Securities and Exchange Commission
Advisory Committee on Smaller Public Companies

Written Statement of:
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Thank you for allowing me the privilege of participating in today's hearing. I understand that today's oral testimony will focus on the perspectives of executive officers of smaller public companies as to the cost and burdens imposed on those companies as a result of the Sarbanes-Oxley Act of 2002 and whether those costs and burdens are commensurate with the benefits to investors and the public. To provide the committee members with some background as to my perspective as the CEO of a small publicly traded bank holding company, let me begin by providing a brief overview of German American Bancorp.

Company Overview

German American Bancorp was formed in 1983 with the expressed purpose of providing a vehicle by which small community banks could join forces to gain both the economies of scale needed to compete in a contracting industry and to provide the shareholders of those community banks with increased liquidity. To that end, GABC listed its stock on Nasdaq's National Market System in 1993.

Since the formation of GABC in 1983, nine community banks, the majority of which have served their respective communities for over a century, have joined our Company, allowing their shareholders to continue to hold the investment in their local bank, which many times has been held in their family for generations, while gaining the enhanced liquidity of a publicly traded stock.

Today, German American has over 3,200 registered shareholders, the vast majority of which are individual shareholders who live and work in our immediate market area in Southwestern Indiana. With a market capitalization of approximately $150 million, our shareholder base remains predominantly retail-based, as reflected in the less than 10% ownership position held by institutional investors and the fact that there currently is not active analyst coverage of our stock.

At first glance, it might appear that there exists incongruence between the size of our Company's registered shareholder base, at 3,200 registered shareholders, and our relatively small level of market capitalization, at $150 million. This combination of a relatively large level of registered shareholders in comparison to the overall level of market capitalization is reflective of the manner in which small banking organizations have historically approached capital formation.

Community-based banking organizations, including German American Bancorp, have approached the issue of capital formation with the same diversification strategy as is used in other aspects of managing a banking organization. As such, the shares in community-based banking organizations are generally widely-held; in the case of German American, no single shareholder or affiliated group of shareholders holds more than 4% of our Company's outstanding shares.

It is because of this diversification approach in capital formation that the financial sector represents the largest component of small public companies reflected in the recently introduced Russell Microcap Index. It is also, therefore, the case that small, publicly held banking companies, such as German American Bancorp, have been more directly affected by the burdens of compliance with the requirements of the Sarbanes-Oxley Act of 2002 than have similarly sized companies in other industries.

Cost of Compliance

German American Bancorp, out of necessity, operates under a structure in which our accounting, finance, and internal audit staff possess a broad range of knowledge regarding the wide array of accounting and banking rules and regulations. Operating within a highly regulated industry, we must be able to deal with a number of varying rules, regulations, and issues, but we recognize that, as a small company, we can't internally maintain the level of expertise required to address the more technical aspects of both internal audit and accounting & finance. Therefore, we have always relied on outsourcing to outside lawyers and accountants certain aspects of these functions in order to allow our internal resources to concentrate their efforts on managing the process.

As we were faced with the prospects of gearing up for compliance with Sarbanes-Oxley, in general, and, more specifically, SOX 404 compliance, we utilized this same approach. Given our limited internal resources, we partnered with outside firms to create the documentation of our internal control systems and to test those systems to ensure they were operating effectively. German American Bancorp's direct costs for SOX 404 compliance in 2004 amounted to nearly $600,000 with an estimated additional $250,000

of internal indirect costs, for a total compliance cost of $850,000, or approximately $0.08 per share. For 2005, we estimate these costs will decline only slightly with direct costs of $400,000 and indirect costs equal to or slightly higher than those experienced in the initial year of compliance.

Benefits to Investors and the Public

While I believe the review of existing corporate governance practices and the implementation of enhanced corporate governance internal standards, driven by the passage of the Sarbanes-Oxley Act of 2002, have been of value to our Company and to our shareholders and the public, I strongly believe that neither our Company, our shareholders, nor the general public has gained any significant value from the compliance process relative to Section 404 of the Act.

In fact, I would state that, given the internal control processes already in place given German American's status as a regulated banking company, there has been little, if any, value gained from the internal control component of SOX without even giving consideration to the cost of compliance. When one adds the cost of SOX 404 compliance, I believe this section of the Act has actually financially harmed our shareholders with no measurable reduction in the level of risk in their investment in our Company.

Observations and Recommendations

From reading the publicly available information, I understand the Committee has heard prior testimony and received numerous written statements on a variety of issues

relative to smaller public companies, including the definition of smaller public companies and the accelerated filer requirements, as mandated by SOX. While I concur with many of the points made in these documents and I encourage the Committee and the Commission to address these issues, I will limit my comments and recommendations to the Committee to the practical aspects of Sarbanes-Oxley compliance that most directly affect German American Bancorp in our day-to-day operations.

I would like to speak to four specific areas that have created the most significant day-to-day operating challenges for our Company. Those four areas are as follows:

1. External Auditor Guidance
2. Scope of 404 Compliance Documentation & Assessment
3. Frequency of Internal Control Certification & Attestation
4. Duplication of Federal Agency Regulatory Oversight

External Auditor Guidance

As I previously noted, German American has necessarily relied upon outside expertise in those areas of our operations which require a degree of specialty for which it is both not economically feasible to maintain the expertise on staff given our need to only access that expertise on a limited basis nor operationally realistic to maintain that expertise on staff as the level of expertise would diminish over time due the limited opportunity to focus in those specific areas.

Prior to the passage of the Sarbanes-Oxley Act of 2002, we were able to utilize guidance from our external auditors when questions arose regarding the implementation of the ever increasing complex array of FASB accounting standards. This ability to

receive general accounting guidance from our external auditors, as part of the overall audit engagement, resulted in GABC being better positioned to ensure that our SEC filings were correct and accurate and to obtain access to accounting expertise without an increase in our overall level of operating costs.

While the Public Company Accounting Oversight Board has recently issued a clarification stating that audit firms may have misinterpreted the limitations relative to being permitted to provide external audit clients accounting guidance, I'm told by acquaintances in the accounting industry that there continues to be a disconnect, as can many times be the case in the regulatory environment, between the announced intent of the regulatory agencies and the implementation of the guidelines at the field examination level. Apparently, during the firm examination process by PCAOB field examiners, the audit firms' fear regarding the potential risk of providing of accounting guidance to audit clients is being reinforced.

Since the passage of Sarbanes-Oxley and the intense focus of external auditors on absolute compliance with the Act, our external auditors no longer are willing to assist our internal accounting staff in a manner which ensures that regulatory financial filings are complete and accurate. In fact, if our accounting staff even requests such guidance it can be construed as a possible indication of a weakness in our system of internal controls over financial reporting. The effect of this change in practice means that smaller public companies, such as German American, must now either engage yet another accounting firm to provide technical accounting guidance or make the necessary determination of various matters of a technical nature based their firm's limited internal resources and

expertise. On the one hand, the result is a reduction in the return to our shareholders and on the other, an increased risk of an inadvertent misstatement.

I urge the Commission and the Public Company Accounting Oversight Board to go further in allaying the fears of the audit firms that their firms are placed in serious risk by offering external audit clients any amount of counsel and guidance in terms of the correct application of accounting standards. While I understand the need for auditor independence, I believe that the need to increase the likelihood that financial reporting is complete and accurate should still be the overriding objective of all parties-the public company, its external auditors, and the various regulatory bodies.

I would suggest that one method of providing accounting firms with some comfort level as to the question of a possible future determination of auditor independence regarding the offering of guidance to smaller public company clients would be to link the penalty an audit firm would face if its actions were subsequently determined to have comprised its independence to some percentage of the fees the firm received from the client during the engagement. Doing this would alleviate the current situation in which public accounting firms believe they are putting their firm's future at risk in every conversation with each and every audit client without regard to that client's relative importance to their firm in terms of the size of the client (and the fees generated from that client relationship).

Scope of 404 Compliance Documentation & Assessment

As a regulated banking company, German American Bancorp's internal control system would certainly be considered as having a low risk profile. Our entire system of

internal controls, both operating and financial reporting controls, have been repeatedly scrutinized and determined as adequate by federal banking regulators. Yet, the scope of the review expected by our external auditors in order to receive a clean opinion is similar to that of other companies which have little or no history of having strong internal control mechanisms in place. I suggest that SEC and/or the PCAOB need to provide guidance to audit firms allowing for the implementation of a risk-based approach to the entire SOX 404 compliance process.

The current system, as interpreted by the audit firms, doesn't seem to recognize the concept of reasonable assurance as to effectiveness of existing internal control processes. In the documenting and testing of internal control mechanisms, external audit firms are applying a very high standard as to the effectiveness of the daily implementation of these control mechanisms. The standard for documentation and testing whether a specific control mechanism is performing as designed is one of near perfection rather than one of providing a reasonable assurance that control mechanism is functioning as designed. Again, the audit firms need clear guidance from the SEC and the PCAOB as to the acceptability of using a risk-based approach and of a reasonable level of assurance in both the documentation and testing of internal controls relative to financial reporting.

Frequency of Internal Control Certification & Attestation

Similar to my comments regarding the need for a risk-based approach to SOX 404 compliance, I also believe the Commission needs to consider adopting a risk-based approach regarding the frequency at which smaller public companies are required to

provide internal control certifications and independent auditor attestations regarding internal control over financial reporting.

Smaller public companies generally don't have complex operations for which the systems of internal controls over financial reporting need to be frequently updated. The current process of SOX 404 compliance of requiring management to make internal control certifications as part of each 10Q and to obtain an independent audit firm attestation of the company's internal control system as part of the annual 10K creates significant ongoing compliance costs with no significant benefit in terms of a reduction in the risk of investors.

I recommend that the SEC consider adopting a risk-based approach to the frequency of the filing of these reports by smaller public companies which is similar to the approach taken by federal banking regulators in the supervision of smaller banking organizations. Banking regulators recognize that smaller banking companies generally have a low risk profile and, therefore, complete on-site examinations of smaller banking companies on a less frequent schedule than that utilized for larger, more complex banking companies. However, if the examination process reveals the risk profile of the smaller institution has increased beyond acceptable levels, the banking regulators increase the review frequency for that institution commensurate with its risk profile.

For smaller public companies which have successfully completed an initial SOX 404 compliance review, including the issuance of clean opinion by its external audit firm, I would respectfully suggest that the SEC adopt a risk-based approach under which these low-risk smaller public companies be required to include management certifications only in their annual 10K and be required to provide a full Section 404 compliance review and

independent audit firm attestation of the company's internal control system over financial reporting as part of the annual 10K on a triennial basis. If the smaller public company, as part of the triennial Section 404 compliance assessment, does not receive a clean opinion from its external audit firm, it would revert to a quarterly management certification and annual external audit firm attestation requirement until the company once again receives a clean opinion and thereby returns to a low risk profile.

The adoption of this type of risk-based approach to the frequency requirement for Section 404 compliance assessment, management certification, and independent auditor attestation would greatly reduce the burden placed on low risk profile smaller public companies by allowing them to concentrate their resources in terms of only needing to complete the full internal control over financial reporting assessment, documentation, and testing every three years rather than having to absorb an ongoing annual compliance cost structure. For German American, this approach will allow us to marshal our internal resources toward Section 404 compliance during the year of the triennial review of our internal controls over financial reporting as compared to, under the current requirements, having to permanently increase both our staffing and our professional fees on an annual and ongoing basis.

Duplication of Federal Agency Regulatory Oversight

The fourth area I would like to discuss is one which is specific to the smaller public banking companies. For these companies, including German American, the introduction of SOX 404 compliance has added yet another layer of federal regulatory oversight to an already excessive regulatory burden. Currently, German American

submits quarterly financial reports and management certifications as to the accuracy of those financials to three separate federal government agencies. For each of our five community banks, German American files a quarterly call report with the FDIC; for the holding company, we file three quarterly FR Y-9s, containing both consolidated and parent company only financials, with the Federal Reserve; and file quarterly and annual certifications with the SEC relative to the requirements of Sarbanes-Oxley compliance.

Additionally, banking operations with total assets in excess of $500 million are required under FDICIA to test their system of internal controls and file a certification of those findings with the FDIC annually. In fact, the internal control testing and certification process required under FDICIA served as the blueprint for Section 404 of the Sarbanes-Oxley Act.

Clearly, this level of duplication of effort and redundancy of reporting serves no purpose in terms of benefit to investors and the public as all of the information filed with the FDIC, the Federal Reserve, and the SEC is readily accessible to the public through the internet. The need to file substantially the same information with three federal agencies under different filing formats only serves to increase the regulatory burden and compliance costs of smaller public banking companies.

This excessive level of regulatory burden could be alleviated if the Commission would adopt a similar approach for smaller public bank holding companies to that which it has historically utilized relative to publicly-held banks having a blanket exemption under the Securities Act of 1933 when issuing their own securities and allowing public banks to register and file their reports directly with the appropriate federal banking agencies in a form substantially the same as required by the SEC.

Closing Comments

I'd like to close my comments today by thanking the Committee for your efforts in addressing the disproportionate burden of compliance that smaller public companies are facing under the existing requirements of the Sarbanes-Oxley Act of 2002.

For German American Bancorp, the ultimate decisions made by the SEC, based on the recommendations of this Committee, regarding the ongoing compliance requirements under Sarbanes-Oxley will have significant long-term ramifications. With a base of 3,200 registered shareholders and a commitment to our shareholders to provide the enhanced liquidity of exchanged traded shares, our Company doesn't have the alternative of "going dark". For GABC, our options are limited to being able to cost effectively maintain compliance with SEC's requirements under SOX or facing the reality that a smaller public bank holding company is no longer a viable business model due to the costs of excessive regulatory burden.

It would be ironic if the requirements of the Sarbanes-Oxley Act of 2002-the purpose of which is to protect investors-becomes a contributing factor which ultimately results in the sale of firms, such as German American, to larger organizations which can afford to absorb the costs of compliance. If this should happen, rather than protect investors, the outcome will be to remove the opportunity for small retail investors to own shares in local organizations in which they originally invested because they considered it to be a safer investment alternative as one in which they could better assess the performance of the company by both personal observation of business activities and direct access to corporate management.

I know that there are no easy answers as to how to best address the inequities facing smaller public companies relative to compliance with Sarbanes Oxley, but I also know that it surely wasn't the intent of Senator Sarbanes, Representative Oxley, and the other members of Congress to create an excessive level of regulatory burden on smaller public companies, such as German American, to the extent that a sale of those companies is the ultimate outcome.