August 31, 2005

Jonathan G. Katz
Committee Management Officer
Securities and Exchange Commission
100 F Street NE,
Washington, DC 20549-9303

Re: Comments for the SEC Advisory Committee on Smaller Public Companies; File Number 265-23

Dear Mr. Katz:

The Independent Community Bankers of America[1] ("ICBA") and the law firm of Powell Goldstein LLP[2] ("Powell Goldstein") appreciate the opportunity to submit jointly the following comments for the SEC Advisory Committee on Smaller Public Companies on ways to improve the current regulatory system for smaller companies under the U.S. securities laws.

Background

On December 16, 2004, the Chairman of the Securities and Exchange Commission, announced the formation of an Advisory Committee on Smaller Public Companies (the "Advisory Committee") to assist the Commission in evaluating the current securities regulatory system relating to disclosure, financial reporting, internal controls, and exemptions for smaller

[1] *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $631 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org..

[2] *Powell Goldstein LLP, a law firm based in Atlanta, Georgia and Washington, DC, serves as general counsel to the ICBA. The firm also represents over 200 community banks, both public and private, located in the Southeast and throughout the United States. Its Financial Institutions Practice Group advises clients on a variety of issues, including bank and corporate regulatory issues, mergers and acquisitions, capital management, de novo formation, bankruptcy, employee benefits and executive compensation.*

public companies. The new Advisory Committee, consisting of twenty-one members, has held three public meetings. Bill Loving, President and CEO of Pendleton County Bank, testified on behalf of ICBA at the New York hearing on June 17, 2005. ICBA has also submitted comment letters to the Advisory Committee dated March 31 and April 8, 2005 recommending ways to reduce the regulatory burden of the securities laws on smaller public companies.

The following comments of ICBA and Powell Goldstein are in response to the twenty-nine questions listed in the Advisory Committee's Request for Input.[3] Not every question was commented on; we limited our comments to those issues where we thought our expertise and experience would be most valuable.

ICBA and Powell Goldstein's Comments

1. *Has SOX changed the thinking of smaller companies about becoming or remaining a public company? If so, how?*

   Our experience evidences a significant trend toward avoiding or eliminating registration obligations among community banks since the advent of the Sarbanes-Oxley Act of 2002 (the "Act" or "SOX"). Non-reporting banks have increasingly revised their strategic plans to eliminate capital-raising activities that would require registration and have instead undertaken private placements and trust preferred securities offerings as their primary means of raising capital. We have also seen increased utilization of tender offers, stock repurchase programs, recapitalizations and similar measures designed to maintain shareholder bases at levels below the registration threshold

   Unlike other small businesses, community banks are often widely held by their shareholders in their communities. However, banks that are currently public are considering going-private transactions in record numbers, with over 60 community banks nationwide having filed to go private since the beginning of 2003. The reasons cited in these filings uniformly include the increased legal and auditing "hard costs" and management/staff time "soft costs" associated with the Act, as weighed against the minimal benefits of registration community banks typically experience given their relatively low market capitalizations and thin trading markets. While Section 404 compliance is unquestionably a significant issue in these deliberations, it is not the only driver of a going-private decision. Rather, it has often served as a "tipping point" for banks for whom going (or staying) private has always made sense, but who did not associate much urgency with the process.

2. *Has SOX affected the relationship of smaller companies with their shareholders? If so, how?*

   The director nomination, shareholder communications, code of ethics, internal controls and other aspects of the Act have not, in our members' experience, generated significant positive or negative shareholder reaction. For many community banks, particularly those that are not listed on an exchange, director nomination and shareholder communications

[3] Request for Public Input by Advisory Committee on Smaller Public Companies: (Release No. 33-8599; August 2, 2005).

policies and the bank's code of ethics have been formalized and published in the annual proxy statement and 10-K, but have not typically generated significant changes in the way in which the bank conducts its business in these areas.

3. *Do you believe that SOX has enhanced, or diminished, the value of smaller companies?*

SOX has diminished the value of smaller companies because the burden of that law has disproportionately impacted smaller companies. Many community banks and holding companies, for instance, simply do not have the resources to comply with SOX. According to ICBA's recent survey of Section 404 costs for community banks[4], community banks expect that the internal control attestation requirements of Section 404 will increase outside audit fees an average of $87,198—approximately 52% of total annual financial statement audit fees. Including outside audit fees, consulting fees, software costs and vendor costs, the average community bank will be spending more than $200,000 and devoting over 2,000 internal staff hours to comply with Section 404 of SOX. Community banks report that these costs represent a significant percentage of their income and that in many instances, they cannot afford to hire the additional personnel or implement the specialized software necessary to ensure compliance with Section 404.

While these expenses could be justified if a corresponding benefit were realized, our members rarely receive significant benefits from SEC registration. Based on our discussions with investment bankers and analysts, a bank should have at least $1 billion in assets, a liquid trading market, a strategic plan involving serial acquisitions using stock as currency, and/or a need to raise capital in the public markets to truly benefit from being public. Many community banks do not meet these criteria, and as such, the money they spend on compliance with the Act represents an expense for which there is a minimal corresponding benefit.

In addition, SOX is redundant for community banks since they are under strict regulatory supervision that assures their safe and sound operation and good internal control systems.

5. *Does the current securities regulatory system adversely impact or enhance this country's culture of entrepreneurship?*

ICBA believes that the current securities regulatory system does adversely impact the country's culture of entrepreneurship. For instance, with respect to the formation of new banks, we have noticed that bank organizers who are seeking public capital are keeping the number of original or incorporating shareholders below the 500-shareholder threshold under the Securities Exchange Act of 1934 to avoid having to register as a public company with the SEC. In some instances, this has meant reducing the amount of capital planned for the de novo bank to the minimum required under the law.

Community bankers have also noticed some reluctance by their business customers to start new businesses or to seek public capital to grow a business because of the costs of SOX.

[4] See ICBA's letters dated March 31 and April 8, 2005 to the Advisory Committee for a complete explanation of the ICBA Community Bank Survey of the Costs of Complying with Section 404 of Sarbox.

6. *Has SOX resulted in a diversion of the attention of company management away from operational activities, or otherwise imposed an opportunity cost on the management of smaller companies? If so, have the benefits of SOX justified the diversion or opportunity cost?*

   For community banks, SOX has resulted in a major diversion of the attention of company management away from operational activities and the business of banking. Many of our members are thinly staffed, with a CEO and CFO but not always a controller, internal auditor or investor relations personnel. In many of these banks, the CEO and CFO have multiple responsibilities, including documenting and evaluating the bank's disclosure and internal controls, preparing and reviewing periodic reports and proxy statements and gathering the significant amount of data these reports require, filing Form 3 and 4 reports and 8-K reports within the time required, complying with heightened internal and external auditing processes, preparing for Section 404 compliance certification, and consulting with counsel on various issues relating to the above. Given the limited personnel available to handle these responsibilities, management is forced either to divert its attention from other business activities or hire additional personnel, with the latter alternative often being difficult given the associated expense and, especially for banks in rural areas, lack of qualified personnel. For the reasons cited in our responses to Questions 1 and 3 above, we do not believe the benefits of the Act balance the diversion of management time and corresponding opportunity cost our smaller public members have experienced.

9. *Has SOX changed the capital raising plans of smaller companies? If yes, how have those plans changed? Has SOX affected the thinking of smaller companies about buying or being acquired by other companies or looking for merger partners or acquisition targets?*

   As is discussed in our response to Question 1 above, our members have focused increasingly on raising money in private placements and through the issuance of trust preferred securities or debt financing as opposed to undertaking broad-based public offerings of their securities. In most cases, they can raise the desired capital by means that do not require SEC registration, and this has inhibited the public offering activity in our industry to some extent. We have also seen community bank boards, particularly in small institutions, decide to seek an outside acquirer in order to address staffing and other resource issues relating to compliance with the Act, particularly Section 404. Some of these banks had previously considered acquiring other banks as part of their strategic plan but shifted their focus in view of the increased costs associated with the registration and maintenance of a liquid security. Internal controls are also receiving more formalized scrutiny from acquirers, although this has always been a primary focus in the banking industry.

10. *In developing a "risk-based" approach for assessing and auditing internal control over financial reporting for smaller companies under SOX Section 404, what criteria would you use to categorize internal controls from the highest risk to the lowest risk controls?*

Community banks assess risks for an area based on different criteria including the number of transactions in that area, the dollar amount of transactions, and the vulnerability of the area to fraud.

11. *Do you believe that at least some SOX Section 404 internal controls for smaller companies can be appropriately assessed less often than every year? Every two years? Every three years?*

Higher risk areas such as lending, wire transfers and certain IT areas should be assessed every year. Lower risk areas such as human resources and investment securities could be assessed every two or three years.

12. *Current standards require that the auditor must perform enough of the testing himself or herself so that the auditor's own work provides the principal evidence for the auditor's opinion. Are there specific controls for smaller companies for which the auditor should appropriately be permitted to rely on management's testing and documentation? Are there specific controls for smaller companies where this is particularly not the case?*

In the case of banks and bank holding companies, outside auditors performing Section 404 audits should rely more on the work of internal auditors and bank examiners. It makes no sense for an outside auditor to duplicate the work of a bank examiner or an internal auditor. Outside auditors should also be permitted to rely more on management's testing and documentation for the low risk areas of a smaller company or bank.

13. *Do the benefits of SOX Section 404 outweigh its costs for smaller companies? Would you support a total exemption from SOX Section 404 requirements for smaller companies?*

For banks, the incremental benefits of Section 404 fall far short of balancing the cost of compliance. This is because the banking industry is already highly regulated, with regular agency examinations of virtually all aspects of the bank's business, including the adequacy of internal controls. Requiring an additional audited report relating to internal financial controls provides little added benefit in an industry in which regulatory oversight holds management to a higher standard of compliance as a threshold matter than is the case for companies in other industries.

In particular, banks have been subject to the internal control attestation requirements of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) since 1991[5]. Those requirements exempt banks with assets of less than $500 million because federal

[5] FDICIA amended Section 36 of the Federal Deposit Insurance Act (12 U.S.C. 1831m). All insured depository institutions that have assets of $500 million or more, whether or not they are public companies, are subject to the provisions of Section 36 of the Federal Deposit Insurance Act and the FDIC's implementing regulations and guidelines (12 CFR Part 363). Section 36 and Part 363 require an annual management report, and impose annual auditing and attestation, and audit committee requirements on covered depository institutions. Part 363 allows the holding company of a covered insured depository institution to fulfill these requirements for the institution. In addition, the FDIC's implementing guidelines reference and incorporate the SEC's requirements and interpretations concerning auditor independence.

banking regulators recognize that internal control reporting and attestation requirements for community banks would be unduly burdensome, particularly since these banks are subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations. Because the average size of a community bank has grown since the $500 million threshold was established and to further reduce the costs and burden of internal control requirements on community banks, the FDIC recently proposed raising the FDICIA threshold so that banks with assets of less than $1 billion would be exempt from the internal control attestation requirements of Section 36 of the Federal Deposit Insurance Act. **We would encourage the Committee to consider a similar exemption for community banks from Section 404 of the Act.**

14. *Has SOX affected the relationship of smaller companies with their auditing firms? If yes, how? Is the change positive or negative?*

SOX has had a negative impact on the relationship of smaller companies with their auditing firms. Traditionally, community banks have looked to their auditors for guidance and information. However, SOX Section 404 and in particular, Auditing Standard No. 2, has changed that relationship. Several bankers noted during last year's audits that they were unable to ask questions of their auditors about their internal controls because the auditors claimed that there would be a conflict if they answered questions and rendered an opinion on the internal controls. In those instances, bankers were forced to incur the costs of seeking opinions from other consultants or accounting firms. Auditing firms appear to be overreacting to the requirement to maintain their independence from the client.

One banker noted that many smaller companies feel like they are being held hostage by their auditing firms because it is simply too expensive to change auditing firms. To change, smaller companies would have to incur the auditing expenses of obtaining sign-offs from their old auditor for prior period financials. This would be in addition to the auditing expenses of their new auditor.

In addition, prior to the effectiveness of the Act, many community banks outsourced their internal audit function to their independent auditing firm. This enabled the bank to fulfill that function in cases in which qualified personnel were unavailable or it was more attractive financially for the bank to handle the position on an outsourced basis. While this arrangement did present the independence issues the Act was designed to address, the additional regulatory oversight characteristic of the banking industry, coupled with the auditor's resulting familiarity with the client and its processes and policies, provided an offsetting benefit. Shortly after the Act's independent auditing standards became law, a significant number of community banks were required to terminate the outsourcing relationship and retain a second audit or consulting firm for this function, often at additional expense. This, coupled with the external auditor's inability to render advice or risk jeopardizing independence under current standards, has often led banks to retain two accounting firms – one for consulting activities and one for the independent audit. Banks perceive this as a "doubling up" of their professional advisors that, while beneficial from

a strict independence perspective, does not often provide a benefit that balances the additional cost.

17. *For smaller companies, would extended effective dates for new accounting standards ease the burden of implementation and reduce the costs in a desirable way? Would allowing a company's independent auditors to provide more implementation assistance than they are able to currently reduce such burdens or costs?*

We support the Advisory Committee's recommendation to delay by one year the implementation of the internal control attestation requirements of Section 404 for non-accelerated filers. We believe this will allow the COSO internal control framework and Section 404 auditing standards to evolve more fully, particularly as applied to smaller public companies, and give these companies additional time to appropriately document, test and evaluate their internal controls in preparation for the related audit.

We also support a change in auditing standards that would allow independent auditors to provide implementation assistance to their clients without being concerned about their independence. Currently, smaller companies must go to other auditing firms to obtain such assistance and are finding a resource problem; relatively few firms are available to perform Section 404 implementation services, particularly in many smaller markets and rural areas of the country. Changing the auditing standard would reduce the burden and costs of the SOX 404 audits.

18. *Would auditors providing assistance with accounting and reporting for unusual or infrequent transactions impair the auditors' independence as it relates to smaller companies? Would providing such assistance reduce the cost of compliance for smaller companies?*

We believe auditors could provide such assistance without impairing their independence. We also believe such assistance would reduce the cost of compliance for smaller companies.

19. *Is the quarterly Form 10-Q or Form 10-QSB information valuable to users of the financial statements of smaller companies? Would a system that required semi-annual reporting with limited revenue information provided in other quarters reduce costs of compliance without decreasing the usefulness of the reported information to investors? Please explain.*

In many instances, community bank investors do not need the information that is required by a quarterly Form 10-Q or Form 10-QSB. A semi-annual reporting system with limited revenue information provided in other quarters would be just as useful to community bank investors.

Furthermore, banks as regulated entities are subject to disclosure requirements under federal and state banking laws including the filing of lengthy Call Reports (e.g., Reports of Condition and Income) on a quarterly basis with their federal supervisory banking agency. With the completion of the Call Report Modernization Project at the end of this

year, the public will be able to access this Call Report data concerning banks almost instantaneously after the reports are filed with the banking agencies. Although the Call Report is a financial snapshot of the bank and is not consolidated with the holding company, in many instances this data is all that is needed by a community bank investor. Because of their responsibility to file Call Reports, banks should be allowed to file abbreviated quarterly Form 10-Qs.

22. *Are the listing standards of the New York Stock Exchange, the American Stock Exchange, or other exchanges or Nasdaq that require a majority of independent directors and independent audit, nominating and compensation committees (or in the alternative, in the case of Nasdaq, that nomination and executive compensation decisions at a minimum be recommended or determined by a majority of the independent directors) creating a hardship for smaller companies? Are there benefits to companies and investors of these listing standards in the context of smaller companies? Do the hardships outweigh the benefits in the case of smaller companies? Are smaller companies experiencing difficulty finding independent directors to satisfy these listing standards?*

In our experience, community banks face challenges in recruiting and retaining directors who are independent under exchange rules. In many cases, they draw their outside directors from the business community in a relatively small town or geographic area in which factors precluding independence are more likely to be present as a result of routine business transactions, particularly in the case of directors who own small local businesses. While these directors are otherwise well qualified, boards have on occasion been forced to look elsewhere for directors who meet the necessary independence standards. As a result, small community banks in small markets and rural areas are encountering particular difficulty in recruiting qualified independent directors. Staffing the audit committee is even more difficult, given the relative lack of available candidates with the necessary degree of financial sophistication. Community banks generally report that a technical lack of independence does not necessarily outweigh a director's contribution to the board. Given that bank regulations already restrict the terms on which insiders may transact business with the bank, the addition of more stringent requirements for service has generally made it more difficult for small public financial institutions to assemble the best qualified board of directors.

For these reasons, we believe there should be a relaxation in the independence standards under exchange rules for smaller companies. The exchanges should also be more flexible on the requirements for audit committee members for smaller companies. It is very difficult for smaller companies to find members of the audit committee with the necessary financial expertise to serve on the audit committee.

25. *Is the relief provided by SEC Regulation S-B meaningful? Why or why not? Should the SEC provide an alternative disclosure framework for smaller companies in the context of securities offerings and periodic reporting?*

To qualify as a "small business issuer" under SEC Regulation S-B, a company must have revenues and a public float of less than $25 million. ICBA recommends that the

thresholds for qualifying as a "small business issuer" under Regulation S-B be increased. These thresholds were set when Regulation S-B was adopted in 1992. Given the explosive growth of the stock market, the current size of companies, and the inflation that has occurred since that time, it would be appropriate for the SEC to raise these thresholds.

Regulation S-B currently governs most of the filings made by small community banks. While Regulation S-B provides some relief—for example, the absence of the performance graph and compensation committee report requirements for the proxy statement and reduced time periods for financial disclosure--the MD&A and Guide 3 disclosure requirements present a significant challenge for community banks, even though a shorter time period is covered. The staff review and comment process is typically the same as for other companies, and the substantive disclosure requirements take essentially the same amount of management time and attention to prepare, albeit often with fewer available personnel. A more streamlined, summary approach to financial disclosure and MD&A in both securities offerings and periodic reporting would be a significant improvement to the relief afforded by Regulation S-B, as would a higher market capitalization threshold for issuer qualification to use it.

27. Will the phase-down to the final accelerated reporting deadlines for periodic reports under the 1934 Act for companies with $75 million market capitalization be burdensome for smaller companies?

For many of ICBA's members that qualify as "accelerated filers," filing on an accelerated basis presents an undue burden. The complexity of today's accounting standards, the volume of disclosure requirements, and the new Section 404 requirements create an immense amount of work for the staffs of smaller public companies and particularly for community banks. Completing all the work that needs to be done to file a Form 10-K within the standard time frame of 90 days after year-end and for filing a form 10-Q within 45 days after quarter-end is very difficult. Compressing this work into shorter periods increases costs to smaller public companies by (a) forcing them to increase their accounting staffs and (b) limiting the time that management can devote to their business during the periods before the periodic reports are due. For publicly held community banks and bank holding companies that are "accelerated filers," the work is even more substantial since they have to file lengthy Call Report data with bank regulators within 30 days of the end of a quarter.

We recommend that the SEC raise significantly the $75 million public float threshold in Exchange Act Rule 12b-2 that subjects an issuer to accelerated filing requirements. In connection with the *Securities Offering Reform* proposal[6], the SEC's Office of Economic Analysis performed a study in which it identified issuers with wide market following. The study indicated that the market capitalization level at which issuers become widely followed is $700 million and that companies with market capitalization of $700 million or more account for about 95% of U.S. equity market capitalization. This study supports increasing the $75 million market capitalization threshold to a level close to $700 million.

[6] Release No. 33-8501

At the current level of $75 million, the costs of meeting the accelerated filing deadlines is burdensome and exceeds any benefit to investors.

We also recommend that the SEC not proceed with the further acceleration of filing deadlines as currently scheduled for accelerated filers but retain the filing deadlines in effect this past year (e.g., 75 days for annual reports and 40 days for quarterly reports). The 60-day deadline for 2005 annual reports and 35 days for quarterly reports will place undue stress on internal accounting departments of small companies with few corresponding benefits to investors, particularly given the more current disclosure provided under the accelerated 8-K filing deadlines and the availability of Call Report data and earnings releases containing the summary 10-K and 10-Q financial information that is most relevant to investors
in our industry.

Conclusion

Powell Goldstein and ICBA appreciate the opportunity to provide these comments for the SEC Advisory Committee on Smaller Public Companies on ways to improve the current regulatory system for smaller companies under the U.S. securities laws. If you have questions or need any additional information, please do not hesitate to contact either Chris Cole at Independent Community Bankers of America (Chris.Cole@icba.org.) or Katherine Koops at Powell Goldstein LLP (kkoops@pogolaw.com).

Sincerely,

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Katherine M. Koops
For Powell Goldstein LLP