



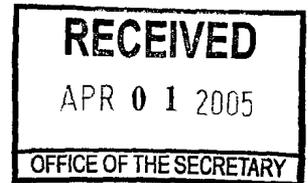
Cardinal Bankshares Corporation

70

Post Office Box 215
Floyd, Virginia 24091
Phone: (540) 745-4191
Fax: (540) 745-4133

March 31, 2005

Mr. Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609



Ref: File Number 4-497
Section 404, Sarbanes-Oxley Act of 2002

Dear Mr. Katz:

Thank you for the opportunity to comment on the implementation of Section 404.

Bank of Floyd is a \$187 million, community bank in rural southwest Virginia. We are the single Bank in Cardinal Bankshares Corporation's holding company.

The first question I would pose is: Does the cost justify the implementation? In 1991, the U.S. Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). This regulation placed many of the same controls and guidelines of Section 404. With the wisdom of congress, at that time, most banks under \$500 million were exempt. Congress and Federal regulators realized, at that time, that small banks were already over burdened with regulation and could not survive the associated costs.

The cost for Bank of Floyd's compliance and implementation of Section 404 is estimated to be in the excess of \$85,000 annually. We say we are protecting the investor when a regulation takes approximately 5.5 cents per share from their pocket. Are we then actually protecting the investors?

In fact, when 65% of our shareholders live within 60 miles of our bank, they will vote us out as directors if they do not like how the bank is operated. I see many of our largest shareholders weekly. The CEO of a small bank can't hide on the 50th floor and escape the scrutiny of his customers and shareholders.

With the added burden of documenting, testing, retesting and personnel oversight we are diverting time and money away from our core banking functions, and who does that harm? It is the customers, shareholders, community and staff members when a small bank is sold.

Ladies and Gentlemen, our Board is now discussing the few options they have. There is one pure fact we must remember in a small bank, or any small business – the investors we so proudly say we are protecting are the customers, community and staff.

Mr. William Wagner, Managing Director of a North Carolina investment bank, writes: “In my opinion, many are going to either find a way to de-register from the SEC or will have to sell to a larger financial institution that can afford to comply with Sarbanes-Oxley (SOX). The loss of the community bank in many small towns will be unfortunate, as large banks typically do not provide the same level of service or community involvement. Without the burden of SOX, community banks can successfully compete, with it, their future is less certain.”

Additionally, the audit committee independence requirement has created significant problems for community banks. As you know, SOX mandates that a company have a “financial expert” on its audit committee who receives no compensation from the company other than compensation for serving on the board or a board committee. This has meant that many accountants for community banks have been unable to serve because they do not want to forego the fees they receive for their professional services to the bank. In the small towns and rural areas they serve, many community banks have had difficulty finding a “financial expert” when their trusted accounting firm is disqualified from serving. There just may not be any other “financial experts” in the community. And the bank may really want its accountant to serve. For this reason, it would be good to relieve smaller institutions of this auditor independence requirement.

SOX is adding significant expense in many different ways. The most obvious relate to the additional professional fees. Accounting and legal fees have significantly increased given the complexity and requirements of SOX. However, there are many less obvious costs. For example, many different products and services purchased by a bank have been modified to comply with SOX and these charges are being passed onto banks. In addition, many have had to hire additional staff or incur more training and development costs. D&O insurance costs have also risen as have directors’ fees.

Community financial institutions face the loss of qualified directors and the reluctance of people to serve as directors. Since a director can be held personally liable for accounting errors, this has made many people hesitant to be a bank director.

New product introduction is stifled as compliance with internal control policies and procedures creates complications and delays. If the systems within the bank cannot be modified to allow for the additional internal control requirements necessary to introduce a new product, or the cost of making these changes is too expensive, the new product may not be added. Even if the current system is able to accommodate a new product, the additional internal documentation and testing of the internal controls can slow the process down and increase the cost.

SOX has eliminated the ability of a small bank to rely on auditors as business consultants. Small banks do not have a large staff of accountants and others that can help them monitor and keep abreast of all the changes going on in their industry and in the accounting profession. In many cases, small banks have relied on their auditor to provide useful insight into business practices.

Therefore, I ask that you please consider the following recommendations:

- 1.) Exclude small businesses with assets of \$500 million or less (FDICIA 1991).
- 2.) Allow businesses with less than 1,500 shareholders, and less than 100 million market capital, to de-register with no SEC opposition. Simple majority affirmative vote of shareholders.
- 3.) Any director that is not part of management and does not draw a salary should be considered independent. When you let compensation from legal fees, teaching fees and anything other than salary affect independence; you do a disservice to both the company, director and shareholders. A small community bank is not an Enron!
- 4.) Lighten up on the restrictions of the kind of service and advice our accounting and audit firms can provide. These are the people that should be working with the Board of Directors and the CEO to make a better company.

In conclusion, I would simply say that all good CEO's want to see their company's run fair and with honest principals. By far, most are run in that manner. No company can survive without high standards, trust of the Board of Directors, Audit Committees, CEO's, CFO's, Auditors and Accountants.

Many provisions of SOX, PCAOB, AICPA, SEC and FASB are driving a wedge between the very people that should be working together. There is an air of distrust being created that must be corrected. If we do not reach a compromise that everyone can embrace, small businesses will slowly fade away. And without small companies, all that will be remaining are the big Enrons' and World Coms'.

Thank you for your time and consideration and please consider my thoughts as a constructive way to solve a broken piece of legislation.

Sincerely,



Leon Moore
Chairman, President and CEO

Encs.

Enclosures

Credits:

- 1.) William J. Wagner, Triangle Capital Partners, LLC
- 2.) Matthew Squire, Report of ACB
- 3.) Grant Thornton Co., The Community Bank Profile
- 4.) Patricia Satterfield, Virginia Association of Community Banks
- 5.) Tim Wilson, Network Computing, What Price SOX?

cc: Senator George Allen
Hart Senate Office Bldg.
Suite 708
Washington, DC 20510

Virgil H. Goode, Jr.
U.S. Congress – 5th District
1520 Longworth House Office Bldg.
Washington, DC 20515

Congressman Frederick C. Boucher
U.S. House of Representatives
2245 Rayburn House Office Bldg.
Washington, DC 20515

Congressman Michael G. Oxley
2308 Rayburn House Office Building
Washington, DC 20515

Mr. Rusty Cloutier, President
MidSouth Bank. N.A.
P.O. Box 3745
Lafayette, LA 70502-3745



TRIANGLE CAPITAL PARTNERS

Investment Bankers

February 9, 2005

Mr. R. Leon Moore
President and CEO
Cardinal Bankshares Corporation
101 Jacksonville Circle
Floyd, Virginia 24091

Leon:

I enjoyed our meeting last week and look forward to working with you. As the weather gets better, we will need to find a time to get down to Pinehurst and play some golf.

I wanted to follow up our conversation regarding the impact of Sarbanes-Oxley on community banks. As an investment banker specializing in financial institutions, I can tell you first hand that the implementation of Sarbox is having a very negative effect on the community banking industry. In my discussions with banks from \$2.0 billion in assets down to \$50 million, most management teams agree that the costs and burdens of Sarbox outweigh its advantages. It is clear to them that the burdens of complying with Sarbox fall disproportionately on smaller financial institutions. Most believe that Sarbox is unnecessary and redundant due to the regulatory oversight already in place in the banking industry.

It is also clear that Section 404 of Sarbox has ratcheted up the burdens of complying even further. The documentation, testing and re-testing are requiring that significant time and expense be diverted from the core business of banking. This not only hurts the shareholder, but the customer as well. I have heard bankers mention the reluctance to introduce new products or services due to the requirement to perform an extensive and expensive evaluation of its introduction on the internal control structure of the bank. Even without anything new, many small banks are looking at spending hundreds of thousands of dollar and weeks of management time this year complying with Sarbox. In my opinion, many are going to either find a way to de-register from the SEC or will have to sell to a larger financial institution that can afford to comply with Sarbox.

The loss of the community bank in many small towns will be unfortunate, as larger banks typically do not provide the same level of service or community involvement. Without the burdens of Sarbox, community banks can successfully compete, with it, their future is less certain.

Sincerely,

A handwritten signature in cursive script that reads "Bill".

William J. Wagner
Managing Director

The “community bank” profile

“Community bank” has many definitions. Some studies base the distinction on asset size; some set a strict ownership definition; and others define it as a philosophy.

To gather information for this study, Grant Thornton mailed questionnaires to a national sample of 4,625 chief executive officers and senior officers of banks and savings institutions in mid-November 2004. A total of 442 completed questionnaires were returned for a response rate of 9.6%, yielding a margin of error of $\pm 4.6\%$.

In this analysis, “small” community banks (30% of respondents) are defined as those with assets of \$100 million or less; “medium” banks (48% of respondents) are those with more than \$100 million to

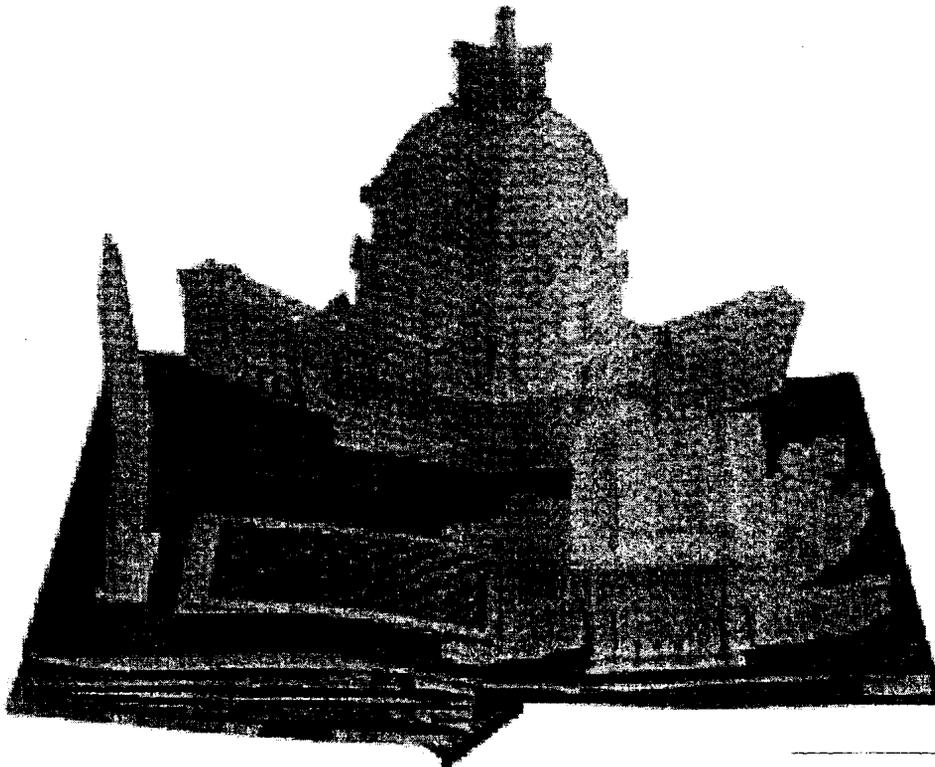
\$500 million in assets; and “large” are those with more than \$500 million in assets, also generally known as FDICIA banks (22% of respondents). Only three FDICIA banks had assets in excess of \$5 billion.

The executives defined the community they primarily serve as rural (45%), suburban (38%) and/or urban (17%). For classification by primary federal regulator, 12% indicated the Federal Reserve; another 12% specified the Office of Thrift Supervision; 21% the Office of the Comptroller of the Currency; and 56% the Federal Deposit Insurance Corporation¹.

Almost one-third (30%) are publicly held; 57% are private corporations; and 13% have mutual charters. One in five (18%) of the respondents is an S Corporation.

This year, Grant Thornton also sent a shorter questionnaire to 407 audit committee chairmen of public banks and received 118 completed surveys for a response rate of 29%. Details of the audit committee chairmen responses are published in a separate document available from Grant Thornton (www.GrantThornton.com/banksurvey).

Grant Thornton extends its sincere appreciation to the community bankers who generously gave of their time to respond to our *Twelfth Annual Survey of Community Bank Executives*.



¹Total may not equal 100% due to integer rounding.

Costs of corporate governance



According to industry trade association executives' and accounting professionals' anecdotes, top on the list of bankers' complaints are the rising costs of audits and expensive SOX Section 404 (management reports on internal controls) related services.

The results of this year's survey support these claims.

Two-thirds (67%) of all community bank executives indicate that the cost of documenting internal controls has increased this year. Nine in 10 (88%) executives at large community banks reported cost increases versus two-thirds (65%) of small bank executives.

This pattern is repeated for general audit fees and general legal fees. This year, four in five (83%) of all bankers reported an increase in general audit fees, including almost one-third (29%) who said the increases were significant. The price of audits increased for practically all (95%) of large community banks, compared to 71% of small institutions. In addition, nearly two-thirds (60%) of all bankers cited increases in general legal fees.

Bankers noting increased cost of operations in 2004 (by asset size)

| | small | medium | large |
|---|-------|--------|-------|
| general audit fees | 71% | 85% | 95% |
| documentation of internal controls | 65% | 59% | 88% |
| D&O insurance | 56% | 66% | 66% |
| general legal fees | 48% | 59% | 78% |
| outsourcing or co-sourcing of internal audits | 53% | 60% | 66% |
| attracting, retaining and educating board members | 30% | 39% | 58% |
| compensation for audit committee chairman/members | 14% | 33% | 53% |

Bankers noting increased cost of operations in 2004 (by ownership)

| | public | private | mutual |
|---|--------|---------|--------|
| general audit fees | 93% | 79% | 79% |
| documentation of internal controls | 83% | 60% | 63% |
| D&O insurance | 70% | 59% | 65% |
| general legal fees | 75% | 52% | 60% |
| outsourcing or co-sourcing of internal audits | 71% | 52% | 65% |
| attracting, retaining and educating board members | 45% | 37% | 47% |
| compensation for audit committee chairman/members | 41% | 23% | 49% |

Bankers noting increased cost of operations in 2004 (FDICIA & public vs. all others)

| | FDICIA & public | all others |
|---|-----------------|------------|
| general audit fees | 93% | 76% |
| documentation of internal controls | 81% | 58% |
| D&O insurance | 68% | 60% |
| general legal fees | 75% | 50% |
| outsourcing or co-sourcing of internal audits | 68% | 53% |
| attracting, retaining and educating board members | 49% | 35% |
| compensation for audit committee chairman/members | 43% | 24% |

Conference buzz: Sarbanes-Oxley making a bad name for itself

March 17, 2005 4:09 PM

By Matthew Squire

The names "Sarbanes" and "Oxley" taken separately usually earn respect in the banking industry. But placed side by side, "Sarbanes-Oxley" is beginning to represent one of the most maligned pieces of legislation in recent memory among community banks.

Passed in 2002, the Sarbanes-Oxley Act, or SarbOx as it is commonly called, was designed to create more transparency into corporate activities and deter corporate fraud. However, attendees at the America's Community Bankers 2005 Government Affairs Conference held in Washington, D.C., were united in their frustration over the law's reporting requirements and the topic was raised at nearly every presentation.

Specifically, bankers say they are becoming increasingly burdened over the law's Section 404, which governs the reporting requirements for internal controls. Bankers note that the added costs of these new reporting requirements are becoming unbearable for some smaller institutions and can ultimately lead them to deregister their stock. Industry representatives are also saying that SarbOx 404 is creating a more adversarial environment between smaller institutions and their outside auditors.

On March 15, America's Community Bankers (ACB) President and CEO Diane Casey-Landry told reporters during a briefing that while quantifying the overall costs of compliance efforts is difficult, SarbOx 404 has caused "a real-dollar increase in [the banking industry's] audit."

Casey-Landry also said that SarbOx 404 compliance has created a windfall for the accounting industry. "There is not a week that goes by where we do not get a phone call regarding the accounting firms using this as a mechanism for increasing their revenues," she said.

Furthermore, Casey-Landry called special attention to the strain that SarbOx 404 has created between smaller, nonpublic institutions and their auditors. The ACB chief said that her organization has been seeing more cases where auditors, who are also feeling the pressure from the newly created Public Company Accounting Oversight Board, have refused to service these smaller institutions unless they agree to SarbOx 404 testing — even though the small banks are not bound to do so by regulators.

There were indications at the conference that the industry's complaints could be making some headway. For instance, on March 15, SEC commissioner Cynthia Glassman met with applause when she told the conference that SarbOx 404 is in need of a "serious look."

On March 16, House Financial Services Committee Chairman Michael Oxley, R-Ohio, spent time during his speech to defend the law bearing his name. Oxley touted SarbOx as an effective deterrent to corporate fraud and said the law would make it much more difficult to engage in the fraudulent activities associated with WorldCom and Enron.

"The fact is that with the transparency in the law, the added penalties, the certification procedures ... it would be much, much more difficult to pull that off," he said.

Still, Oxley noted that SarbOx could require more attention, and acknowledged, "It's not perfect; it is costly."

Oxley said that Congress is planning an oversight hearing on the issue in April that will have testimony from SEC Chairman William Donaldson and Public Company Accounting Oversight Board Chairman William McDonough.

In addition, Glassman noted that the SEC is scheduled to hold a public roundtable on April 13 to discuss SarbOx 404 implementation for ways to improve the process.

If the mood of Glassman's audience was any indication, the SEC can be sure to get an earful from the banking industry.

SURVEY OF COMMUNITY BANKS

March 3, 2005

Sarbanes-Oxley Comments

Bank Name/City: Farmers & Merchants Bank / Timberville

Asset size: \$370 million

Estimated Cost for Compliance: 100k – hand costs to CPAs, etc

Estimated Number of Additional Staff Hours: 2000 hrs = *\$75 k soft costs for salary/benefit allocation

Effects on Board Members: Increase in number of audit meetings from 4 to at least 6.

Regular board meetings will be longer, more training required for all directors.

- *These are 1st year costs. Not sure of on-going costs but they will be substantial – est. 50% of 1st year.*

Bank Name/City: Millennium Bank / Reston

Asset size: \$375 million

Estimated Cost for Compliance: 500,000

Estimated Number of Additional Staff Hours: 6 FTE people

Effects on Board Members: Difficulty in understanding the complexities or details of Act. Causing many to want to leave or ask how to unlist based on cost and cost effectiveness. We were under an MOU which increased our written procedures and back testing getting us a jump start on this process so cost maybe underestimated.

Bank Name/City: Pioneer Bank / Stanley

Asset size: \$130 million

Estimated Cost for Compliance: 100,000 – 125,000

Estimated Number of Additional Staff Hours: 1000 +

Effects on Board Members: Not determined at this time.

Bank Name/City: The First National Bank of Altavista / Altavista

Asset size: \$225 million

Estimated Cost for Compliance: 100k

Estimated Number of Additional Staff Hours: 1200

Effects on Board Members: We had to rearrange our audit committee due to independence matters.

Bank Name/City: Community Bank / Staunton

Asset size: \$375 million

Estimated Cost for Compliance: 100k direct

Estimated Number of Additional Staff Hours: 1000 hrs est.

Effects on Board Members:

Bank Name/City: Freedom Bank of Virginia

Asset size: \$56 million

Estimated Cost for Compliance: 25,000

Estimated Number of Additional Staff Hours: 2000 hrs

Effects on Board Members: Significant Risks

Sarbanes Oxley Comments: Page 2

Bank Name/City: FNB Corporation / Christiansburg

Asset size: 1.4 Billion

Estimated Cost for Compliance: 250k

Estimated Number of Additional Staff Hours: 2 FT Assigned to 400 hrs.

Effects on Board Members: Minimal—Impact on Audit Committee

Bank Name/City: Virginia Financial Group / Charlottesville

Asset size: 1.4 billion

Estimated Cost for Compliance: 120K outsourced

Estimated Number of Additional Staff Hours: 1,600 internal hours

Effects on Board Members: They must understand the requirements and effects of Sox 404 and follow-up is key!

Bank Name/City: Union Bankshares Corporation

Asset size: 1.7 Billion

Estimated Cost for Compliance: Direct Cost > 75,000 In house did not use consultants

Estimated Number of Additional Staff Hours: 1500-2000

Effects on Board Members: SOX 404 education

(Redirected significant time from other projects, including budget, etc.)

Bank Name/City: Albemarle First Bank / Charlottesville

Asset size: \$120 million

Estimated Cost for Compliance: 120k hard and soft costs

Estimated Number of Additional Staff Hours: 1000s of hours

Effects on Board Members: Very concerned about effects: Liability, costs, bank performance.

Bank Name/City: Highlands Union Bank / Abingdon

Asset size: \$570 million

Estimated Cost for Compliance: 175K

Estimated Number of Additional Staff Hours: 3 to 4 thousand

Effects on Board Members: 1. Accountability 2. Education

Bank Name/City: River City Bank / Richmond

Asset size: \$30 million

Estimated Cost for Compliance: Consultants \$50,000 + CPAs?

Estimated Number of Additional Staff Hours: 1000 / year of implementation

Effects on Board Members: Question the benefit vs. cost. Reduction in CPA role as advisor, specialist, expert. Why a small bank requires all this work in highly regulated industry.

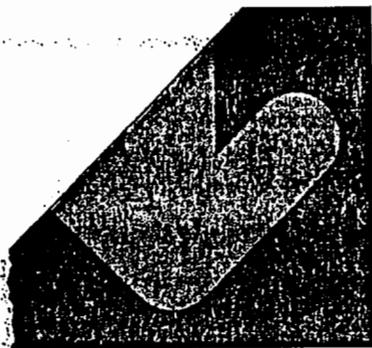
Bank Name/City: Bank of Botetourt

Asset size: \$212 million

Estimated Cost for Compliance: 40,000

Estimated Number of Additional Staff Hours: 600 hours

Effects on Board Members:



BUZZCUT

[News Without The Noise]

What Price SOX?

» We've long suspected Sarbanes-Oxley is a black hole for IT staffing and dollars—and now there's proof. A study released by financial consultancy A.R.C. Morgan says that most companies have no idea how much they will spend on SOX compliance.

Companies—and their IT departments—have been complaining for more than a year about the sucking sound created by SOX Section 404, which is supposed to reduce book-cooking by requiring them to make systems and data more auditable. The A.R.C. Morgan

report suggests there's good cause for these complaints, though there's an alarming lack of data about the associated costs. The report expresses surprise at how few companies with annual sales greater than \$10 billion have put a cost on SOX in their SEC filings.

The problem is that the SOX regulations don't specify the exact requirements of IT systems and data, so companies must rely on independent auditors to advise them on what must be done to comply. The auditors don't know IT well enough to define what will be required, and the IT people don't know what the auditors will ask them to do. Hence, no one knows what SOX compliance will cost from company to company, or whether there are standard steps to reach that goal.

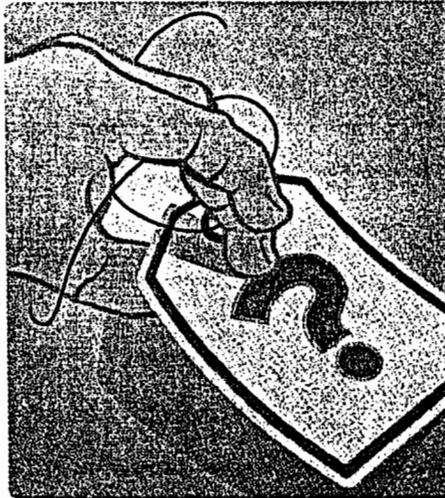
Till now, many organizations have been using a rule of thumb that says a company should plan to spend about \$1 million on SOX compliance for every \$1 billion in annual revenue. But in its study of SEC filings, A.R.C. Morgan found that companies in the \$1 billion revenue range are already spending more than \$2 million on IT consulting and other outside services. And that's just the part that's easy to quantify—if you add internal resource spending and growing auditor fees, the figure is likely to be more than \$3 million, A.R.C. Morgan says.

What can you do to control SOX compliance costs? Planning is essential. Many companies have hired outside professionals because they fell behind on deadlines or because they didn't see the need for

CONTINUED ON P.18

must reads

- » See the full report from A.R.C. Morgan, www.arcmorgan.com/Section_404_Costs.htm
- » Talk to other users working on SOX compliance, www.sarbanes-oxley-forum.com
- » Get a SOX education from the Big Four accounting firms, www.s-oxinternalcontrolinfo.com/



CONTINUED FROM P.17 in-house expertise until too late. Also, be aware that you can use local auditors to evaluate systems and data in the regions where your organization operates; according to A.R.C. Morgan, many companies have spent too much money flying auditors from the Big Four to their sites around the globe.

Meantime, enterprises must push their SOX auditors to develop some compliance standards that can be used across the board. Right now, the auditors are driving the ship, and nobody's sure exactly where it's going. —Tim Wilson