

## **Sarbanes-Oxley and Small Business: Addressing Proposed Regulatory Changes and their Impact on Capital Markets**

Testimony of  
Richard Wasielewski, Vice President and CFO  
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Before the  
U.S. Senate Committee on Small Business & Entrepreneurship  
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Chairman Kerry, Ranking Member Snowe and Committee Members, thank you for the opportunity to share our company's experiences and insights into the benefits and costs of complying with the Sarbanes-Oxley Act of 2002 and increased Security and Exchange Commission (SEC) regulations.

My name is Richard Wasielewski, and I am the Vice President and Chief Financial Officer for Nortech Systems, which is a publicly traded Minnesota Corporation, organized in 1990. We file annual and quarterly reports, proxy statements and other documents with the SEC. We are an electronic manufacturing services company with facilities in Minnesota, Wisconsin, Iowa and Monterrey, Mexico. We have over 1,100 employees who manufacture wire harness and cable assemblies, electronic sub-assemblies, and printed circuit board assemblies for a variety of original equipment manufacturers. The markets we serve are Industrial Equipment, Medical Equipment, Military/Defense and Transportation.

Our 2006 revenue was just over \$105 million, with a net profit of \$1.3 million or 1.25% of revenue. Our industry is highly competitive – we are battling against global competitors with significantly greater resources. We have assets totaling \$42 million with a market capitalization at 2006 fiscal year-end of just over \$20 million.

I'd like to begin by stating that Nortech's Board of Directors, CEO and Officers fully support the goals and objectives of the Sarbanes-Oxley Act of 2002. The major benefit of this Act is the assurance and continued confidence our investors have in our company's reporting of our financial performance and management, along with the additional governance from a stronger internal control of our financial processes. Our internal control policy and procedures are also benefiting from a solid structure of clearly defined roles and responsibilities, priority management, risk assessment, monitoring, and corrective actions for continued improvement.

However, these benefits come at a significant cost to Nortech from the large administrative costs and fees necessary to meet the regulations. Our company faces a competitive disadvantage against larger public companies with greater economies of scale to deal with increased compliance costs, as well as private and foreign companies that do not have to comply with Sarbanes-Oxley requirements. In addition, in order to meet the requirements of Sarbanes-Oxley and other internal control initiatives from expanded SEC and Financial Statement Standard Board (FASB) reporting requirements, our relatively small finance department spends a disproportionate amount of time on pure regulatory compliance activities rather than supporting the business and operations.

Over the last five years, our compliance costs have more than doubled, from \$376,000 in 2002 to \$933,500 in 2006. We estimate that approximately 50% of this increase is a result of costs incurred from our Sarbanes-Oxley compliance and internal control initiatives. The other 50% is costs incurred to meet expanded SEC and FASB reporting requirements. A detailed breakdown of Nortech's total cost of compliance for financial statement audits, SEC filings and internal controls over the past five years is included in the table below.

**Nortech Systems, Inc., Historical Costs for Audit & SEC Compliance**

	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Actual Fees Paid:					
Auditors	\$103,500	\$131,000	\$200,000	\$224,000	\$266,000
Tax, SEC & GAAP	\$ 52,500	\$ 90,000	\$113,500	\$196,000	\$134,000
Consulting & Advising					
Sub Total Fees Paid	\$ 156,000	\$221,000	\$313,500	\$420,000	\$400,000
Estimated In-House Costs:					
Management & Staff	\$200,000	\$250,000	\$300,000	\$400,000	\$485,000
Expenses	\$ 20,000	\$ 25,000	\$ 30,000	\$ 40,000	\$ 48,500
Total Compliance Costs	\$376,000	\$496,000	\$643,500	\$860,000	\$933,500

Another cost of the Sarbanes-Oxley Act has been the increased need for auditors and their services. The increased need to hire auditors for attestation reports for the earlier accelerated filers has resulted in higher compliance costs of our audit, consulting and GAAP advising fees due to the increased demand for resources.

It should be noted that our current compliance costs do not include the cost for the Sabanes-Oxley auditor attestation reports, because they are not required for our Company until the end of 2008. The earlier cost estimates in 2002 and 2003 for our auditor attestation reporting requirements were roughly 25-40% of our financial statement audit cost for a given year. Now that estimate has been increased up to 75-80% of the financial statement audit cost and the cost base is much higher. We estimate our auditor attestation cost to be an additional \$200,000 to the above 2006 figure on an ongoing basis once we reach the required audit attestation stage.

In addition, the increasing cost burden of compliance puts us at a significant competitive disadvantage against private and foreign companies, who, as I mentioned previously, do not have to comply with Sarbanes-Oxley requirements. Our competition has more time to focus on the growth and management of their business and less on regulatory requirements. Every dollar spent on increased regulatory requirements is one dollar less we are able to spend on growth opportunities, capital investment and attraction of new investors to our company. Every hour spent by me and my staff on regulatory requirements is one hour less we can devote to overseeing the critical financial performance metrics essential for day-to-day operational decision-making as well as short- and long-term strategic planning.

We know that the SEC and the Public Companies Accounting Oversight Board are working hard to understand the impacts their regulations and oversight are having on small public companies such as

Nortech Systems. We look forward to the new interpretative guidance on Section 404 for small companies to help us reduce costs and save time in order to keep us competitive in the marketplace and provide our shareholders a fair return for their investment.

We support the Committee on Small Business & Entrepreneurship and their request that the implementation date of Section 404 for small companies be delayed up to one additional year from current effective dates. This delay will allow us to continue to build upon our current internal control processes without the time and cost pressures of the current deadlines and requirements for audit attestation.

Thank you again for the opportunity to participate in today's Hearing and for the Committee's interest in this critical issue to Nortech and other small businesses. I look forward to responding to any questions you may have.