnette Fallon?

MS. FALLON: Just to give you -- first of all, my firm does use our auditor for tax compliance. But one area of significant activity for us and many companies, even very small companies that are global is tax planning for transfer pricing.

So that you are structuring your arrangements with
your subsidiaries, so that the tax authorities in various foreign countries will respect the amount of income that they're getting to tax. It's a very complex area. You need a national firm to do that, so right away, you're limited to the Big Four, the final four.

And you also need a firm that really understands your business. And for that reason, it makes a lot of sense to keep that work with your auditor if you can.

MR. BAILEY: Go ahead, Herb.

MR. WANDER: This is one area where I think audit committee members are very concerned about what the marketplace and institutional investors have been telling them. And so I think they're shying away from loading up their regular accountants with more tax work.

I think whether the PCAOB or the SEC says something, they're more concerned with the market reaction, and, therefore, are lessening the amount of tax work that they give to their regular accountant.

MR. BAILEY: Before we leave this area, I attended another meeting recently, where I was surprised by the number of questions that came in with respect to AS2, the internal control standard, and the interaction that the auditor and management particularly -- these were smaller firms, also -- can have with respect to the auditors supporting management in some way with respect to the assessment process,
I wonder if Doug would just comment on that. We seem to have shifted to the accounting side, and this is really an audit panel.

MR. CARMICHAEL: The assistance, of course, is permitted with preparing documentation and identifying weaknesses in the system. In the standard, because this area was so judgmental, the PCAOB did not draw any bright lines. And instead, it relied on the audit committee to look at the particular situation and evaluate whether in the circumstances there was sufficient management involvement -- substantive management involvement -- for the auditor not to be making management decisions or performing management functions.

So specifically, approval by the audit committee for any internal control related services is required. And I would add to that, though, that the -- merely saying in an engagement letter that management will be substantively involved is not sufficient.

And that's why the requirement is there in the standard to have specific pre-approval of any internal control related services by management, because it does depend so much on the particular services that are being provided and what happens in the particular circumstances.

MR. BAILEY: Herb?
MR. WANDER: The difficulty is, how does an audit committee make that decision. It's almost impossible. And they turn to the lawyer, and the lawyer reads all the releases and comes up sort of, well, on the one hand, on the other hand,

And so you ask the accountants literally -- give me a representation that this work won't adversely affect your independence, and they shy away from that. So the end result is you're not using your regular accountant, I think, to the extent you probably can, because of the fear of losing the independence and the lack -- and I don't want bright lines, but I think the PCAOB has been a little bit -- you may not have meant to, but people are reading what you put out as saying you've got to be extremely careful, don't go there.

MR. BALHOFF: I'd agree with the "you have to be extremely careful" part.

MR. WANDER: And therefore, don't try it. I mean, this is the first year we've had this. Nobody knows what the end result is going to look like. Nobody knows -- you know, God forbid you lose your independence. It's almost unfathomable to think about what that means.

And so people aren't going to jump into that area, particularly when their own accounting firms aren't going to represent or warrant that this won't adversely affect independence.
MR. BAILEY: Bruce Webb?

MR. WEBB: I'm our firm's director of auditing and independence, and, as such, it was my responsibility to develop the auditing principles and methodologies to implement on Standard Number 2.

And I will simply say that I agree that there are no bright lines in there, but if you read -- and I believe it's paragraph 46 that talks about the fact that inadequate documentation could be a material weakness -- I had a lot of heartburn with us getting very involved in the documentation process.

And as a result, and not knowing how we would be able to effectively control that on a case-by-case basis or agree with audit committees on the extent of our involvement, vis-a-vis the extent of management's involvement, we simply decided that we would not be involved with the client documentation process.

On the other hand, I firmly believe that the audit of internal control has to be a continuous audit. It should not be a management goes and does everything and then the auditor comes in and says, "Whoops, you blew it. Start over."

So we are certainly encouraging our people to go in as management has completed the phase one planning and identification of significant accounts, relevant assertions
and the significant controls, and perform audit procedures to
assess that assessment.

And then as management evaluates design
effectiveness, to come behind them and then again, as they
test operating effectiveness. So you do it sort of step by
step as management does it. And hopefully, through doing it
in that sort of an approach, control deficiencies that do
exist can be identified and remediated and a clean opinion
can be achieved.

MR. BAILEY: Commissioner Goldschmid?
COMMISSIONER GOLDSCHMID: Excuse me. This goes to
independence and the 404 discussion before. How much of the
cost -- that side of the equation that we're worried about,
is transitory? Is something new being put into effect, and
over a period of time, a great deal of it will diminish.
MR. BAILEY: Lynnette?
MS. FALLON: I think we just don't know. I mean,
we certainly hope -- I know that we certainly hope our 404
costs will go down starting in '05 and beyond. We also hope
that the -- a benefit of the 404 work will be a decrease in
the audit fees.

So there should be some synergies there that should
reduce, long term, reduce the overall fees. But, you know,
one of the issues here is, you know, the general economics of
the auditing profession and what 404 has really done to that,
and whether we will see, you know, we've talked about the
availability of good help.

You know, one thing that hasn't really come up is
-- and I heard this from peers that I know that are in the
industry -- is there's a lack of job satisfaction in the
auditing business that's arising out of the fact that the
creative side of the work is somewhat curtailed now because
of the independence concerns.

So if you have to start paying auditors more and
there are fewer of them out there, will the fees come down?
I don't know. I don't think we know.

MR. BAILEY: I think we'll finish this up with
Lawrence Moreau, and then we'll move on.

MR. MOREAU: I couldn't agree more with Herb. I'm
the Chair of our audit committee, and I actually put together
a group -- informal group -- of audit committee vote chairs
and members out in the LA area.

It's very, very different -- we've ended up having,
as an audit committee, having more and more experts
ourselves because, well, my background is I was an auditor
for many years and then an investment banker. So I've got a
background.

But these areas, when we're being asked to be put
on the spot, okaying this or not okaying this, especially
smaller and even bigger companies, these things are coming
up all the time, it's huge. It's huge for risk.

And like Herb was mentioning, the best answer is no. And unfortunately, that's a difficult one. I've had to say no many times.

MR. BAILEY: Alan?

MR. BELLER: Thanks, Andy. This actually relates a little bit to something that a few of the panelists have mentioned -- most recently, Lynnette Fallon, when she talked about the difficulty in getting good help.

We wanted to spend a few minutes talking about that issue, the kind of -- the difficulty of getting good help, particularly in the corporate context and particularly with regard to the cooling-off period that the independence rules require before a company can hire someone from its audit firm.

The question really is, is that having an impact on smaller companies? And is it having a disproportionate impact on smaller companies vis-a-vis larger ones? There certainly has been some atmospherics that suggest that the answer is yes, but we could get a little bit further into it than that.

Maybe someone wants to start that off. Maybe Bill Balhoff?

MR. BALHOFF: Okay.

MR. BELLER: If no one else.
MR. BALHOFF: I will start it off, but I don't really have a lot of experience with the clients. I am from the CPA firms. My answer would have to be yeah, it's a disproportionate issue for smaller companies, because the larger companies probably have more resources.

And speaking from an auditor, I'd just as soon the clients not hire our people. We have the same problem with resources you guys have. So I'm going to make this very brief.

My general feeling is, the cooling off period, particularly for smaller companies -- I don't see it as a real -- just personal perspective -- I don't see why that's something that's incredibly needed. It's an integrity issue. I think you'll have the integrity, the size of company and the CPA firm -- I think you'll have -- I know by the rules there.

It's not something that I ever thought was going to be that effective. Maybe for the largest of companies it's an issue, but from a personal experience, I have not seen it.

So.

MR. BAILEY: Bruce Webb?

MR. WEBB: Well, I will simply say that had these rules been in effect 15 years ago, we would have probably lost our top ten largest issuer clients many times over, because the fact of the matter is, is that historically, it
has been a situation where public clients, as well as --
probably more so than non-public clients -- but clients of
public accounting firms become familiar with the talent pool
of the auditing firm and hire them.

And if they go in at a high level and clearly the
way the rule ultimately came down being expanded beyond the
four name positions into the financial oversight role, you
know, it does create a problem.

On the other hand, I acknowledge that there's a
risk, and it's -- so the ban is one -- is the way Congress I
guess, chose to deal with it. And that's what we're stuck
with. I think now that our clients and our audit committees
are aware of the consequences, they're having to look
elsewhere to find that talent.

We have not, to date, lost a client because they
chose to ignore the cooling off period.

MR. BAILEY: Larry Moreau?

MR. MOREAU: I'm going to put on my auditor's hat
from years ago, when I was with Touche Ross in the small
business. I'm for this, because there is a lot of influence
that if you want to move from public accounting or private,
there is pressure to satisfy, or at least not be at -- you
know, difficult to the person you might be hiring.

Also frankly, it's a huge network out there, and no
news. Best way to get an audit engagement was to get one of
your partners or one of your people to be CFO of the company
you wanted to audit. Well, once you got in there, it's kind
of a network, and now it's both boys and girls, that self
feeds on itself. So I think this is a very good regulation,
and I think it's best that they know that you know, if I
please the person that might hire me, I can't go there for a
year if I'm the head audit.

MR. BELLER : Yes, I'd like to ask Herb Wander, as a
very interested but nonetheless on this particular issue,
watching as I did before I got here, watching the
relationship between senior finance officials and auditors,
is that relationship different in significant ways that
make this ban appropriate where the senior finance guys are
former partners, senior employees of the audit firms?

MR. WANDER: I think it is. And again, I hate to
keep saying the marketplace or the investors' view of this
is that you shouldn't do it. And therefore, an audit
commitee who is going to be an active participant in hiring
a CFO probably starts off by saying don't go to our
accounting firm.

I mean, it's just that simple. It's not a problem
that we want to face. And I think so far, most people have
been able to find somebody outside of their own accounting
firm. So I haven't seen any problems with this.
MR. BELLER: Any other thoughts on this one?

MR. BAILEY: I have one.

MR. BELLER: Okay.

MR. BAILEY: Because I have to deal with these, it's amazing how often, in fact, smaller firms have encountered this problem. And the question I guess I'd ask is, everybody has commented on a network, just what are the alternatives for a small firm in an out-of-the-way location to attract someone into these top positions that wouldn't conflict with the rule?

I mean, we've said that it's not been a problem, but where are they getting them? Where are they getting this talent?

MR. MOREAU: Well, even the final four -- there's others -- three others by definition than who you're with, and there are various recruiters and other ways that you can get these individuals.

Just because they're on your audit staff, you know, the auditors -- the outside auditors -- yeah, you may have gotten a look at him or her, but like I said, in a way, may be that you're going to hire somebody out there that you think from them that could help you out.

So it's just like recruiting anything else. And I think it's good. It keeps things, like I said, from an audit point of view, independent.
MR. BAILEY: Mark?

MR. JENSEN: I'm not going to try to be controversial, but I may wind up being so (Laughter). But so be it. I think first of all, resources are a problem everywhere. And the Big Four have resource constraints, as we all know, anybody who's interacting with them today knows that.

You know, we're trying to build up our resource pool. Obviously, that pool is being drained by companies who need the kind of resources and talent that we have, whether they're our clients or not our clients. Because, you know, as we moved a lot more kinds of advisory services that the accounting firms used to provide into the companies, those companies need better resources.

And, as a result, the only place they can look to is firms like ours. And that is a problem right now, and it will be a problem for some time to come. I think -- and when you look at really smaller issuers -- at the much smaller companies -- large companies, I don't see this as much of an issue for.

I think in the really small companies, when you have that kind of demand in the marketplace for people with those skills, I do think a small company is at a competitive disadvantage in attracting people.

And I think that to some extent, being able to
allow them to use their network, which by and large in many
of these very small issuers, their network really is their
attorneys and their accountants. I think when you prevent
them from using that network, it can be a problem.

I think there's also an issue around companies
thinking about going public. And I'm thinking again -- and
I'm just going to put my role on with my firm, which is
working with venture capital firms and with what I would call
hyper growth companies, the companies that we all like to see
grow and become public.

You know, those rules apply even when that company
is private. And so we really have to treat every company
that has venture capital in it as a public company. And we
apply all those rules to them, even though it inhibits them
early on.

A lot of times, they want to hire someone because
the CEO may have been the founding CEO. There may have been
a very informal accounting structure, and they reach a point
pre-public where they now want to improve their resources,
and the logical conclusion there is to bring in somebody
who's familiar with the company.

And at this point, we're telling them you can't do
that, because you know, we're going to, if you ever go
public later, it's going to be a problem for us, as long as
that year is included in the registration statement.
So I think there are some areas here that are worthy of exploring, but that's one man's view.

MR. BAILEY: Well, the next question, really -- I think we've been addressing this to a large extent, but I'll put it on the table just in case -- over a time, over the last 20 years, the trusted business partner idea has been pretty strong within the profession, and particularly with respect to smaller firms.

And I think as I said, we've addressed some of this. But do you see a disproportionate impact on the smaller firms. We've just addressed the issue of hiring from the firms. Any others that we might want to put on the table?

(No response heard.)

MR. BAILEY: Do you think we've adequately covered most of those?

MR. JENSEN: I just want to make a comment there. I'm not sure I've ever used the word "trusted business partner." I have used the words "trusted business advisor." And I still believe that that is a role in small and mid-sized companies that I think audit firms, you know, should apply.

I think it's necessary. I think the companies just lack the resources to -- they don't -- they can't access the kind of resources that the accounting firms have, and I think they need to have the ability to do that.
So I guess I would just correct it. I'm not sure any audit firms ever used the words "trusted business partner," but maybe they have. I'm not sure I would ever have used it, but --

MR. WANDER: But it's a -

MR. BAILEY: Go ahead, Herb.

MR. WANDER: No, I'm sorry.

MR. BAILEY: Go ahead.

MR. WANDER: No, but it's even necessary in larger firms, as well, because your capabilities of benchmarking are limited to a great extent, unless you can say to your accounting firm who represents four or five people in the industry, you know, what are other people doing. How are other people attacking the problem?

So I don't think this is just a small business issue at all. But I do think you will see the accountant stepping back and not being, as we've said, partnered. They're not a partner. They're independent accountants who have to approach this now, now that we have SAS 99 with skepticism, fraud and everything else.

And so I think you will find them shying away from being the business advisor as they have in the past. And I think that may be something good, by the way. I don't think that's a negative.

MR. BAILEY: William Balhoff?

MR. BALHOFF: Yes. As a counterpoint, I think
being a trusted business advisor, particularly for small
business, is a very important relationship. Certainly, you
have to maintain your non-management role and not auditing
your own decisions.

But the other point I wanted to make quickly as it
relates to this is, we've talked a little bit about
Sarbanes-Oxley being used as a model for other industries and
non-public companies, private businesses. And I think that
it is happening, and to the extent it erodes that
relationship in those small companies, particularly not-for-
profits sometimes and financial institutions.

I know the insurance industry has an audit rule
that mirrors ours -- basically mirrors Sarbanes-Oxley. I
think that there are a number of companies that will be --
their financial reporting, their ability to solicit advice,
not from a management perspective, but just to help them make
their decisions, I think is going to be harmed by it.

I think those businesses and probably the users of
those financial statements will not benefit from that. So as
far as it cascading or trickling down from Sarbanes-Oxley to
the non-public companies, I think that's definitely a concern,
particularly in the not-for-profit arena, where they already
don't have -- at least the small ones, don't have -- many
resources to hire and pay consultants to begin with.

MR. BAILEY: Bruce?
MR. WEBB: I do think that as Mark has suggested, none of us like the word “partner,” but “advisor” I’m very comfortable with. And I think it would be our firm’s experience that, actually, the fact that a client has a pretty close advisory relationship with their accounting firm would be viewed by investors as a plus, as opposed to a minus, as long as they have -- continue to have confidence in the financial statements.

And I think generally, they would view the involvement of the firm as enhancing as opposed to detracting from that quality.

MR. BAILEY: Mark?

MR. JENSEN: I'm just going to make two really quick comments about it. I think one -- I think in the case of small and mid-sized companies, the role played by the auditor as an advisor, I think actually can become and is in many cases, perceived by the CEO, probably the CFO, as part of their risk management process.

That it is actually part of the internal control structure, because they want to understand, they want to make sure the auditor understands all of the ins and outs of the transaction, because they don't. And they don't always understand the nuances of the accounting rules, and therefore, I believe, they see that role as being part of their internal control system.
And I understand all of the other issues around that, but I'm just telling you how they perceive it. I think the other thing that from an auditor -- being an auditor and most of my life I've spent auditing early stage start-up companies -- you basically start that audit by understanding what goes on in that company everywhere, and understanding every material transaction they've entered into, and understanding their business risks and understanding what their objectives are and what their expectations are. And I think that knowledge base that you have is critical to be an effective auditor in those early stage companies and other smaller companies. And I think that companies know that. They know that you know a lot about their business, and they want to tap into that knowledge base.

MR. BAILEY: Doug, I'm afraid I've got to ask you a question. What is your attitude about the issue raised by Mark with respect to the top management not understanding? It might be not understanding the internal control issues or not understanding specific accounting issues and taking that level advice from their auditor?

MR. CARMICHAEL: It's an area that I would recommend great caution in. The dividing line is important there, and it is the case that the auditor cannot be a part of the internal control system, should not be viewed as part
of the internal control system, and that has to be crystal
clear.

There is room for advice on complex accounting
issues, as I said earlier. But there are lines there that
really need to be adhered to.

MR. BAILEY: Lynnette?

MS. FALLON: I was just going to say that, you know,
this is obviously a cost benefit -- another cost benefit
analysis discussion where you really have to say, if our
financial auditors are becoming more like IRS auditors,
that's a good thing in terms of objectivity, but there's
clearly a value loss in terms of that advisory role.

And obviously, you can buy advisory roles from
other people. And then again there's another financial loss,
because you're going to be paying somebody else to come up to
speed and someone else to be familiar with the business, and
you're going to have to internally manage yet another
relationship with a third party vendor.

So I think, you know, we'll see down the road
whether this cost benefit has been worth it for the investors
in the public companies.

MR. BAILEY: We have one more question, and so
I'll give Lawrence Moreau the last word on this one.

MR. MOREAU: Very quickly. I guess I come down on
the part of the independence, and I think we see a great
example here. Where do you end up advising and becoming, all of a sudden -- because you're the expert, you're the outside auditor. You're the one that's going to have to pass being in effect, as far as management is concerned, telling them what to do.

So I think Doug's point, if you're going to go that route, I think 404 says you'd better be extremely careful, because the public is not going to understand. I forget which one, Lay or Fastow, said "Well, when my auditors, Arthur Andersen, said it was okay," bingo, there you are.

MR. BELLER: Let's address the last item that is at least on our list. I want to leave a few minutes to go around the table and give everybody about 90 seconds to tell us what we've missed, or leave us with a parting thought or something.

But before that, I want to ask, at least briefly, has the passage of Sarbanes-Oxley and the registration and oversight requirements and the other complexities that Sarbanes-Oxley has brought to accounting and auditing, is that resulting in a decrease in the number of smaller or more regional firms who will audit public companies?

And if so, is that having an impact on the smaller issuer community? Bruce Webb, do you want to --

MR. WEBB: Sure, Alan. I can only tell you -- I
can give you my reaction, and I don't have any empirical
evidence. But I think what we saw initially was that, based
on the number of firms that registered versus the number of
firms that were formerly members of the SEC Practice Section
and auditing public companies, you didn't see many running
for cover.

Most thought they were going to continue to audit
public companies. I think we're now seeing that the firms
are re-evaluating that decision, and they're re-evaluating
that for a number of reasons.

Some are the complexity of the audit of internal
control, for example, and, another, audit and accounting
standards applicable to public companies. But secondly, and
perhaps more importantly, is the cost of professional
liability insurance is -- we're facing a real insurance
crisis in our profession right now, and it's forcing many
companies to re-evaluate their original decision.

And it's all of those things are, as has been noted
earlier today, driving up the cost of external audits.

MR. BALHOFF: Yes. I get a great deal of oppor-
tunity to talk to different firms about the decision on this
and consult with them a great deal about whether they're going
to continue performing audits of public companies.

And a number of firms, as Bruce said, probably
initially said we're going to stay in that arena, I think
because of malpractice insurance, I think because of the process of the PCAOB inspections, which are going on right now and some of the relative, I guess, pain that's being felt there.

I think that firms are definitely re-evaluating. Some large firms - LarsonAllen, I think, probably being the most prominent -- made a decision not to do public company audits initially, and a number of small firms did, also.

I think the fact that they registered with the PCAOB didn't necessarily mean that they were going to perform audits of public companies. I'm not sure of the number of firms that registered that don't, but malpractice insurance, I'd say, is probably the biggest, quickest kick that firms are having to evaluate right now to determine.

So it's ratcheting up costs for even the smallest of firms. It's ratcheting up costs incrementally for them, and certainly for the registrants in the larger firms -- are I guess not doing audits of firms below a certain amount that is considerably higher than what we saw before.

So I think it's much harder for firms. We had a registrant come to us the other day. It was an S-B filer. And, just as an aside, they had not really addressed their 404 reporting and documentation to the degree that they needed to. Got that -- light in the tunnel is an oncoming train for them, I believe.
But their costs were going to more than quadruple from what they were paying before, and probably should to a degree, but I think it's incredible, the cost of the registrants is also -- and also, the CPA firms, how much they're incurring.

(Off-mike speaker - inaudible)

COMMISSIONER GLASSMAN: Thanks. And this relates to the number of firms available. Clearly, the costs are going up as a result of the 404 audits. But I'm also hearing, especially from small businesses, that they can't even get a 404 review by audit firms. That they're being told that the firms just can't get to them by the deadline.

Is that really happening? And to what extent is that happening? And if it is, how are firms planning to handle that if we don't do something?

(Discussion held off the record.)

MR. WANDER: Well, I can give you one answer. Because the firms are stretched, the Big Four will tell you they've blocked out these many people (sic) in this amount of time. And if you fall off your schedule, the issuer, you may not have the accounting firm staff available to you.

So that's one way this is; people are dealing with it. So you can't have any slippage of your own plan to get this done. I think this is an excellent question, because I think what you're going to have happen after the
404 opinions come out, or even before, I think the four
national firms are going to walk away from a number of their
clients, leaving the field for other firms that have to step
in and do this work.

And that's going to create, I think, a heavy burden
on them. I think firms who are not issuers are going to
want, frankly, globalized firms, because almost every
business, no matter how small you are, has got some foreign
operations today.

So having only a national accounting firm is going
to be a detriment, I think. And so I think this is going to
become a very growing problem for the insurance reasons, the
staffing, getting enough people. And I don't know the answer
to it.

MR. BAILEY: Bruce Webb?

MR. WEBB: Yes, we are, I think our firm is
experiencing an ever increasing number of opportunities to
propose on smaller public clients that the Big Four are
simply walking away from as a matter of a resource issue.

We also, just last week, were asked to propose on a
company that is not all that small, where a Big Four firm had
essentially terminated the relationship on the basis that
they did not feel that registrant was sufficiently far along
on their 404 preparedness. And they're an accelerated filer,
December year end. And they're being cut loose the middle of
September.

Clearly, we're also experiencing in our own practice that I would -- we have a grave concern in a number of our accelerated filers are not really where they need to be. And we're trying to send a strong message that they need to get there very quickly, because if we can't do our work by the end of November, there's virtually no chance that they would be able to remediate any material weaknesses that would be detected in the process.

So I guess I am very concerned about some of the issuers sort of being abandoned, and some of the issuers simply not being ready.

And as Herb said earlier, the market will tell us what the consequences of having an adverse opinion are. But I would anticipate there will be a significant number of adverse opinions on the effectiveness of internal control.

MR. MOREAU: Just very quickly on this and getting ready -- I was surprised when I was calling people, how many said that they hadn't even started addressing it. Like I said, most of my contacts are in the small business community.

And then I came across this, and as of the 16th of September, this is a survey of a thousand firms by the Sarbanes. Nineteen percent hadn't even started looking at the problem. Just beginning, 29 percent. A plan created and
ready, and you know what that means, 14.

So only five percent said they're ready. And almost compliant at 11, 16 percent. That's scary. And that's as of the 16th of September.

MR. BELLER: Yes it is. We have about ten minutes, and I guess I'd like to go around the table for final thoughts. If you could keep it to about a minute to 90 seconds, that would be great. We'll start with Bill Balhoff on my right.

MR. BALHOFF: Okay, well thank you. As I mentioned earlier, probably one of my big concerns from a small business perspective is not just the public companies, but the non-public companies, the cascading of Sarbanes-Oxley.

So anything that can happen as a result of this and other processes that provide some relief for the smaller companies, the better. My belief is, if S-B filers would have been carved out of some of the requirements of Sarbanes-Oxley, there would have been a cut higher than non-public companies, and people wouldn't necessarily look at it as absolutely best practices for all companies.

So, to whatever degree that S-B filer is, you can evaluate whether the limitations are still appropriate, and whether or not there are things that can be carved out for S-B filers. I think that would be helpful.

MR. BELLER: George Batavick?
MR. BATAVICK: Yes. Just confirming what I had mentioned before, and I think what you've heard around the table is that the system definitely has a lot of fatigue in it right now, from the standpoint of all the work that is going on.

And just reiterating what I said before about a potential ripple effect might be the slowing down of improving some financial reporting, new standards, because the system and the pace of change can only be so much at one time.

MR. BELLER: Thank you. Doug Carmichael?

MR. CARMICHAEL: Yeah, I think the -- I'd certainly agree. There's a great deal of uncertainty up to an extent. A large amount of it is unavoidable in the sense that auditors in the past were not doing enough work to express an opinion on internal control, so in writing the auditing standard on what the auditor had to do, we realized that this was a brand new service.

It wasn't something that was just a little add-on to what was done before. So, to an extent, uncertainty is to be expected, and there will be a large amount of sorting out that happens in the first year.

MR. BELLER: Lynnette Fallon?

MS. FALLON: Well, just -- you know, my feeling is that we are -- we have lost a significant amount of value
that was contributed to small public companies by their auditors, individuals and auditing firms as firms in terms of the services that were made available.

And I think we are yet to see whether the benefit to investors, which is the ultimate goal of Sarbanes-Oxley, justifies that loss of value, whether there really was equivalent value or greater value delivered at the end of the day.

But I'm also hopeful that -- I think there are a lot of unintended consequences of the Act, and I think it's going to impact a number of industries and professions as a result. And we'll see what the -- and they will adapt, and we'll see where we are a year or two from now.

MR. BELLER: Mark Jensen?

MR. JENSEN: Yes, I would just say, I think that if you took all of the questions that were asked today, the underlying question to the whole thing is: Are the new rules and all of the new rulemaking bodies and everything that's come out, is it somehow starting to limit access to the public capital markets by smaller companies? At least today, my answer to that is, yes it is. I think if you look at the venture capital community, they increasingly look at their companies being acquired, not really going into -- or even thinking about them becoming public companies.
And I don't know whether that's good or bad. But I do think that we have somehow started to send a message that unless you're at a certain level, you really shouldn't be in the public capital markets. And I think that's bad. We live in an innovative economy. Small business is a big -- and growing business is -- growing small businesses are a very important part of our economy, and I think we need to protect that.

We need to be jealous about that. We need to protect that.

MR. BELLER: Larry Moreau?

MR. MOREAU: Talking about what Mark was saying, I think that's very important. I think one thing, and it's not quite privy of this -- part of the equation of the other side is the investor side. The reason that VC's -- my reaction is they felt that there was no, or very little, benefit is because, of course, they're very sophisticated and they know what they're doing. They get in close to the companies.

And they don't need all these formalities.

Frankly, having had my own registered NASD firm for 15 years, the investors, small investors, shouldn't get involved in a lot of these companies. They are high risk.

And I think that's where you can do a service to the company -- to the investor, keeping them -- that they
shouldn't be taking this risk. Having said that, the big
advantage of the small company is everybody is close.
Everybody can see it.

And that's why I say -- I go back to the
governance. They know what's going on. I spend a lot of
time with my companies actually getting to know what they're
all about, and have almost weekly conversations, not just
with top management, with other people involved.

In a big company, impossible. So that's the
strength of the small company, is how close it is to its
investors -- typically much closer than a large company -- how
close management is, how close the auditors are, because they
know the management. So that's the other side that needs to
be taken into COSO or any other analyses.

MR. BELLER: Bruce Webb?

MR. WEBB: Well, I would just observe that in
addition to, I think, perhaps restricting the access to the
capital markets to new potential issuers or registrants,
there are also a number of companies that we call orphan mid-
caps out there, that are lightly traded -- probably shouldn't
have been public companies to begin with.

Yet they're not able to raise the venture capital
to reacquire shares and exit public reporting requirements.
So they're stuck with a significant additional cost of
compliance with 404.
MR. BELLER: Herb Wander?

MR. WANDER: Well, my take away is, first I would continue to maintain the independent standards as they are. I think that's been a significant improvement to the entire system, and I think will eventually help raise capital.

I do think we're facing resource constraints, and I think they're going to become more severe before they get better. And I say this both in the individual sense, getting the CFO, getting the accounting staff, in-house as well as providing independent accounting firms, to all the issuers.

Perhaps one way firms can do it is outsourcing CFOs. I have seen placed advertisements crossing my desk where firms are providing outsourced CFOs for that.

Finally, we talked a little bit about the trusted advisor or trusted partners. And I think everyone agreed, "partner" was not the right term. I also think the word "trusted" is not the right term, either, because trust sort of connotes, at least to me, that I'm going to go to somebody and give them some confidential information or some information that I trust them to use only for my benefit.

And I think that's antagonistic to what the accountants are supposed to do. So I think they can continue to be advisors, but I think we have to be very cautious about thinking of them in that sense of a trusted advisor.

MR. BELLER: Commissioner Glassman?
COMMISSIONER GLASSMAN: As many of you know, when we are promulgating rules, I spend a lot of time worrying about the costs and the benefits as we go into the rulemaking process. I think it's just as important if not more important to make sure we're monitoring the costs and the benefits as we implement the rules, and look at the unintended consequences as well as the intended ones.

So I think this kind of panel is very important. I appreciate the input. It's important that we listen and it's important that we understand the differential impact on small business, another topic that's near and dear to my heart, having worked in this area for over 25 years on small business issues.

So I want to thank you all, and hope we do continue to listen.

MR. BELLER: I think those points are extremely important for those of us at the Commission. I'd just like to thank the panelists on behalf of the Commission, on behalf of the staff and on behalf of all of the other participants in the forum. I think this has been a really good panel and I think it's been really informative, and I thank you. (Applause)

MR. BELLER: We will -- since we are running late, let's try to keep the 15 minute break to 15 minutes. We'll try to start this promptly at 11:25 with the next group.
Thank you.

(Whereupon, a 15 minute break was taken.)

MR. LAPORTE: There's been a slight change in the roster of the panelists for the second roundtable. Marc Morgenstern, who was supposed to be the co-moderator and has been a member of the Planning Committee, his mother died last night, and so he had to fly back this morning.

He actually had come to Washington. So Alan suggested that I try to sit on for Marc. I'm not sure I'll do anywhere near as well as Marc would have done, but I'll try.

MR. BELLER: Thanks, Gerry. Since I know I won't do nearly as well as Marc, I'm counting on you to take up the slack. This panel is going to be addressing issues of disclosure, issues of corporate governance and related matters.

Let me, again, for the sake of those of you who aren't in the room and can only hear us, go quickly and introduce the members of the panel. Starting on my left, Gerry Laporte is sitting here at the moderator's table with me.

Gerry is the head of -- those few of you who don't know -- the head of the Office of Small Business Policy in the Division of Corporation Finance. On the panel, to my left is
Herb Wander. I guess Herb and I share the distinction of doing double duty this morning. He was on the first panel, as well, as you know.

To Herb's left is Denise Voigt Crawford who is the Securities Commissioner of the Texas State Securities Board. After the little machine, Jamie Brigagliao, who is an Assistant Director here with the SEC in the Division of Market Regulation.

And to Jamie's immediate left, Brian Bussey, who is an Assistant Chief Counsel, also in the Division of Market Regulation. For their benefits, I think Gerry gave a general disclaimer, but for your benefit, since you weren't here, anything that Jamie and Brian say as a matter of policy, they are speaking only for themselves and their views don't necessarily represent those of the Commission or other members of the staff.

To Brian's left is Steve Bochner, a partner of Wilson, Sonsini, Goodrich & Rosati in Palo Alto, California. To Steve's left is Stan Keller, a partner of Palmer & Dodge in Boston, Massachusetts. To Stan's left is Rich Leisner from Trenham Kemker in Tampa, Florida. And to Rich's left is Hugh Makens of Warner, Norcross & Judd in Grand Rapids, Michigan. Why don't we kick this off?

We thought we would -- as Gerry said at the
beginning, there were a number of subjects that have been
discussed in a considerable amount of detail in previous
fora, which we decided to leave off the agenda for this year
to get some new subjects like Sarbanes-Oxley on, and to focus
the discussion on some other things.

But there is one subject that certainly has gotten
a lot of attention at this event in previous years,
including last year, that we did want to put back on
the agenda to talk about, for at least a few minutes, and
that's the subject of finders.

And I guess I'd start maybe with Hugh Makens.

Would rulemaking or other guidance about how our broker
dealer registration requirements apply to persons who act as
-- I guess I would say occasional securities intermediaries,
and finders as sort of the classic example -- be of benefit
to smaller companies in raising capital?

And if the answer to that is yes, sort of how do
you square that with the requirement that anything we would do
in that area also has to be appropriate in the investor
protection sense?

MR. MAKENS: The answer is clearly yes.

We're at the point now where there's been sufficient
recognition of the need for some kind of effective control of
finder activity, coupled with a dramatic -- I don't want to
say easy, because that's not a fair term -- I think
rather a rethinking of the method of regulation of finders. We try to regulate finders now as though they were full scale broker-dealers, and the result of that is that you have a tremendous number of provisions that just don't make much sense in the regulatory scheme for finders.

Therefore, if you can change those, I think you can bring in a very effective regulatory system, and my advice is that something be done at the federal level, and that in some instances, the Commission recognize an intra-state finder, and that you permit finders to engage in state- registered activity and consider also the possibility of some kind of regional finding activity as well at a reduced or lower level.

MR. BELLER: Let me first mention that Commissioner Atkins has now joined us. And Rich Leisner, any additional --

MR. LEISNER: Yes, I'd like to put a little bit of gloss on what Hugh has said, because he and I have both been involved in an ABA project directed towards I think ending what you can best call a “don't ask, don't tell” policy.

And I think it's very interesting that we -- the materials use the word "finder" rather than unlicensed, illegal, law breaking (Laughter), compensation taking, deal negotiating broker, which might be a more accurate term.
MR. LAPORTE: I think that was the first draft (Laughter).

MR. LEISNER: Well, so we are on the same page. But to be quite honest about that, what you're talking about is the thousands of transactions in which unlicensed individuals provide a varying array of services, finding the money and engaging in activities that, under the current law, are almost always going to be broker activities that make the transactions voidable under federal law, and possibly void and certainly voidable under many state laws.

And that's -- for people who are providers of sophisticated legal services -- that is a heck of a position to be in. You have a client who can't find the money. He's got someone who can find the money, but oops, the transaction is dead on arrival. And that's the environment.

And a reaction to that environment is where Hugh succinctly is coming from when he talks about the desirability of asking reputable people in this arena to become registered. But in a regime that is not as difficult and shouldn't need to be difficult as getting to be a "real" broker-dealer.

And in the materials, Hugh sketches out some of the key issues in his materials that are extraordinarily helpful. I think you've got to start at it in that context. And I know we have some folks from Market Regulation, and
they probably think I was a little bit tepid in my
description of the activities, for which I apologize.

MR. BELLER: Rich, thanks very much. One other
housekeeping matter. I'm not sure you were all here earlier
this morning. I think the best way for me to be able and for
Gerry to be able to see whether you want to be recognized is
if you would just stick your tent card up on end the way Stan
has.

And let me turn to Stan Keller next.

MR. KELLER: I'll put my card back down. Indeed,
some of the states have already dipped their toe in the water
and started this. So for example, in Massachusetts, we have
a finder registration system. I know -- frankly, I don't
know how much it's used. I've never used it.

But in concept, it's there. And what really lies
behind it are really two thoughts. One: We're really
talking in the first instance about capital formation. And I
think as -- it was a good segue -- left off at the last panel
-- that high on the list of priorities as we're balancing
competing interests has to be capital formation, and
particularly for smaller businesses.

I mean, that's the life blood that drives it. And
so access to that capital is key. And how can you get there
while protecting investor interests? And I think what you and
Richard are suggesting is that with a sensible registration
system for -- call it finders, limited broker-dealers -- that works.

You get legitimate people, if you will, into the system registered, which can only help compliance, help regulation, and therefore help investors while striking the right balance.

MR. BELLER: Stan mentioned the states. And let me segue over to Denise Crawford on that note.

MS. CRAWFORD: Thank you, Alan. The states are very interested in this issue. In fact, we've been waiting with baited breath for Hugh Makens' paper, which arrived this morning in your notebook.

The states believe that there is a way to address this problem. Obviously, the first step would need to be taken by the Commission, because anything that the states try to do in this area is probably not going to be exceedingly helpful unless we have a federal regime that recognizes that finders are indeed different, and perhaps could be subject to a less rigorous review in the context of broker-dealer activities.

The states have talked about this at length. And I think it's fair to say that there's a great deal of sentiment in favor of having a regulatory regime that just addresses finder activities.

One of the issues, of course, will be to define
what it is that a finder does. We don't want it to be used
inappropriately. Also, there are some issues associated with
the willingness of the responsible, professional active
finder community to comport with rules that are admittedly
less, but nevertheless do require them to set forth some
information that they may not be all that comfortable in
setting forth.

So those things would have to be worked through.

But conceptually, I think that the states are on board. I
think that we could work with the Commission and come up with
a viable regulatory scheme for this whole area.

MR. BELLER: One unspoken assumption in this
conversation is that it's difficult for small companies to
find registered persons who would carry out this activity.
Does anybody want to talk about the validity of that
assumption?

MR. MAKENS: I'd be; I'd love to jump in on that.

MR. BELLER: Hugh Makens, for those of you who
can't see us.

MR. MAKENS: I describe small business financing
generally as cup of gas financing. That is, you go out to
your friends and family and you hold out your cup and you get
some money and you put it in your tank and you run for
awhile.

Then you start to run out of money pretty quickly,
and the next step is you go out to your friends, your suppliers, your customers, and you get a little bit more gas and put that in.

Well next, you're ready to go to angel investors or to venture capital firms, but those are pretty few and far between in relation to the demand for them. And that sends you then to the broker-dealer community. Well, most of the broker-dealers I'm seeing around the United States have got thresholds of $15, $20, $25 million.

Many of them are boutiques. We've seen a shrinking of brokerage firms that do a traditional stock and bond business that has been dramatic. And there just aren't firms in the United States, not remotely enough firms in the United States that are going to provide the kind of service that you need.

The risk in relation to benefit is fairly high, and most of the firms that have done that have moved away. Look where your shift has come. If you look at a lot of the firms that I see is -- and my practice as primarily a broker-dealer practice -- what I'm seeing is people going more and more into mutual funds and to variable products and less and less into initial stock products.

And that market has been largely delegated to a relatively small set of firms in the United States today.

MR. BELLER: And most of then unregistered, Hugh,
in terms of --

MR. MAKENS: No, no. There's a number of registered broker-dealers that do this kind of activity, but nowhere near enough. And because of that void, people are now turning to the people who used to be in accounting firms or the people who used to be executives of companies, or the people who used to be at brokerage firms and retired and moved on, or used to be in the investment banking business.

And now, they will make some contacts and open some doors and get things done, or they may be turning to the accounting firms who, by the way, have been migrating toward full broker-dealer registration over the last couple of years, but who used to do this all on an unregistered basis in order to fill that gap to get the money they need.

MR. BELLER: Denise Crawford?

MS. CRAWFORD: I wanted to talk just a little bit about one of the other places that small businesses go. And they go to, really, con artists, because they don't realize that these people who say that they can get access to capital for them, for an upfront fee, are really not going to do anything for them at all.

So this is a major enforcement problem that small businesses have to contend with. And if we had a simplified registration on the state and federal level for the legitimate folks, one of the things that would be a red flag
for the smaller companies would be to find out whether or not
the finder is properly registered.

And if the finder were registered -- of course
that's no guarantee, but it certainly relieves one problem,
and it makes this person look a little bit more viable.

MR. BELLER: Yes, Brian Bussey, any thoughts from
the --

MR. BUSSEY: I feel like I'm on the hot seat here.
You know, first off, I want to stress that we recognize in
the Division of Market Regulations and specifically the Chief
Counsel's office, the importance for small businesses to grow
and prosper and for the economy to do well and to create
jobs.

As Commissioner Glassman pointed out last year in
her keynote address to this same forum, there's another side
to the story. If you look at our enforcement cases, you see
a huge number of frauds being perpetrated either by small
businesses or involving small businesses.

And so, in looking at our mission, which is investor
protection, and in looking at this area, both in terms of
being concerned about impediments to capital formation, but
on the other hand, protecting investors, we believe that
regulation is necessary in this area.

Now Denny, you've suggested the possibility of
lesser regulation, and I think that really is a possibility.
But as we've stressed before, this is a massive undertaking to review the regulatory scheme that applies to broker-dealers.

It's not just the SEC's rules. It's the states. It's NASD, a very large undertaking. And one of the things that we have asked for in past forums is specific detail on what are really the problem areas in specificity. What are the things that are impeding or -- impeding people from registering as broker-dealers to engage in this type of business?

Hugh, you made a comment. I'd actually like you to elaborate on it. You said that broker-dealers are moving upstream in terms of the size of deals that they're interested in doing. And you say it's because of the risk versus reward. And --

MR. MAKENS: Part of it is risk versus reward. Part of it is the number of people --

MR. BUSSEY: Well, what --

MR. MAKENS: Yes, I'm sorry. Go ahead.

MR. BUSSEY: What's the risk? Why are legitimate broker -- registered broker-dealers not interested in doing smaller deals? What kind of risks are there?

MR. MAKENS: The chances of getting sued, whether you do a $50 million deal or a $10 million deal are the same. But at least you're going to get paid a lot more if you're
You're also, with the smaller company, not going to have as good internal controls as we talked about on the first panel. You're not going to have the level of sophistication. You're not going to have the depth of management.

You're going to have lesser levels of market. You're going to have a lot more risks with the smaller company than you will in a larger, growing, diversified company.

MR. BUSSEY: So if it's not a registered -- if a registered broker-dealer isn't willing to take on those risks, are you suggesting that it be the investors in the businesses who take on those risks?

MR. MAKENS: Well certainly, yes. That's the way our country has worked since the beginning of time. And the question is, how do you get it in the right -- into the hands of investors who are sophisticated enough to understand those risks and willing to take those risks?

MR. BUSSEY: The question that we have for the panel here is, it speaks of occasional finders. But it sounds like you're talking about something more than occasional finders. It sounds like it's really a new professional class of intermediaries, not somebody who does it --
(Simultaneous discussion)

MR. MAKENS: Actually, Brian, I'm talking about a very wide spectrum, from the person who might do it once every two or three years to the regional accounting firm -- the national accounting firms before they were registered, were doing this on a monthly basis. They'd do a new deal each month.

And so the -- it's a very, very broad spectrum of people who do this.

MR. BUSSEY: And what about -- I think your paper, which I've reviewed a draft of, speaks both of finders for issuers and also for business brokers?

MR. MAKENS: Yes.

MR. BUSSEY: You see a need for relief on both those --

MR. MAKENS: I see a need for relief on the business brokers. Right now, we've created an artificial solution to the problem in that the business broker is -- as long as you start the deal, advertised as an asset deal, you can do it if it migrates to a stock deal. But --

MR. LEISNER: You're sure?

MR. MAKENS: Yes.

MR. LEISNER: Positive?

MR. MAKENS: Positive.

MR. LEISNER: Okay.
MR. MAKENS: But if you follow the you know, ten, 12 directions in the no action letters -- on the other hand, if you instead take the approach that you have -- from the very beginning, conceptually, you are doing a transaction that involves two fairly sophisticated entities, and you are putting those entities together, the need for public protection in those circumstances is dramatically reduced.

MR. BUSSEY: You're talking about in the instance of a full business?

MR. MAKENS: In the -- yes.

MR. BUSSEY: Not a transferred --

MR. MAKENS: Right.

(Simultaneous discussion)

MR. MAKENS: And whether you do it through a simplified registration, whether you do it through greater relief on the no action level, something needs to be done to make a little bit of sense of this process.

MR. BELLER: Rich, do you have anything to add on that?

MR. LEISNER: Well, I think it's very important to go back to something that Hugh said. And it's that we're talking about a spectrum of activities in which there's very little guidance, with all due respect.

We have finders. Those are people who are not broker-dealers and don't have to register, because that -- a
finder means they're not engaging in activity that requires registration. Then we have a whole spectrum of capital formation activity that may or may not be finders or may or may not be broker-dealers.

And I agree with the Commissioner who says, "Gee, at least if we had a registration process, we'd know that the people who don't have a ticket might be -- maybe we shouldn't do business with." Now, everybody doesn't have a ticket. And when you take a full stop now and look at the M&A environment, that's probably where the larger volume of dollars and transaction are going on now with people relying on the "you know" exemption. You know (Laughter).

And I've sat in a room with counsel from the most prestigious firms in the country who said, "Well, they don't have to register to do that, because . . . because no one ever registers to do that."

And the canyons of our financial centers are filled with hundreds of firms that are completely reputable that are doing these transactions, mostly with sophisticated clients, and very few of them are asset for cash deals. And there's usually a security floating around there someplace, and they're actively involved at -- like an investment banker.

And they're at the table. They're negotiating the transaction. They're providing value. But they're unregistered. And my colleagues who have sat in a room and
indicated that they thought the limited broker-dealer registration process was a solution in search of a problem, insofar as they were concerned.

That's a very big part of the industry that at least needs to -- you need to decide what you want to do with it. Because that's not a capital formation function in large part, except to the extent that it may be a cash register event for the seller.

But certainly, most of the buyers are very sophisticated, and the transactions are usually bona fide private placements from a securities registration standpoint. But the broker activity is there. And I think we just have to sort out what we're talking about.

If this is a capital formation focus, we are talking about a different part of the spectrum from the M&A part. But it is part of the complexity of trying to make a solution here.

MR. BUSSEY: I would echo that. I mean, I think understanding exactly what it is we're talking about, you know, segmenting the problem and addressing each one of the sub-problems in a way that makes sense from an investor protection standpoint, but also from a business standpoint.

MR. LEISNER: Well, but the investors -- the "protection" that the investors are receiving is that they're left to deal with good guys, bad guys. They're all
unregistered guys.

And so at least on the capital formation side, I think that this is something that would assist the investor protection activity. We're not talking about giving up the anti-fraud rules. We're not talking about giving up the '33 Act securities registration rules.

But we are talking about trying to put a little bit of lubrication on the wheels of commerce where we have issuers who don't know where to get the money from. And we have people who do know but who are not registered.

MR. BELLER: I think we've spent a good amount of time on this. I'm going to give Hugh a minute, and then I'm going to give Denise Crawford a minute, and then we're going to move on. We could spend the whole hour and a half on this, and I don't want to.

MR. MAKENS: You're not seeing a lot of these transactions. Most of the transactions we're talking about here are Section 4(2) transactions that don't migrate into the Regulation D environment. So there's no filing.

At the state level, they're finding state exemptions, but often they're institutional placement exemptions. And therefore, you're not seeing any kind of filing there. So there is no way of tracking these. Frequently, they're done out of the broker-dealer environment, so when OCIE goes in to take a look
and see what's going on, they're not going to see these either.

So they're largely happening under the visibility surface, and the accountants and the attorneys are seeing it, but that's about the only place that you're going to get any kind of measure. And that's kind of a collective knowledge and memory, rather than any kind of compilation of what's there.

So your challenge is, how do you find this information? And I suggest that it may, in the end, be simply focus groups talking about issues like this that provide you the best information that's going to be available to you.

In terms of the finders, right now the conventional finders for cash for small issuers, a lot of those are being done in the 506 context, and your Form D's are reporting that information. And about a third of the states now are starting to go to the Form D's and send inquiries out to the unregistered finders and say, "What are you doing?" And come in and talk to us about getting registered or getting in compliance.

So it's a difficult environment to reach the question that you're raising. That's all.

MS. CRAWFORD: Thirty seconds.

MR. BELLER: Denise Crawford to give us the last word, unless Brian wants the last word.
MS. CRAWFORD: Thank you. At last year's forum here at the SEC, the number one suggestion that came out of the forum was to have the SEC issue a concept release in this area so that the kind of information that the SEC staff needs in order to formulate a solution to the problem would be there.

And I just wanted to reiterate that, because it seems to me that that's something that we all could work on together this year.

MR. BELLER: Okay. I want to take us in a different direction. We have under our regulatory regime, and I think to the extent that listing standards are applicable, there are some differences in listing standards -- it's sort of tiering of regulation depending upon the size of companies.

I'm thinking particularly of our Regulation S-B for small business issuers, and I'm thinking about a number of our rules, including those that were adopted in response to the Sarbanes-Oxley requirements, where we did make some accommodations for smaller companies.

We've actually drawn another line in our regulatory regime for accelerated filers in recent years. Basically, $75 million companies who filed at least one annual report. I guess with that as background, the question is: Should we be moving more in the direction of tiered regulation?
And if the answer to that is yes, sort of: What sizes should we be looking at? And then maybe we'll get into what some of the tiers maybe should look like, at least on a preliminary basis. But first of all, the basic question. Should we move more towards tiered regulation? And for what sized companies?

And I guess I'd ask Steve Bochner to kick that off for us.

MR. BOCHNER: Sure. Well, I may not be the best person to ask this question, because I've -- although I've worked on you know, probably close to 60 initial public offerings for venture backed technology companies -- I think maybe one of those took advantage of the, you know, the streamlined regs.

And I think maybe that is telling. I'm not sure --

MR. BELLER: Maybe that's part of the answer.

MR. BOCHNER: Yeah, that may be part of the answer. So I think to the extent you wanted to provide some sort of regulatory relief to the capital formation process, I think the standards would have to be defined well above the -- you know, the 25 million threshold.

I think the issue affecting, that seems to be affecting, things most in my neck of the woods, Northern California, really is 404, not to get back to that, but to talk about this in the context of streamlined regulations or
what can be done.

I mean, people complain about governance reform generally, but I think ultimately, you know, you'll have your code of ethics and you'll disclose whether or not you have a financial expert, and you tick off those things. But the 404 regulation is the one that's costing the money and is punitive for the smaller issuers that can't afford it. And I think -- and I'm not sure -- the crisis I'm feeling was really brought out in the last panel in terms of just how many public companies' auditors are resigning.

You know, the ones that don't look like they're going to make the 404 threshold are saying "see you later."

So I think if you were going to go in the direction of providing some relief with respect to 404, which I think is -- we're seeing the burden of that -- does appear to be an impediment to small business in the capital formation process.

And, if you want to provide real relief, I think it would have to be well north of the levels that we've traditionally thought about in terms of small business issuers, because today, in part because of the regulatory burden, it's hard to get public with market caps much south of 200, 250 million, at least where I come from.

MR. WANDER: I think that's absolutely --

MR. BELLER: Herb Wander, any thoughts?

MR. WANDER: Yes, I think that's absolutely
correct. I mean, we generally advise companies who are, you
know, less than 50 million not to go public in terms of the
offering, because you're not going to get coverage. Your
stock price is not going to receive the kind of reception you
think, unless you're just a dramatically growing company.
And you're going to become an orphan very fast.
And so it seems to me that the tier concept maybe has to do
some rethinking about having an intermediate stage before
you're a fully public corporation until you receive a size
that you'll get the market following.

Because if you really are counseling your clients,
you're going to say to them, well, okay, no analyst is going
to cover you. Who's going to buy your stock? Who's going to
be selling it? And what you thought was a valuable company,
you're going to be subject to a market that's probably not
going to appreciate it.

MR. BELLER: What, do you have a sense of, if
market cap is the right measure or whatever measure is a right
measure, what size you're talking about?

MR. WANDER: Well, as Steve said, it's got to be --
his was 200 million. I certainly think that's a good
starting point.

MR. BELLER: Stan Keller?

MR. KELLER: I find this a difficult question to
deal with, which is why I put my card up, so I'll deal with
it because, in the abstract, of course there should be
tiers. But that doesn't mean anything until you start
drilling down to what are we talking about, in what
particular area, and what are the consequences, how should it
work?

I and some others on this panel were involved, I
think, with the development of S-B, and I can tell you, one,
my heart was never in it, because I don't think it was viewed
as particularly significant. And I've never used it.

So that tiering -- you know, that's make
weight, and, in fact, it was done during a Presidential
campaign some years back, as I recall, so it really was make
weight.

But real tiering where it counts, means something.
Now, we have the concept of accelerated filer and various
things turn upon whether you're an accelerated filer or not.
And so that can be a meaningful tier.

When I think of tiering, I think of one, we are
choosing, because of the cost benefit analysis, to separate
out a particular group, and they can either be looked at as
wearing the scarlet S or the scarlet S-B of small business.
We're not as good as others, and therefore we suffer a
detriment.

Or it can be viewed as recognition of what risks
are appropriate to let the market bear. I did a program like
this 20 years ago in the early days, when I was involved in
the formation of the small business conference -- so this is
the 23rd annual, so maybe that was the third annual -- in
which I was waving the flag for making accommodations for
small business. And I had Steve Friedman, who happened
to be a law school classmate, and then just recently
former Commissioner. And he said, you know, there's
an anomaly. Some of the bigger problems that we've had in
violations in enforcement have involved small business. And
here, we're talking about making it easier for small
business.

Well, I think what we've seen in recent years is
that the impact of those violations, if you're prepared to
accept them, of those risks on a cost/benefit analysis are
tolerable, unlike what we saw with large cap companies where
there's greater potential for serious market disruption.

So you can, in fact, choose to allow some risk into
the system. And that leads me to say if there's tiering, it
should be by disclosure of what the consequences are by
companies who choose to tier. In a funny way, we'll get into
this auditor financial expert.

Okay, you don't have an audit committee financial
expert? Fine. Disclose it so the market knows that. They
can assess what the risk is associated with it. And then I'd
have more flexibility to allow opt-in. I wouldn't just say,
you're not an accelerated filer.

But I would allow a seasoned company to opt into --

I'll call it the more heavily regulated regime if they want
the stature and whatever the perceived benefits are by
playing with the big boys.

MR. BELLER: Denise Crawford?

MS. CRAWFORD: One of the things that could be done
is to put the problem off as long as possible. And by doing
that, you'd need to raise the limits under Rule 505 and
Regulation A. Right now, there are $5 million. Five million
dollars is an extremely low amount of capitalization.

It seems to me that the SEC could take a look at
those very low levels and raise them. What amount? I don't
know. But it would give these smaller companies more time to
grow, more time to get it together, to then become public
companies where they have to comply with more federal
requirements like Sarbanes-Oxley and those other requirements
that kick in once you become a publicly traded company.

MR. BELLER: It's sort of interesting that we have
a bid in our regulations in the five to ten million range and
have an asked of the 200 and 250 million range (Laughter) --
and that's at least --

MS. CRAWFORD: Where are all those finders today?

MR. WANDER: Well Alan, don't you also have to, I
think, attack the issue of what is the public market for these
smaller companies? Because the fear is that unscrupulous brokers or unscrupulous traders, you know, drive up the price. All of the sudden, some stock that went out for $1 is $10.

And it might last at the $10 level for a month, two months, three months, but it's going to go back down to two cents. And I think you also have to look at what happens once it's public, in terms of who should be buying the stock, what sort of information is required. And to really -- if you're looking for investor protection -- and that's for the investors who put their money in who need a slow growth pattern, as Denny said.

So I think you'd have to look not just at the disclosure and the governance, but also the trading markets.

MR. BELLER: I think that's right, and I'm -- anybody have a thought or a solution to Stan's problem, which I can tell you makes regulators very uncomfortable, which is when you start reducing requirements, if the requirements are the right requirements, and let's assume that's the case for the moment.

When you start reducing them, you start increasing risk. And I think it's very hard to -- for us to just say, well, we'll take -- we're willing to allow more risk in the system for smaller companies than we are for larger companies. It's not so hard to say the converse of that.
We want less risk in the system for larger companies than smaller companies. But the first phrase, it does catch in the throat. And I guess the question is, is that just an element of life we have to deal with, or is there some way to deal with that or address it? Rich? Rich Leisner?

MR. LEISNER: Alan, nobody is suggesting that we reduce that -- the cost -- and eliminate certified financials for a minute, for an IPO. But I think it is fair maybe to pursue a different framework for companies under 404.

We don't need a COSO, we need a COSTCO approach to that, where somebody can come forward and say, "Here are some of the significant differences with smaller companies, and this procedure, procedure number two, without a scarlet letter on it, is one that would satisfy the requirements."

And perhaps that would not even require a statutory amendment. Because I think in a lot of these -- in this panel, we are sort of suspending our disbelief about what the statute compels the staff and the Commission to do, and what it would be nice to be able to do in a perfect world.

But I think that if we don't focus on trying to develop a meaningful second tier of regulation that is without a taint and without a second class citizenship badge, I think what you're risking is the loss of a whole segment of the capital formation process in this country.
Everyone knows that, whatever the numbers were for being public, they've gone up. Maybe they're not as high as the Foley study, but I don't suspect it would be useful for us to go back and look at the Commission's proposing releases and look at the back part of the release that no one ever reads that says, this compliance will cost $5,000 per company.

We know -- as you said just a minute ago, we now have the range, somewhere between three million and $5,000 to comply. We know it's a lot and it's more than it used to be. And I think it's the responsibility of people in the industry to try to come up with a solution.

Think about the logical consequences of the alternative. If in 1995 you could get a legitimate broker-dealer to take a company public, two million shares, $15 a share, it qualified for NASDAQ NMS, with a $30 million gross proceeds offering.

And now, that same offering is now going to have to be the better part of a hundred million dollars and have a post-IPO market cap of more than $200 million. Everybody that fits in between that, they're either never going to get to market -- you know, maybe the next Intel doesn't get done, the next Microsoft doesn't get done -- or they're going to get sold to some giant corporation and scenes of the last reel of "Indiana Jones" with that new micro-chip going
off into the storage room some place is going to be done.
Or it's simply never going to happen. They'll be sold to a bigger company or they won't do it, or they'll go do something else, which is a dire set of predictions. But it certainly isn't illogical to think that there would be adverse impacts like that if we cut out this part of the capital formation process.

MR. BELLER: Stan Keller?

MR. KELLER: First, let me say, I don't think it's binomial. I mean, do you reduce regulation or not. I mean, I think it's much more surgically analyzed as to where you can do it and where you can kind of bear those risks.

And, as I put it, coupled with disclosure of what's happening and the ability, if you will, to opt into the higher tier. I think what Denise said and Richard was picking up on -- was very important. Clearly, we've increased the price to companies going public. When I say the price, the level at which -- the amount of money. The access to the public capital market. And that may be a right decision. I'm not so much quarreling with that decision. But a corollary of that is we then have to focus on the alternative means of financing.

And I know we don't want to talk about elimination of general advertising and general solicitation, and we don't have to. But you still have to come to grips with that, with
access to financial intermediaries in a system that works, so that the flow of capital on an unregistered basis is there, that allows companies to grow until they mature to the level where they go public.

I don't think I mind deferring, because we get the same advice that Herb mentioned. You don't want to go public unless you've got the credibility and the background of support, because then you're just going to become an orphan company -- you're going to have a moment of satisfaction and then you're going to lose.

So I'm looking at, what do we do in the private capital market. And then once a company is public, okay where -- is there a way of relieving some of the burdens and tiering it at that level, both on a corporate governance basis.

Right now, it's somewhat self selective, but not really. You're a listed company. You opt into the corporate governance regime that's now imposed on listed companies. Well, is there a way of tiering that. For example, NASDAQ Smallcap.

Maybe there's more flexibility in the system -- the corporate governance system than there is in the NMS and New York Stock Exchange market, for example. So it's that kind of differentiation that I would see taking place.

MR. WANDER: You also -- this is not a new problem.
I mean, years ago, you had two a week Charlie Plohm. Right? And you had these schlock brokers who were doing them, Whale Securities and all those people.

MR. KELLER: I did one of those here.

MR. WANDER: Well, so did -- everybody did one. Because you had a client -- I had a client -- kids of one of my best friends who started a great company, but no one was going to give 20-year-old kids financing. And the father said, "I'm tapped out."

And so we went -- I forget -- Whale Securities or somebody else, and they charge a left lung and warrants (Laughter). You know, I mean, it's -- reading the underwriting agreement, you almost vomited, but that was the only source of financing for those companies. So we haven't really changed a lot, because now it's just as difficult and you don't have those brokers doing it. And so I think --

MR BELLER Well, that's a start.

MR. WANDER: Yeah. But I think you do have, as Richie and -- has mentioned, that you need somebody to fill that void in a responsible manner.

MR. BELLER: Let me note, for those of you who can't see us, that Commissioner Goldschmid has joined us and Steve Bochner wants to be recognized, so let's do that.

MR. BOCHNER: Yes, I agree with what Stan said. I
think what we're saying is that it appears -- and I don't think this will just be transitory -- it appears that it's going to be much tougher to go public now for a whole variety of reasons, from analyst coverage to independent directors to 404 requirements.

So you're going to need to be bigger. And I think that merits a stance at taking a look at the -- both the set of regulations that apply to private companies, and are those thresholds really adequate now for private companies that have to get bigger and incur higher revenues and therefore achieve higher revenues to offset the additional operating expenses and infrastructure to be a public company.

So, are the 701 thresholds really rational in that kind of an environment, or the exemptive schemes under the '33 Act really rational? So I think it's good to look at that, to just watch what's happening to the IPO process.

And, at the same time, I think some -- it's hard to -- and you know, Alan, going back to your point about, you know, you don't want to open the -- start scaling back on regulation for companies that, in particular, really need it, I think. But, as regulators, you've got to watch and see what happens.

You know, you put in place regulations and you see what happens to the market and try to adjust, and try to do what's right for business and investors and strike that
balance. I think what -- and this is just an early -- I think we're seeing some early warning indicators that 404 is having consequences far beyond what anybody thought in terms of cost, in terms of auditors resigning.

And I think that would be something to focus on quickly to see if that's the tip of the -- if it's going to go away and people are just -- it's going to be sort of a one-time event.

Or rather, is this something that really is going to start creating a hardship for smaller companies because the auditors are saying, look, it's just not worth it for us to audit this client or come up with a negative 404 attestation, you know, that the internal controls aren't adequate. And therefore, we're going to resign because we just can't bear the liability and don't want to be associated with the account.

MR. BELLER: Guess I want to ask one more question in this area, and then maybe we could move on. We certainly -- and I think we understand the message regarding internal controls, and I think we intend to be vigilant in seeing what happens out in the market over the next few months, and frankly, after that.

Stan Keller mentioned some of the exchange listing standards in the corporate governance area as places where you could think about tiering. And I guess I'll just throw
open for this group briefly -- put 404 to the side.

We've got that message. But what other areas -- if you were to think about tiered regulation, what other areas would you want to, want us to, focus on, or the states or the exchanges or whoever? Rich Leisner?

MR. LEISNER: Well, I'll jump in and say I think that the independent director problem for smaller businesses is one that has been underappreciated. Because what's -- the unarticulated word is good independent directors.

And qualified personnel are not rushing off to become directors for smaller public companies, because it's not an attractive thing for them. Of course, it's not the Commission's job to make it attractive, but I think you do need to take that into account.

And I think that's a -- you know, the cost of insurance is more important for a smaller company than for a big one, because the big one may be cash rich, and they can indemnify their officers and say it's never a chance that you'll ever suffer any personal liability for serving on this board.

At a smaller company level, they want to see what the insurance is like. And those costs are higher, if the insurance is available, than they've ever been.

MR. BELLER: I just want to make sure you're talking about companies that are on the small scale
of listed companies, when we're talking about
this.

MR. LEISNER: Well, when I -- when they're -- yes,
they might qualify for being on NASDAQ Smallcap or maybe
even at the small end of NMS where they would be --

MR. BELLER: Right.

MR. LEISNER: -- where getting the good directors
for -- a company that's a candidate for winding up as an
orphan if it isn't careful.

MR. BELLER: Right. Are institutional investors
forcing the unlisted segment of the market into the -- affect
the same requirements as the NASDAQ and New York impose on
listed companies?

MS. CRAWFORD: Uh uh (negative).

MR. BELLER: Hugh Makens?

MR. MAKENS: I think (inaudible) -- (Off-mike) the
institutional trend -- there's two other factors that appear
to be affecting that transition. Number one is,
if you're going to position yourself for acquisition,
you're going to be putting these kinds of systems in place.

And secondly, if you have public directors on
private companies' boards they tend to want many of the
same protections and systems. And both of those are migrating
into the private environment as well.

(Simultaneous discussion)
MR. BELLER: Let me take Stan first, and then --

MALE VOICE: Oh, go ahead.

MR. BELLER: Stan Keller.

MR. KELLER: I was going to say what you said.

There are in fact -- I mean, the trend is moving down, yes, because of institutional investors, because of professional directors, because you may indeed want to go public and your investors want you to go public.

And we're saying in the acquisition area, if you want to be acquired by public companies, you need to have disclosure controls and procedures, internal controls ready for the offing, because as you know, as you created, the acquiring company's CEO and CFO have to end up certifying to that.

But let me say -- in my mind, what I was referring to isn't a carte blanche, okay, we leave you out of the system. Because I don't think that's right. I mean, I think indeed, the benefits of Sarbanes-Oxley are there, are important, and should apply to all public companies if you want access to the public company market.

It's how do you calibrate it. And so take corporate governance. Richie mentioned independent directors. Well, I wouldn't eliminate the smaller listed companies from the requirement of having independent directors, but there's no magic in the concept of a majority
being independent directors.

And so there could be a lower level for a lower tier that you then disclose what you're doing. And you can have more if you want to. Have a minimum, you know, number, percentage of independent directors. Similarly on the committees.

You know, you can have a by, if you will, on independence for a member as long as you've got maybe a majority on the committee. The definition of independence can be adjusted somewhat to recognize that you're likely to have somewhat more relationships if you're a smaller company with your directors, because that's how you get people involved, and in fact you use them that way.

And you could look at where that cut is. So there's -- you know, what hasn't happened is the recalibration process that I think is so vitally necessary, to now put back into proper balance, what was important and needed legislation at the time and rulemaking at the time.

(Simultaneous discussion)

MR. BELLER: Herb Wander?

MR. MAKENS: Well, Alan, you asked whether investors are forcing all these things on people irrespective of whether Sarbanes-Oxley or the SEC does. But lawyers are forcing it.

I mean, someone comes to me and says, "I've been
asked to become a director of Richie Leisner's new
corporation." And so I look at the Corporate Director's
Guidebook, the Fourth Edition, which was just published, and
has a new chapter on if you want to become a director of a
public corporation. Here are the questions you should ask.
And those questions are exactly these issues that
we're talking about, and so the lawyers are going to tell
their clients, "Why go on that board under these circum-
stances?" So I think it's broader than just investors.
I think it's a whole sort of reaction to the
excesses that we went through in the past five years, and now
what's the balance, as sort of Stan said. And I think
everybody is gun shy.

MR. BELLER: I think that came out also quite
clearly in the first panel. And I think that is an element
that, you know, we have to deal with on both sides of the
table, if you will. I'd like to move on to a different
question.

One of the things that we have heard, and I think
the numbers bear it out, is that the number of companies with
analyst coverage is decreasing, and that that's probably
impacting smaller companies to a greater degree than larger
companies.

In a sense, I suppose we could say we're not quite
sure what our role is, but I'd like to flip that around and
ask it as a question. And that is, “What's the view of the
panel with respect to whether the SEC does have a role to
play with respect to analyst coverage, and I guess especially
with respect to smaller companies?” Jamie, did I see your
hand up, or --

MR. BRIGAGLIANO: Well, I can talk about where we
are on that and what's happened. The Commission has approved
two comprehensive sets of SRO rules that really changed the
landscape and posed significant disclosure and structural
requirements on research analysts at sell side firms, you
know, broker-dealers.

I think it's important to remember that many of
those requirements were imposed by Sarbanes-Oxley itself, in
which Congress, among other things, directed loud and clear
that the Commission and the SROs should adopt rules to insure
the objectivity and independence of research analysts and to
make sure that material conflicts of interest are disclosed.
So you know, we've done that.

Nonetheless, the SROs and the Commission have been
aware and cognizant of any disproportionate impact on either
small broker-dealers or issuers in terms of coverage. To
that end, there is a small firm exception to some of the
structural -- what we call gatekeeping -- requirements of the
analysts' rules.

And one of the theories behind that is some of
these smaller firms cover smaller issuers, and often
companies that are important in regions, but that may not be
covered by large investment banks.

In addition, what we anticipate is that next May,
May 2005, will be the one year anniversary of the
effectiveness of all of the new requirements. After that
point, the SROs are going to survey the landscape on those
rules and see what's working, what's not, what their impact
has been.

And the impact on small issuers and coverage is
going to be part of that report. And, at that point, we
certainly are going to look at whether there's anything in
the rules that has, you know, diminished coverage in a way
that's not either warranted, healthy or appropriate, and
consider whether to recommend any changes, you know, after
that.

It's certainly -- we certainly sense, as Alan noted,
that the number of issuers covered has declined, perhaps by
as much as a third. I don't know at this point how many of
those issuers would be classified as small businesses, but
it's a safe bet that many of them are.

We also don't know entirely whether the cause,
how much of the cause, of the diminution in coverage is linked
to the rules as opposed to other factors. For example, maybe
fewer companies -- small companies around to cover.
But in any event, we expect the report to look at those issues and we'll move from there.

MR. BELLER: Herb Wander, you have your tent up.

MR. WANDER: Well, I -- oh actually, I should put it down. It's hard for me to see how you -- how the SEC, other than changing the regulations, could induce people to start coverage. And I haven't figured out a way. I thought about the question before we came down here.

Most of the -- what I've been told, sell side analysts are now running hedge funds, so they're out of business. The firms' structure is totally different. So I think they'll have to be a growth, again, into some sort of analyst.

But it may be different. It may be funds or investment managers will start focusing on these smaller companies, taking larger positions in them, and that's where you're going to get the buy side or the pool to get them. But I find it difficult to think of how you're going to induce people to come in and provide more analyst coverage.

MR. KELLER: I do think, however, it's fair to ask whether regulations that have been adopted discourage analyst coverage of smaller businesses. And then, if so, is there anything you can do about it, about those regulations in particular?

So for example, I mean, the overall limitations
upon analysts to deal with the abuses that we saw in the
system -- I don't think anybody is going to say, hey, let's
back track, we don't need those anymore, because analysts
will do the right thing just because we call them
professionals. That some of those are needed.

But are there ways of changing it? So, for example,
take a second look. The prohibition on analyst coverage
during, you know, in the IPO process I think has affected
small business coverage because the analyst is no longer at
the table and part of the dynamic of the going public
process, which frankly, was one of the selection criteria --
often a controlling criteria -- in what banker you ended up
using.

Not that they committed what kind of -- you know,
opinion they would render on you. And still, getting that
objectivity is important. But do we really need to, with
other controls in place, exclude them from the process?

There was a recent study, and I'm happy that
Commissioner Goldschmid is here so we can talk about this or
I can raise this. There's a recent study by three professors
at the Wharton School, which vindicates what we were saying.
It doesn't change the result, by the way.

And that is that Regulation FD indeed, would limit
analyst coverage and it would be the smaller companies that
would be the ones to lose that coverage first. I'm not
saying that's a reason for not applauding, in hindsight, in retrospect, the adoption of Regulation FD.

   But, on the other hand, it's at least worth asking the question, well, is there something that can be done. So for example, can you carve analysts out of the community to whom you can't speak, if that analyst undertakes certain duties of dealing in a more public way with the information that they receive?

   I don't think if that would make a difference, but it's that kind of thinking, of revisiting the regulations, and the impact that I think is important.

   COMMISSIONER GOLDSCHMID: Yes, Stan, just to answer that, I do agree that looking at this whole research analyst area is very important. Indeed, I've been saying that for a long time.

   And I am worried about the amount of money that's been withdrawn. I think we did the right thing in cutting off the investment banking money. It had a perverse effect. But there's no doubt, as I see it, research budgets are down by a third and more at many firms.

   And that, much more than FD, I suspect is what cut out coverage of some smaller firms. But looking at this whole picture, I am very concerned about the limits on coverage today and the amount of research money that's been lost.
What we can do is unclear to me, but not doing something is a terrible mistake.

MR. KELLER: Because that hurts investors as much as it hurts the companies themselves.

COMMISSIONER GOLDSCHMID: Oh, I agree. I agree. I think too much money -- now the market will adjust over time. But right now, looking at what's happening and trying to understand -- and we do have -- as suggested at the beginning, a mixed set of rules from the SROs, Sarbanes-Oxley rules, our rules. There's a mish mash, and they don't always work together. There's more to do in this area, is my view.

MR. BELLER: Steve Bochner?

MR. BOCHNER: You know, I think when you talk about analysts, you're really talking about a lapse in research, maybe a lapse in prognostications, forward-looking statements, coming from that community.

And so perhaps, while you're looking at the, you know, the impact of all of these things that have impacted analyst coverage, you can also look at things from the issuer side, because you can also encourage issuers to provide forward-looking statements, particularly if you look at the IPO process, which is one where there is no existing analyst coverage, companies are constrained in providing their own guidance because in 1995 when the Private Securities
Litigation Reform Act was adopted, IPOs were specifically excluded, I think for valid reasons then about hype.

But I wonder whether in light of this lapse of analyst coverage where we can't take a look at some of the perhaps, quiet period rules. And I know you're doing that, I think you're taking a look at some of the communication issues.

I think that's a good idea. Should there be more openness? Should we take advantage of some of the means of communications that have arisen since 1933 and make that available to the IPO process?

But in particular, taking a look at whether denying safe harbor protection for IPO candidates is really, in this environment, the right thing. Or would it be better to encourage those companies to provide that information?

I think there's ample liability, potential liability, through other provisions of the securities laws. So that may be another way of trying to get that information to the market.

MR. BELLER: Thanks very much. As we did the last time, I want to leave ten minutes or so to go around the panel and get some closing thoughts. But I do want to cover one other subject, at least briefly before we do that. And that's the prohibition on insider loans of Sarbanes-Oxley, Section 402.
That provision produced as much of a flurry of attention as I think any other provision, when the Act was -- immediately in the aftermath of the adoption of the Act -- in July, August of 2002. A lot of that seems to have died down, I think in part because the bar, the private bar, organized itself and attempted to provide some constructive advice.

I think we continue to hear from time to time, at least, the suggestion that whatever you think of 402 as a general matter, it does have some unintended and disproportionate consequences for smaller companies. And I would like to spend a couple of minutes on that before we close. We'll start with Stan Keller.

MR. KELLER: Let me pick up, having been involved in the bar's organized effort, which one academic said was a violation of the anti-trust laws.

In the main -- this is not a small -- limited to a problem for small business. I mean, it runs across the board. One area where I think it can be identified as a small business issue in which something could be done, and I would submit after now more than two years, the Commission with its rulemaking authority under Sarbanes-Oxley can judiciously dip its toe in the water, is grandfathering of pre IPO arrangements that were not entered into in contemplation of the IPO.

In other words, private companies have arranged
things. Okay, it's disclosed up front and it's not subject
to the same abuses that new arrangements of public companies,
which were the target of 402, are subject to.

Beyond that, I think again, judicious
interpretative assistance from the Commission in areas where
it's easy to bring clarity in this area would help all
companies, and therefore, would help smaller companies. You
know, for example the status of advance of expenses and
indemnification.

And that's low hanging fruit in my judgment --
cashless exercise arrangements of -- low hanging fruit,
relocation loans for legitimate, you know, business
arrangements, maybe with a cap, so it doesn't pick up mansions
on Nantucket, is easy to deal with.

So that would -- I think the -- enough time has
passed. It isn't the 60 years, I guess, from the 1930s. But
the Commission can act in this area.

MR. BELLER: I'm sorry. Herb Wander?

MR. WANDER: I suspect most independent directors
actually like the rule. Because one of the hardest decisions
that they have to make is -- President comes in and says, "I'm
margined up to the hilt and I'm going to -- stock is going to
go out and we're going to have a market disruption. You've
got to loan me money because I can't get money anyplace
else."
And the directors had to grant those loans, but they're under the wire on those situations. So I don't -- I think I agree entirely with Stan, that there are many areas that this was just sort of a meat ax that we could surgically fix that are legitimate.

But all in all, I suspect most independent directors like the rule. They just don't want to -- go to a bank. We're not a bank.

MR. BELLER: Steve Bochner?

MR. BOCHNER: Yes, I would agree with that. I think a couple of narrowly construed exceptions -- I'd try to settle the option exercise issue -- you know, get that off the plate. I would you know -- maybe relocation, new hires, you know, where independent directors approve loans for legitimate business purposes.

I think it can be a very useful tool and to the benefit of shareholders. And I think I would -- but I agree with Herb -- I think having those kinds of restrictions are probably -- or having very specific limitations and -- I mean, obviously, maintaining the general prohibition is probably the right approach.

MR. BELLER: Okay. If no one has anything to add on that subject, I'm going to close this off again by going around the panel. I'll start at the other end this time with Herb Wander.
Any take-aways, closing thoughts in 60 to 90 seconds?

MR. WANDER: Well, real quickly, I think the finder business, broker question is not a difficult one to address. And I think it should be addressed, whether it be a combination state and SEC regulation.

But again, as putting myself -- and a lawyer, when somebody comes to me and they can't find money, and they bring somebody in and the guy promises him all sorts of money, I look at him and I say, "There's no tooth fairy."

And --

But he says, "Well, I'm going to go out of business or I can't make payroll and what do I do?" And so having some sort of registration that doesn't mean you're a broker-dealer and that capital rules and all these other sorts of things probably makes sense and is easy to do.

On the questions of tiering, I agree with Stan, that I think you have to sort of -- before you decide on what size to tier, you have to decide on what it is that you're not going to require and then look at the size. I would look at the size secondly.

But at the end of the day, I think it's going to be a hard chore to do, to say you're not quite a full citizen here. And because of the other pressures that are out there because of investors and lawyers, frankly.
MR. BELLER: Right. Good. Denise Crawford?

MS. CRAWFORD: In an effort to create a more perfect world, I have two suggestions, two take-aways. One would be that -- and this will be a bit repetitive -- that we give these smaller companies more time. That the SEC really consider raising the limits for Rule 505 and Reg. A deals so that there is a maximum amount that is more realistic in today's times.

Five million dollars is just too low a dollar amount. It's a 20-year-old amount, at least with regard to one of them, and a few lesser years I think with regard to the other.

The other take-away is one that we didn't discuss, but I would be remiss if I didn't bring it up. And that is, just as we need to look at the numbers for giving the companies more time, we also need to revisit the standard for being an accredited investor.

That has not been looked at in over 20 years. The standard is extremely low. And I know that it's very hard for small business people to sort of swallow the idea that you would want to narrow the universe of acceptable investors in small businesses.

But if you really get a long term, if you really think about it, you want to have people who can afford to invest this money, because long term, the investor confidence
that you gain from doing that inures to your benefit.

So to sort of synthesize those two suggestions, we just need to revisit all these old numbers in every context that affects the small business capital formation.

MR. BELLER: Actually, let me ask you two -- one, let me point out, we look at the accredited investor definition almost certainly every six months or year. You were right that we haven't proposed anything in a very long time.

But I think that's a reflection of the tensions around that rule. I understand the point you're making. With respect to your first point, would you restrict the -- those increased amounts in terms of the types of investors who could invest as a trade off? And how do you feel about sort of public markets developing around those exempt offerings?

MS. CRAWFORD: Well, we used to say in the regulatory area when I first started out, that the ideal situation would be to license investors. Because then you didn't have to worry about all this other stuff.

But yes, there are a number of ways to get at the problem. And I think just starting that dialogue with a very serious focus on making improvements would be a good way to go. I don't think that anybody is necessarily locked into one formula.
MR. BELLER: Jamie? Brian? I don't know if you want to participate in the closing remarks or not. We didn't rehearse that, so --

MR. BUSSEY: The devil is in the details on finders. And as we've asked for before, I think a clear articulation of the problems -- and I think it's occasional finders, professional finders, business brokers and then proposed solutions.

Because what I think I'm hearing is that it's not a one size fits all situation. And to the extent it's through the ABA Small Business Committee or otherwise, we really appreciate the input. Our doors are open.

MR. BELLER: Steve Bochner?

MR. BOCHNER: Just two parting comments. One, to echo Denny's comments about taking a look at the private company exemptions. I think that's a worthwhile thing. And in addition to the exemptions for capital raising, I'd also take a look at 701.

I think the other thing to keep an eye on --

MR. BELLER: 701 is the exemption for --

MR. BOCHNER: Compensatory.

MR. BELLER: -- security offerings to employees.

MR. BOCHNER: Compensatory --

(Simultaneous discussion)

MR. BOCHNER: Because I think companies are going
to be bigger when they're private and have to issue more
stock to employees. Because we've got -- you know -- I think
the other thing to take a look at is perhaps work with the
SROs in figuring out what is going to be the impact of all of
these companies that aren't able to get their financial
statements filed due to auditor resignations and 404 problems
and so on. I think we're going to see a lot of that going
on.

MR. BELLER: Stan Keller?

MR. KELLER: To try to summarize, I guess the theme
I was hearkening on -- you know, like all reactions to
dramatic events, they tend to be overreactions. And
clearly, Congress did not take the time, or have the time
perhaps, to differentiate in the meat cleaver legislation.
And it's up to the regulatory agencies, particularly when
given the statutory authority to do so, to start that
differentiation process with the benefit of some experience.

So I think that needs to take place. And in saying
that, it's recognizing that the changes that were made, the
regulations that were imposed, the requirements that were
placed on business in the whole were sound and important for
the integrity of the markets, which is what capital formation
is all about.

So it ends up being dealing more surgically with
where relief can be provided and where it's not inconsistent.
And we talked about corporate governance.

I think the other key -- and it all comes down to capital formation -- is as we're doing, revisiting the capital formation process, the regulation of the capital formation process. And I would urge that that not be limited to the top tier of companies, and certainly not the super top tier of companies, but that it be brought down.

Now if it be done in steps, so be it. But it should be an acknowledged first step. The focus is going to be on top tier companies. But with the mission of bringing the process down to where it's really needed. It's not needed by the top tier companies because they already have free access to the marketplace and to the hard thinking at the lower levels.

MR. BELLER: Rich Leisner?

MR. LEISNER: As empirical proof of Stan's erudition, the Sarbanes-Oxley Act according to Bill Gates is 29,144 words long not including spaces. The word small business, according again to Bill Gates, doesn't appear in the statute.

The word "small" does appear once in good old Section 209. I'm sure you're all familiar with that. A provision dealing with small and regional accounting firms. So it falls to the regulators, as Stan has suggested. And I applaud his statement to begin this recalibration process
with the focus on the consequences all the way through, going backwards from the public company down into the capital formation process, and see how it all fits together.

And so you've got some ideas here about the people who raise the money, the broker-dealers, 701, looking at the private placement numbers. Those are all great suggestions. I only have one to add, which is that you look again at the idea of what is advertising and general solicitation as a part of that -- looking through that spectrum of the process.

And we have confidence that you'll do the right thing.

MR. BELLER: Hugh Makens.

MR. MAKENS: I get the last shot?

MR. BELLER: No, I think Commissioner Atkins and Commissioner Goldschmid get the last shot (Laughter) --

MALE VOICE: As it should be.

(Simultaneous discussion)

MR. MAKENS: (Off-mike) Let me hit several areas.

The important part of the capital formation process is the aftermarket, for people who buy stocks in small businesses. One of the things I would do, suggest doing, is re-looking at the 15c2-11 requirements and imposing a requirement that the 15c2-11 information be published on the website of the company, rather than just in the hands of the broker-dealer.

One of the real problems is getting that information out into the hands of the public, rather than
just in the hands of the broker-dealer. I would also do away with the requirement that another broker-dealer can piggyback on someone else's. I would also ease the ability or look at the process of easing the ability to allow small businesses to use smaller broker dealers to participate in transactions in inactive markets. I see it continually in the areas of insurance companies, banks. It's very difficult to go into those markets and provide any kind of -- even a very inactive market -- and I think it would be a major service to develop the system to be able to do so. And I would love to see you crack down on the computer touts because I -- about once a week, I forward off to the Division of Enforcement another tout sheet on something that's going to triple in price, and we're about to hit -- go on the New York Stock Exchange. On the loans areas, I'd recognize -- first, I'd think setting some caps and permitting activity below those caps makes a lot of sense. I would also recognize that there are companies that are filing with the states and going through the registration process with the states. And there you've got -- NASAA has their loan policy. And that policy provides a very tight stricture for circumstances under which loans can be made. And I would suggest, for those that have passed through that policy,
probably the Commission doesn't have much of a concern.

I also would liberalize the area of loans in the recruiting process, again with the caps. In the finders area, I urge the creation of private placement broker-dealer regs. with a simplified, targeted registration process, opening up the process of intra-state and possibly regional finders.

The creation of relief in the M&A area for greater transactions, stock based transactions, recognizing as long as they're done company to company, the chances of public risk in that area are very small.

And I would recognize that the states have developed a process for the last almost hundred years of registration of agents of issuers, and that the agent of issuer registration process may work well and serve small business.

And if you have that registration process, you may not need to trigger broker-dealer for more limited activities than are circumscribed presently by 3(a)(4). In the --

MR. BELLER: I'm going to --

MR. MAKENS: -- I focus --

MR. BELLER: Hugh, I think I'm going to stop us there.

MR. MAKENS: All right.

MR. BELLER: I guess I'd ask Commissioner Atkins or Commissioner Goldschmid whether you have any closing
thoughts for us.

COMMISSIONER ATKINS: Well, just to thank you for your participation. You've given us a lot to think about. Now that the two-year mark after Sarbanes-Oxley was enacted is, I think, obviously a perfect time to look back and see what the effects, both intended and unintended, are and see how we can address them. Thanks.

COMMISSIONER GOLDSCHMID: Yes. I very much share that view. And we really appreciate your coming. To me, this has been a very helpful session. As the opening statements indicated, small business is at the heart of much of what's dynamic and important in the economy.

And we appreciate your coming and telling us what to do. Sometimes we'll do it (Laughter).

MR. BELLER: I'd like to add my thanks on behalf of the Commission and the staff and other participants in the forum. This was also a wonderful panel, extremely informative, and we appreciate your time and effort in spending some time with us this morning and afternoon. Thank you very much.

(Announcements follow.)

(Whereupon, a luncheon recess was taken.)

MR. DUNN: Okay. Then we’re going to do this: We've collected questions. I've handed them out to the folks up here who I think have the best answer for them. I'm going
to let them read them and give the answer, and then I
have a few at the end.

And in the interim, I think some folks from Gerry's
office are going to be walking around in case you have any
more. So with that, I think we'll start on my right with
Carol Stacey.

MS. STACEY: Thanks, Marty. For those of you who
don't know me, I'm the Chief Accountant in the Division of
Corporation Finance. We have, it looks like, one accounting
question or semi-accounting related question.

The question is: “Sarbanes-Oxley clearly allows Over
the Counter Bulletin Board companies not to have an audit
committee. If, under 404, an accounting firm cannot give a
clean opinion because there is not an audit committee, isn't
that contrary to Congressional intent?”

I think you're probably all familiar with the rules
that the Commission has done, and anywhere they cite what an
audit committee's responsibility is, they always say, or we
always say, if there's no audit committee, you would look to
the board of directors who are presumably fulfilling that
role in place of, or in the absence of, an audit committee.

I think even if -- and I can't remember
if the PCAOB's Rule on 404 specifically says this, but if it
doesn't, I think it's still reasonable to assume that if
there is no audit committee for 404 purposes, you would look
to the effectiveness of the board of directors in performing the audit committee function.

So I don't understand why an audit firm would not give a clean opinion, just because there's no audit committee, because that would be now the board of directors functions.

So I think it should not be an issue. You would then be evaluating the effectiveness of the board of directors in that role.

MR. DUNN: Gerry, you're up next.

MR. LAPORTE: Okay. First question: "What is the status of the S-8/8-K release regarding public shell mergers? Will it be adopted as proposed?"

The status of the release is that the comment period has ended. We're looking at the comments that we got, and we hope to be able to recommend something to the Commission before the end of the year. Will it be adopted as proposed? I can't answer that one (Laughter).

MR. DUNN: We gotten along the lines of what, 30, 35 comments, a lot of them very good on the definition of shell and along those lines. So we'll factor them in. But who knows?

MR. LAPORTE: Right. We can't predict what the Commission will decide to adopt. Second question: "Is the "test the waters" provision operative? If so, how effective
The "test the waters" provision is only operative in Regulation A, and it hasn't been used by very many people. To some extent, there's a problem at the state level that people can't overcome, so I'm not sure that it's been very effective in its current iteration.

We've talked from time to time about redoing Regulation A, and those of you who were here this morning heard some people saying that it's time to take another look at Regulation A. So maybe, as a result of this morning's discussions, we'll speed up our review of Regulation A.

And if we do, that will be an appropriate time to consider "test the waters." It's also possible that in connection with looking over small -- what this morning we called the "intermediate area" of small business financing -- "test the waters" might be something that we can do in addition to looking at general solicitation or something to see what we're going to do between the $25 million and the $200 million offering.

Third question: “Are the proceedings from prior forums programs available? If so, how does one obtain copies?”

The proceedings from prior forums like this, which is the SEC Government-Business Forum on Small Business
Capital Formation, back to 1993, they're available on our website. If you go to the SEC website and you click on “Small Business,” there's a page for the small business forum. Before 1993, if you want them, you can get copies from our office.

MR. DUNN: Okay. We'll turn to Brian Bussey.

MR. BUSSEY: First question is: “If finders do get registered with the broker-dealer, what is the broker dealer's liability for that finder, now a registered person with the firm, for his outside activities away from the broker-dealer?”

I point the person to NASD Rules 3030 and 3040. 3030 contains a notice requirement for outside activities for compensation; and then 3040 is a rule that deals with outside activities involving private securities transactions.

And the rule splits the world into private securities transactions for compensation and those not for compensation. Private securities activities for compensation -- they -- first, the person needs to put the broker-dealer on notice. The broker-dealer needs to approve that outside private securities transaction activity; and then, third, has to supervise that outside activity as if it were the broker-dealer's own activity.

And then the second question is: “What discussion, if any, has there been on creating a tiered marketplace for inactive stocks? Specifically, this marketplace would be
absent of broker-dealer middlemen, a Dutch auction system or marketplace simply matching orders.”

I can't speak to discussions outside of the SEC, but I can point you to the fact that such a marketplace would either have to register as a broker-dealer or as an exchange, depending on the specific circumstances of how the market would operate.

MR. DUNN: The next set -- we're going to turn to John Reynolds, who is the Assistant Director for our Office of Emerging Growth Companies.

MR. REYNOLDS: Thank you, Marty. For those of you who don't know what my office does, my office reviews most of the IPOs filed by small businesses with the Division. The question I have -- I have one -- is: "Why does the SEC not consider Pink Sheets equivalent to the OTC Bulletin Board for the purpose of enabling issuers to use market price as sales price on a Form SB-2, since the NASD rules for "firmness and trader reporting" are the same?"

I believe this arises in the context of a selling security holder offering where it's an initial public offering. There's not a primary offering. It's just a registered selling security holder offering.

And the securities are not quoted on a market or they're quoted on the Pink Sheets. We have, for the last several years now, taken the position that resales of those
securities need to be made at a disclosed price until such
time as the securities get quoted on the Bulletin Board.
And after that time, these securities can be sold
either at the prevailing market price or in privately
negotiated transactions. We have not extended that position
to quotes from the Pink Sheets. You know, I'm sure we'll be
ready to consider your arguments to equate the two and treat
them similarly.
But at this point, we look at the Bulletin Board as
being a marketplace that provides a good indicia of value for
the securities that are traded on that market. And I would
like to point out that the Bulletin Board issuers are
reporting companies. And that's it for my question.
MR. DUNN: Liz Osterman's next. She's an
Assistant Chief Counsel in the Division of Investment
Management.
MS. OSTERMAN: Good afternoon. My question relates
to business development companies. And it reads: “With all
of the negative implications of the current regulatory
structure on small, often orphaned, small businesses,
wouldn't the SEC be doing the market good by adopting a more
friendly stance towards business development companies as
opposed to a more onerous one as currently seems the case?”
And I guess the answer to that sort of falls into
two categories. If you've looked at business development
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companies very carefully, you would understand that they were
created in 1980 and they were intended to fund small
businesses.

And that is something that we are interested in
having them do, and I think that is clearly their purpose.
At the same time as they were created under the Investment
Company Act, Congress specifically imposed what they called
“important investor protections,” which essentially means the
Investment Company Act generally applies to BDCs as if they
were closed-end investment companies.

There are a number of exceptions to that rule where
there is some more flexibility to BDCs than there are to
registered funds. But nevertheless, we consider those
important investor protections very near and dear to our
hearts and we stay true to them.

At the same time, we've become aware of an issue
that has had an effect on limiting the investment
opportunities of BDCs, and that was because of a change in
the definition of “margin security” that the Fed made.

That change was completely unrelated to business
development companies, but it affected what they could freely
invest in. So we're looking at that provision. We're
considering options of things that we can do as a staff, and
we are certainly interested in insuring that BDCs continue
with their stated purpose of funding small, developing and
financially troubled businesses. That's it.

MR. DUNN: I will jump in. I have a bunch here, and to the extent I know about half the answer, the rest of these folks hopefully will join in. I have one particular I'm going to have to ask John to help a little bit about.

But the first two I have here relate to independent equity research. And one goes to defining “independent” and adopting some rules around it, and another goes to looking to perhaps what Singapore has done or what other similar countries have done as to fostering independent research.

And I think the best answer for that is what Commissioner Goldschmid had said earlier -- it may well be time for us to start looking at these rules and figuring out what we need to do about research. The world of it has certainly changed in the last couple of years, and that's exactly what -- one of the reasons we're here is to figure out what we should be doing next.

So those, I will take as suggestions. I don't speak for the Commission. I can't say “Done, it's a rule.” But there are things that we definitely need to be thinking about that the world has changed, and we may be behind on it.

So we're going to work on those. So thank you for those. One other question is: “Is there anything we can do to speed up processing of our 1933 Act filings?” I think usually, that
should be the question we should be asking you, because we do
everything we can to speed up the processing of 1933 Act
filings.

And we've done a lot of hiring and a lot of trying
to do some tweaking of our review process for just this
purpose. We still have our goal of getting under 30 days,
and I think we average that pretty regularly. If there
are any suggestions on smaller businesses, I'd ask John if
there's anything specific you see that holds things up.

MR. REYNOLDS: You know, I get that question a lot.

MR. DUNN: Nobody ever says, "How can we slow down a
review of a 1933 Act filing?" (Laughter)

MR. REYNOLDS: No, no. Well, I think a lot of
factors go into the length of time that it takes for a filing
to go effective.

You know, obviously, it's an issue with the staff
on this end, with the amount of work that is in my office.
That's an issue. Also, you know, the small business filings
frequently come in different forms.

There may be significant changes during the
course of a registration statement. The nature of the
offering could change. Sometimes we don't get amendments for
long periods of time and financials need to be updated at that
point, or perhaps I've lost staff because they're no longer
in my office, and I have to assign a new examiner and new
accountant to it.
So there are numerous reasons why it -- which go into the timing of filing effectiveness. I would suggest for small businesses to double check the documents that you file with us to be sure that they are significant in every material way.

I mean, be sure you have your audit report in there. Be sure you have current financial statements. Be sure you're not missing part of your document. Also -- so those are things that you can do to help us help you. And I would encourage you to do those sorts of things.

In other words, just be sure that your filing is in good shape when you send it in on EDGAR. And that would help us a great deal.

MR. DUNN: Thanks. "What are the repercussions of not complying with SOX in regard to small businesses?" The repercussions are the same, small or large businesses. SOX's main term is "reporting issuer."

So the -- most of the provisions in there apply to you once you're a reporting company under the 1934 Act, or have a registration statement in here under the 1933 Act. It doesn't matter whether you're small, big, anything, there. The repercussions mostly are civil. The 906 certifications are criminal. And they are -- some of them are directly in the 1934 Act -- so they would be 1934 Act violations. Others would be violations of the particular provision of
Sarbanes-Oxley. But it's mainly civil and it applies across the board.

“Given the high cost of public compliance for companies that are or have been small orphans as well as high Rule 13e-3 and related costs, has any thought been given to ways to help such companies off the playing field with a more streamlined, going private process?”

It's an interesting question, and we've gotten the same question for foreign issuers. Is there some notion that this isn't what folks bought into? And so there should be some way of getting out.

Of course, the goal, as always, is to keep everybody in and keep that as streamlined as possible. But we recognize that the world has changed. Some of the discussion in the last six months that you've read in the press is certainly that the Commission has been, or the staff, at least, is bouncing around ideas about whether that would be appropriate, because some folks are just not able to do it any longer.

And we have said in the press that we are thinking of such things. Who knows what will ultimately happen, but it's in the hopper of things as to realize that not only do we need to streamline whatever we can for whoever is in the system, but sometimes the ease of getting out isn't there, and it should be there.
It's always a balance. You know, do you want to let people out and then look at the investors who aren't getting the information, versus is it really in their interest for all the money to be spent keeping them in? So I don't know that there's a win or a lose side of that. I think that either side is a little bit of a loss, and it's a question of which loss you take. But I recognize there are losses on both sides, and the staff has been saying it's something we need to think about and try to come up with a way or, if there's not a way, then to explain why not.

So I take that as a suggestion. It is something that we've been trying to figure out. I apologize -- I have a Reg. SHO question which I got late in the process. And Jamie wasn't around to answer it, because he asked me about five minutes before we came up here if there were any SHO questions, and I said “no.” So whoever gave me this, I apologize. Please come up and I'll make sure Jamie gives you a call tomorrow as soon as we can. The only thing I know about SHO, being a Corp. Fin. guy, is it's a kind of Taurus. I don't really know.

I don't know short sales from the Market Regulation side and I do apologize for that.

Question: “Women and minority owned businesses are critical to the success of the economic security according to President Bush. Therefore, why is the SEC yet to establish
an office of minority- and women-owned business? It is worth noting that only four percent of small and medium sized businesses that go public are majority owned by minorities or women."

I think that's a fair question. It's something to think about. And occasionally, we get it. I tend to view Corp. Fin.'s role as explaining the law to all companies as best we can and trying to ease the process of getting through it and providing investors with the information that's required.

Our responsibility under Section 2(b) of the 1933 Act is to balance investor protection and capital formation. And I don't know if the purpose of such an office would be to support a particular type of company, which usually is not in our role.

However, if somehow in our role we are not providing our guidance to a particular type of company, we need to think about that. I would think that most of those companies would be asking Gerry's office for information, and that need would seem to be met there.

We don't usually go about promoting one type of company or another. We see our goal as helping all of them, and, in the small business area, because we know there are particular questions, we have an office for that.

Perhaps the purpose of the question is to say there
are particular questions in that area that we haven't thought of. And if that's the case, we'll definitely think of it. But I would tend to think the Small Business Office works in that area.

Another question goes to, "What is the SEC doing -- or I'll read the end of it -- "What specific action is the SEC taking to remain competitive in the global economy in respect to insuring that U.S. financial markets can compete with ethical foreign public equity markets?"

I don't know that I could give a list of specific things, because I think that if at any point the Commission got up here and voted on something, and we said, "We're doing this because we think we can keep -- it keeps us from being able to compete with other markets," they'd probably shake their heads.

I understand the viewpoint that is asking that question, and I respect it. However, I think that everything the Commission does is with the goal of making the U.S. markets as liquid and transparent as they can. And in that way, you compete with foreign markets.

So I will take that as the best answer I can give for that. We definitely factor that in to everything we do, and we recognize the world is changing. To have a xenophobic approach to markets is stupid. And I don't believe that the Commission does that. And we try very, very hard to relate
to what is going on around the world and contemplate it.
The last two questions I have go to the structure
and attendance at today's forum. They are what they are.
The Planning Committee believed that this was the best way to
have this and get the most information around. I personally
think it's the best way, because this way, having it here and
doing it this way, allows it to be webcast, and you don't have
to actually be here to get all the information you can learn.

I think it's a wonderful idea. We'll, of course, try to get better and tweak things as we go, as always. But I just think the opportunity to get on the web and not have to go to the hotel in Virginia or whatever particular part of the country we're in, is the way to go.

Being here helps with participation in the break-outs. I think those are the key to the whole thing. But the gathering of information up to this point, I think this is a wonderful idea as to how to do it and I congratulate the forum folks on thinking about it.

With that, we've gone through these. Again, I apologize for the SHO question. If I had gotten it two minutes before, I would have had an answer. I'm very sorry. That's my mistake. So please come up and talk to me about that.