RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE
on
SMALLER PUBLIC COMPANIES

Second Day of Meeting

June 17, 2005
9:00 a.m.

Columbia Law School
435 West 116th Street
New York, N.Y.

The following individuals were present in person:

Committee Members:

Patrick C. Barry

Steven E. Bochner

Richard D. Brounstein

C.R. "Rusty" Cloutier

James A. "Drew" Connolly III

E. David Coolidge, III

Alex Davern

Joseph "Leroy" Dennis

Janet Dolan

Richard M. Jaffee

Mark Jensen

Robert E. Robotti

Scott R. Royster

Kurt Schacht

Ted Schlein

James C. Thyen

Herbert S. Wander

Committee Observers:

George J. Batavick

Daniel L. Goelzer

Jack E. Herstein

SEC Staff:

Cindy Alexander

Anthony G. Barone

Gerald J. Laporte

Kevin M. O'Neill

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First Panel

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HERB WANDER, Presiding:

MR. WANDER: Good morning, everyone. I am Herb Wander, Co-Chair of the Advisory Committee. I would like to welcome all of you. We have a much bigger audience than we did yesterday, although from hearing comments from a number of you, many of you did listen in to the webcast of our session yesterday, either while we had it or later in the evening.

The purpose of this morning's session is to have our invited guests and some who have asked us to speak to provide us with information, facts, and their analysis of how our Advisory Committee can stick- handle our way through all of the various regulations and try and streamline them and make them more user friendly for smaller companies without jeopardizing the benefits of the various laws that have been put in place to protect investors.

We thank all of you for coming. We are going to start off this morning and I'll give you a few housekeeping rules.

If you speak, you are supposed to touch the button and you will see this little red light go on. When you are finished, please turn the light off because I understand only three of the mikes can be alive at one time.

What we are going to do is have a short presentation by our first panel, each of the panel members, and then we will open up the questioning by members of the Advisory Committee. I will try and -- if members of the Advisory Committee would raise your hands, I will try and mark down who is next to ask questions and please feel free to ask each other questions, our guests.

If there are any questions before we begin? If not, why don't we start, and I'll start with Ed Knight because he is the first on my list. Briefly introduce yourself, Ed, to those of us here and in webcast land.

That's another thing. Because we are being webcast, please state your name so that people will know who is speaking.

MR. KNIGHT: Thank you, Mr. Chairman. This is Ed Knight, I'm executive vice president and general counsel of Nasdaq. Thank you members of the committee for allowing us to appear today and for your service on this committee.

Nasdaq believes this is a very important committee. It deals with a critical issue for our economy, but also for Nasdaq. We are the home of many large companies, but we're also the home of many early stage, growing, smaller companies. And the issues that you discussed yesterday and that are on your agenda are critical to us and I am going to comment on them briefly today. I have a formal statement which I ask be made part of the record and I will summarize that. I will try to limit my remarks to a few minutes, but if you could allow me, there are a number of things that I want to touch upon.

Nasdaq does have, like the American Stock Exchange and other stock exchanges, a unique perspective in terms of the seat it has on the U.S. economy to observe what goes on with smaller companies and to see on the front lines what they are experiencing with corporate governance with Sarbanes-Oxley, with many of the critical issues you are dealing with today.

A little bit of history: As you would expect, in 2002, with the crisis in corporate governance, we reviewed all our listing standards. We did this with the help of a standing committee that advises our board, the Nasdaq Listing Hearing and Review Council, of which Steve Bochner we are honored to have as a member of the committee and made many contributions and had input from the public on that.

We tried to reshape our listing standards with a few goals in mind that I will just briefly touch upon. One, we felt it was important to have mandatory listing standards, not just recommended best practices.

Two -- this is particularly, I think, important for smaller companies. We strive to have clear listing standards, unambiguous listing standards. We did not think if you were a small company and wanted to list with Nasdaq that you automatically needed to go out and incur a major legal bill to understand our listing rules. As much as we love the legal profession, we feel our rules ought to be as clear as possible on their face and we sought to do that.

Third is, it was very important for us to work into our rules that one size does not fit all. And this is a topic I know you are discussing in other areas. We worked particularly in the independent director definitions, how independent directors populate committees to deal with the issue of one size does not fit all.

Fourth, we felt it was very important to underscore the importance of timely and adequate disclosure. That is at the heart of our compliance systems. It is at the heart of getting investors' confidence around the market, so we have reemphasized in our rules the importance of timely and complete disclosure.

Lastly, it was do no harm. If we did not know what the likely result of a new rule was, we waited until we had the evidence. We did not want to harm the capital formation process in the United States.

We applied these principles, we adopted rules that gave smaller companies more flexibility, particularly in the independent director area. For instance, you can deal with the requirement of having all independent compensation or nominations committee in a couple of ways which small companies have found very effective. You can use the directors on the full board and not populate separate committees. Smaller companies with only seven directors found that particularly useful, that they didn't have to rush out and recruit new directors. They could use the independent directors on their board for these functions.

We have since then worked very hard to streamline our listing rules wherever we can and to make clear the process of delisting, make it as transparent as possible and, as I said, reinforce the time limits that apply to companies who file late 10-K and 10-Q filings.

Emerging issues. What are the issues we see today, particularly since the beginning of the year, that are affecting small companies? Not surprisingly at the top of the list is 404, I know a topic that is receiving a lot of attention here today.

I want to underscore, this is not an issue of lack of support amongst our companies for Sarbanes-Oxley. We have done a survey of those companies and we found that 74 percent of them feel Sarbanes-Oxley is necessary. But it does appear that what we have in place right now is a fairly inflexible framework to deal with 404 obligations that is putting excessive compliance and control requirements on smaller companies. That is having a cost impact that is disparate in terms of smaller companies as a percent of revenue. Smaller issuers, meaning issuers in our survey that had less than $100 million in revenue, appear to have spent eleven times more than companies who are on the larger side as a percentage of revenue.

The average cost for a Nasdaq company, as best we can tell from our survey result, is a million dollars, but some companies have spent as much as 15 million; and the total cost of 404 implementation, extrapolating some of these numbers and making some estimates, we conservatively estimate at $3.5 billion. On average, companies are spending two and a half times more than their fully loaded audit costs on 404.

There is new guidance out there, as you know, and I know you discussed over yesterday and in the past. To this point we are not seeing that that guidance is changing auditor behavior. We are still seeing a very conservative approach by the major auditing firms and firms helping companies with 404. That is 404. I want to come back to that with some suggestions of how some of these issues can be dealt with, but in addition to that, we are finding companies are -- and in a related way are having trouble making timely filings, quarterly filings and annual filings because the Big Four auditors are dropping them as clients generally because they fall below the Big Four's risk profile.

Since auditor resources are stretched very thin in these firms, the set of smaller companies that do retain national auditors often receive, frankly, less attention is what we are hearing, and they are put on a lower priority than the larger companies. This makes it more difficult for smaller companies to get back on track within a reasonable period of time and, therefore, we are seeing some results in our delisting process. So far this year we had to issue 60 delisting letters to issuers who failed to file forms 10-K. Last year only 14 were in that similar position at this point.

What is contributing to this trend of late filing? One, auditors, as I alluded to earlier, are very risk averse, particularly when it comes to smaller companies. Therefore, less well established firms are often retained. These firms do not have the national office structure and the SEC relationships and, consequently, underwriters are reluctant, we are finding, at times to participate in transactions with these firms, impacting smaller companies' ability to raise capital.

I would also mention, thirdly, the issue of smaller companies retaining and recruiting CFOs, finance staff and internal auditors. That is another frequent issue that we hear when people are late with their filings. They are losing people, they can't keep people in this area. It is a very competitive market for talent. The larger firms, of course, are spending to compensate individuals at a higher rate and, frankly, individuals are less willing to take these positions that have some reputational risk associated with them, especially if they are going to be paid less than a larger company would pay.

Fourthly, I underscore that what we are hearing from companies is some degree of being overwhelmed with the disclosure obligations, particularly 8-K. We think perhaps additional time in that area to allow them to deal with their various disclosure obligations might be called for and ease some of the burden on them.

Getting back to 404, a couple of suggestions I would briefly recite. One, incenting the CPA firms away from overauditing. Understandably, many CPA firms are extremely sensitive that they will be judged as too lenient by the PCAOB. They feel they are getting squeezed on both sides and therefore are taking a very conservative approach. How those firms are evaluated I think is going to be critical in terms of how they provide their services to smaller companies.

Second, raising the level of materiality used for planning the scope of 404 and what must be reported as material. I know that was discussed yesterday. I think that is an important area and I know this committee is focusing on it, looking at, for instance, several measures that a company could choose from and clear measures as to what is material for these purposes, such as gross revenues, market caps or assets should be considered.

Thirdly, permitting different forms of evidence, particularly internal reports that are used to monitor certain controls as opposed to going out and creating new reports that entail additional cost, and alternating the frequency of control testing. Staggering internal control assessments to mid-year to alleviate the year end rush to evaluate internal control deficiencies and allowing more flexibility for issuers to implement mediation and premediation plans.

Lastly, in the 404 area, I mentioned the good work of the COSO task force that I understand is focusing extensively on smaller business and trying to tailor a framework that would be clear for smaller businesses in applying the COSO model.

I want to emphasize that in terms of Nasdaq's own experience, we are a public company. We like to say we eat our own cooking. We apply our listing standards to ourself, wth SEC oversight, to ensure it is done in an arm's length manner, but we also comply with 404. From our experience we have urged our companies to look at this as an opportunity to continue to improve their financial reporting and, frankly, to urge them to embrace it as part of their culture and looking generally at minimizing compliance risk. But we are finding, given all that and given the efforts the SEC is making, that we are making to ensure that we can still have a place for small companies to enter the public capital markets, some companies are choosing not to do that.

This year in the first quarter 22 Nasdaq issuers voluntarily delisted compared to only 7 for the same period in 2004. This includes domestic issuers that elected to deregister and also foreign issuers who suspended and terminated their ADR programs. In each of these cases the companies explained their decisions by citing the increasing regulatory cost associated with being a public company.

We are also hearing from venture

capital firms that smaller issuers may be filing to become a public company, but they are doing it in part to attract interest in acquisitions, as an acquisition candidate, and not solely because they want to be a public company. Of course, if small businesses forego the lower cost capital raising opportunities afforded by public markets, in the long term I think that will adversely affect the economy.

Lastly -- I appreciate you indulging me with a few extra minutes here. I just want to mention the number one issue after 404 that we hear from our companies is a lack of research coverage. We have approximately 1,200 Nasdaq companies out of 3,200 that have no research coverage and 35 percent of all public companies have no research coverage.

We think we have a partial solution for that supplied by the market that won't require regulatory action. We announced last week that in partnership with Reuters we are forming a new company to help public companies obtain independent analyst coverage. The independent research network will aggregate multiple independent research providers and distribute that in an independent way to investors and to the public. We hope that will help deal with the lack of research coverage by providing a distribution and function for those companies.

Again, in closing, I want to thank the SEC for establishing this committee and for allowing Nasdaq to appear, and thank the members of this committee for their service.

MR. WANDER: Thank you very much, Ed.

Why don't we go on to the rest of our guests and then we will open it up for questions. So, please, write down your questions for Ed and we will follow up.

Next, Neil Wolkoff, we'd like to have you introduce yourself and provide us with your thoughts.

MR. WOLKOFF: Thank you, Mr. Chairman and thank you, members of the committee, for the invitation to be here. My name is Neil Wolkoff. I am the chairman and chief executive officer of the American Stock Exchange. As most if not all of you know, the AMEX is a national exchange; it's part of the national market system. While some of our approximately 700 listed companies are large cap stocks, companies like Imperial Oil, IVAX Pharmaceuticals and Nabors Energy, the large majority of our listed companies are small and mid-cap stocks with market capitalization between $50 million and $500 million.

Any regulatory system that has the potential to disincentivize such companies from listing is of course of vital importance to our exchange and of vital importance to our listed companies.

In preparing for my testimony today, I want it to be noted, I am not an accountant. I have never led a public company. I thought it would be useful, however, since so many of our listed companies are really the living, breathing examples of the concerns of this committee, that I would reach out to those companies and ask for their opinions, both complaints and recommendations. And as I proceed through my brief statement, I will report on some of those ideas. I think you will find them most useful.

Before doing that, however, I would like to follow through on my colleague's description of the listing process because I think it can be of great importance, particularly since so many of the concerns about Section 404 deal with the fact that it is a one-size-fits-all box that companies find themselves in. And to the extent that some of the recommendations and some of the thoughts concern either differentiating or layering of Section 404 compliance, I thought it might be helpful to explain a bit more about what the listing process really means as far as the regulatory scheme because, after all, this is a regulation that fits together with other regulations; it doesn't sit on its own.

With regard to the role of AMEX, which is a role that is shared by my Nasdaq colleague, we perform a thorough review of all applicants for listing on the exchange. The review consists of confirming objective information. The listing requirements are firm listing requirements. We look at financial condition and size of the applicant, but we also look at non-public sources of information. We look closely at the background of the principals.

The review is conducted by a branch of the regulatory department, which does not report to me or other management and is, therefore, independent and not subject to the business pressures to approve companies for listing.

Based on the prelisting review and the ongoing monitoring of listed companies as well as given the threat of delisting, listed companies are exempt from Blue Sky requirements of individual states.

With that as background, many companies have complained about one size fits all and, in contemplating a layered or differentiated approach to applying Sarbox to small cap companies, I recommend you consider exchange listing as a mitigating factor in requiring full scale uniform 404 compliance.

With that, I would like to get into some of the comments. Without being repetitive, I think in the words of our own listed companies -- I would prefer, of course, not to be giving names. I will follow up my verbal testimony subsequently with a written statement for the committee and for the public.

Starting with some of the complaints dealing with the issue of segregation of duties in small companies. Over and over again people talk about how in a small company you are basically required, in order to be profitable, to have people wearing many different hats. One commentator says auditors expect to see segregation of duties, such as individual IT departments, et cetera. In small companies, head count alone does not allow for this segregation. In many cases the small companies, individuals act in multiple capacities.

Another comment on the same subject. Someone says, "We are not a large company. Therefore, we are limited in segregation of duties. Most of our employees perform a number of functions which make us efficient and profitable as shown by our past history."

Of course, a number of companies have talked about the cost of 404 compliance and the difference that this cost can make literally in profitability or not. Just a couple of comments on the cost implications. One commentator says "SOX 404 is a problem. Cost is very significant. This includes both money paid to outside consultants and auditors as well as time management we will spend. We are estimating 400,000 to 500,000 dollars in the first year. In good years, this is 30 to 50 percent of our earnings."

There are other examples not said quite as dramatically or perhaps as melodramatically, but the point is that the costs of compliance are deemed to be quite a serious concern. Just as the report -- I believe the Foley Group came out with a report on the issue of relationships with auditors. Several people commented on the impact that this has had on the relationship that they have had with their auditors, including one commented about a Big Four firm -- if, indeed, there are four big firms left. "After being with us for 35 years, they told us they did not want to do our audit anymore. They do not have the staff and are concentrating on larger corporations."

Another one said, "External auditors

are now regulators and unable or unwilling to provide technical expertise."

Another comment that made, I thought, quite a bit a sense and would like to report came from a couple of banks that are listed companies, talking about the impact of multiple and separate regulators, including Sarbanes-Oxley. So it is not simply a complaint about the impact of Sarbanes-Oxley, but the lack of coordination and the inability to use the compliance with one set of regulations to satisfy another. Just a couple of comments. "The non-differentiation of SEC requirements for regulated versus non-regulated companies is frustrating, as a company such as ours already has internal audits, external audits and regulatory exams."

Another says, "I would like to believe the opportunity exists to merge the information acquired in all oversight to a combination of Federal Reserve, FDIC and SEC reporting."

So, in addition to a complaint, you might consider that as a recommendation.

Some other recommendations I would like

to get to that came in from our listed companies. One generally says, "I suggest that requirements for smaller companies should be tailored to their size and should be discussed with their auditors for improvement, but should not result in extra cost to the company."

"Company size," another one says, "should be measured by revenues and not market capitalization. A small company with a large market cap must still rely on its revenues in order to maintain efficient operation."

As an aside, we find a number of applicants have market capitalizations in the pharmaceutical or biotech industries that are 100 or $200 million, yet no revenue because the market values the prospect of what the company is going to do. So you have a substantial market cap, substantial audit requirements, no revenue really to audit. So you might take revenue into account.

One commentator has a helpful recommendation and asks for additional guidance. It says, "While the cost of compliance with Sarbanes can be overwhelming, the recent guidance provided by the SEC and PCAOB are helping us to manage and minimize these costs. Additional guidance which further addresses uniformity of testing will be helpful in the areas of cost control and program efficiencies."

Lastly, one commentator recommended that without necessarily changing the requirements of Section 404, simply extend the period of time over which full 404 audits are conducted. If SOX 404 applies to all companies, instead of an annual control review and auditor attestation starting in year one, the work could be phased in over several years, one or two areas could be picked each year for management to document and test internal controls followed by auditor review and attestation.

I hope my comments have been helpful to the committee. I hope I have been able to give voice to many of the concerns of the listed companies of the American Stock Exchange and I thank you very much for your time.

MR. WANDER: Thank you, Neil.

Next, Alan Patricof, co-founder of Apax

Partners.

MR. PATRICOF: Thank you, Mr. Chairman and members of the committee for inviting me to appear here.

I would like to preface my remarks by saying I strongly urge you and hope that you will take action, in whatever form it is, sooner rather than later in connection with this issue because it is becoming, has become a very, very important issue for young companies and the longer you delay implementation of revised rules, the more companies are going to be injured by the current regulations.

My name is Alan Patricof, and I am the co-founder of Apax Partners, a leading private equity firm operating both in this country, Europe and Japan. Our firm's range of activities run from early to later stage investments and we currently manage in excess of $20 billion dedicated solely to private equity investments. During the course of the past 35 years, I personally served on the board and committees of more than 15 public companies, most of which have been listed on Nasdaq, but several of which have also been listed on New York

Stock Exchange. In addition to that, I have been on many, many more private companies and members of my firm have been members of boards of a multiple of that number.

In preparation for this appearance, I have spoken in the last several weeks with at least ten of the companies with whom I am personally associated at the present time, each of whom has operated at different levels of market capitalization, revenue and profitability and most of whom are currently listed on Nasdaq, Small Cap board, Bulletin Board or Pink Sheets. It is a compilation of their concerns as well as my own inputs and personal experiences that I will communicate today with the hope that the committee will take these comments to heart when considering revisions to SOX compliance for small companies.

It goes without saying that the requirements under Sarbanes-Oxley are not only frustrating to the companies with whom I deal, but without exception have caused them considerable expense, diverted significant number of personnel to paperwork which they can ill afford to do and changed the overall nature of their business process to living in constant fear of violation of some aspect of the regulations.

These problems have compounded the already existing problems facing a small company in meeting the requirements for Nasdaq listing and complying with normal SEC reporting. While I admittedly heard positive comments from several of these companies on certain aspects of SOX, which in no way as the law should be discredited, the overwhelming majority of the comments I received were of a constructive nature on how to improve what these companies hope are evolving compliance guidelines.

An area that came up in nearly every one is the mechanisms that trigger Sarbanes-Oxley compliance for small companies. The law, as currently written, mandates SOX compliance for those companies with market capitalization equal to or greater than $75 million. The primary intention of my appearance here today is to point out to you that this is a totally arbitrary measurement by which to mandate compliance and in the end will unnecessarily cause small companies to suffer the burdens of being public which they can ill afford to incur.

In some cases it will cause them to delist and go private. In other cases, they will find ways of getting marketability for their companies on alternative markets such as the AIM Market in London where, based on my personal knowledge, many Israeli companies formerly listed on Nasdaq are now focusing their listing attention. I will agree with the previous speaker that many companies are going through the formality of putting out offering memorandums with the real intention of advertising for merger and obtaining premature -- as a premature means of liquidity, rather than facing the burdens of being a public company in the United States.

Let me move on and recite to you some of the specific complaints repeatedly made regarding SOX legislation.

Market cap has no correlation to a company's resources or complexity. In today's world, virtually no company -- I emphasize. No company can go public at less than a $75 million market capitalization with a reputable underwriter. Therefore, the only companies who will be excluded under the current rules from compliance with SOX are companies whose stocks have performed poorly in the market and have fallen below their initial market capitalization. They then face the problem that if, for example -- I just took an arbitrary example. They have a hundred million shares trading at 60 cents a share or $60 million market capitalization and are excluded from SOX, they may have a run up in their price by a very modest amount, say 25 cents a share, from 60 to 75 cents a share, and they will now be in a position where they will have to comply.

The result is that even those who are under that level have to live with the possibility that minor fluctuations can put them in a regulatory position, so they really have to think about being regulated under SOX even before the event happens.

More to the point, I ask you a question to which I do not have the answer. How does market cap accurately reflect upon the size, stage and operations of a company and resulting internal controls that should be placed?

Number two, companies are being forced to add employees or hire independent contractors in addition to literally thousands of hours on the part of their own employees, and I repeat, thousands of hours, at significant cost to assist them in the SOX implementation process and ongoing SOX compliance. In addition to these incremental costs, they are diverting attention of existing employees from critical day-to-day functions. Ironically, this is, unfortunately, caused in some cases internal personnel to temporarily divert themselves from their own internal audit functions which had been in process in order to comply with SOX.

Number three, as a result of the change in the accounting industry and consequent pressure from institutional investors and retail investors, increasing importance has been placed on using a, quote, Big Four accounting firm. As a result, small companies, who are the least prepared to negotiate, are increasingly facing oligopolies, causing a disruption in a normally balanced relationship between a company and its accounting firm. Young, small companies are now in constant fear that their auditor will either abandon them because of the pressure of business from more profitable, larger companies to do work that makes no business sense or increase their auditing fees. That is the alternative.

At the same time, an unnatural relationship is developed between the companies and their auditors as accountants have become more gun shy about taking a risk-focused approach to their audit. Rather, accountants are frequently defaulting into a position of letting process take over from substance. In this regard, the auditors themselves are constantly referring to their own concerns with the pressures from PCAOB compliance. Over all it is this dynamic that has caused the relationship between auditor and company to go from cooperation and consultation-focused to adversarial.

Number four, directors themselves have

become overly concerned by SOX, in particular 404, making it more difficult to get directors for any board, much less a small company board. In addition, directors, in order to attract them to serve, are receiving higher fees and are requiring higher levels of directors and officers liability insurance as they are increasingly concerned with their own personal liability.

Five, lastly, another consideration is that under SOX small companies are being painted with the same brush that large companies face and they are disproportionately less able to meet those challenges.

As a result of the foregoing, I would like to specifically recommend some or all of the following elements be incorporated into legislation.

Number one, change the mechanism for mandating SOX compliance to $75 million of annual revenues, not including revenues from research and development fees as referred to a minute ago from biotech companies, rather than a $75 million market capitalization. This would be a much more appropriate measurement that would preclude a great many more companies who are at the early stage of development from mandatory SOX compliance. In today's world, a $75 million revenue company is not a large company. It is a small company. If one takes into consideration the potential profitability from a company at that size -- and I hope you can follow my math here -- and assumes the incremental cost from Sarbanes-Oxley are at least a million dollars, as I constantly hear, and have heard much larger numbers and been cited much larger numbers, I have found -- as I have found through my conversation, and even if you apply a high profit margin to a $75 million company you will find that in general terms you are talking about ten to twenty percent of pretax profits being applied to SOX compliance if they do have profits which is far beyond what a business can tolerate for process.

But in addition to that, you have to add all the costs of requirements from Nasdaq and SEC requirements. Under the circumstances, I would consider this a reasonable compromise, namely a $75 million figure since a company has more foresight into its projected revenues and, thus, more ability to plan for meeting this threshold than it does for planning to be at a $75 million market cap.

Two, even if a company is slightly below the $75 million level, say 50 to $75 million in revenues, I would suggest you develop a form of Sarbanes-Oxley Light, which would include certain elements that are essential to you as the committee and to the SEC and with which no one could disagree that should be continued. This would help to gradually prepare these companies for full SOX compliance. This would include procedures such as the CEO and CFO signing off on the financial statements, the requirement for the establishment of certain committees, the need and composition for independent directors, et cetera. You can add whichever ones you, as the committee, think are the right, key elements to be include in this Sarbanes-Oxley Light approach. But, most importantly, this would include a dramatic reduction in Section 404 controls, which is the major stumbling block and the major cost item in relation to SOX.

Number three, I would suggest an adjustment in how companies account for the initial cost of SOX compliance, which is undoubtedly more than the ongoing cost. More specifically, I believe this initial cost should be treated, perhaps, as a stock issuance cost by charging in the same manner and by charging the equity account directly rather than treating it as an expense item on the income statement.

The impact of this proposed change is, perhaps, best captured by one public company with $15 million in annual sales whose CEO told me he would be instantaneously profitable if it were not for the expenses attributable to Sarbanes-Oxley compliance.

Number four, I would strongly urge that emphasis be placed on the acceptability -- I want to emphasize this particular recommendation -- that emphasis be placed on the acceptability of more regional accounting firms for use by small companies, so that there is a more competitive element introduced into the current accounting system. Also, the establishment or encouragement or in any way possible of a fifth or sixth big -- four, five, six or seven or eight, as we used to have, should be encouraged to restore a more appropriate balance between accounting firms and the client company to contain costs currently being incurred by these small companies and at the same time to give them an alternative that is generally accepted by the investment community.

Five, if there is any reluctance to using the measurement of revenues, which I again believe is the most appropriate metric, I would urge other factors be taken into consideration, such as stage of development, how many years in business, its geographic dispersion, does it have one plant or many plants, and whether it is profitable or loss making, but I still feel the $75 million level is the best one.

Six, the overall issue of material deficiencies, significant deficiency and deficiency. I am sure you are familiar with those definitions under SOX 404 is one that needs to be reviewed particularly, since a company, as I understand, can have a material deficiency and yet get a clean opinion from its auditor something to me seems to be inconsistent since both are covered by the same auditing firm and significant deficiencies in particular can be created by very, very minor difficulties.

Perhaps there is a better way to categorize what is in the material category and in the significant category and redefine all those categories for small companies. Perhaps public notification can be eliminated for a period of time until a certain amount of time is passed so companies have an opportunity in a private basis to correct material or significant deficiencies without having public disclosure.

In summary, I believe Sarbanes-Oxley has been a constructive force in the securities market and I am not in favor of eliminating it, merely modifying its provisions as they relate to small companies. Process cannot be allowed to take over from the substance in building companies. I have been involved with the creation of literally hundreds of companies during my career. The engine of growth in our economy comes from smaller companies and we do not want to overwhelm them at their early stages of development with unnecessary paperwork and compliance with process which will discourage risk-taking at a time when they should be focused on building dynamic, successful companies which have an employment multiplier and ultimately add to the strength of our country.

Thank you very much.

MR. WANDER: Thank you.

MR. PATRICOF: One last thing. I will submit a letter written by a woman by the name of Susan Strausberg, with whom I am in contact, CEO of EDGAR Online, which deals entirely with the issue of filing for small companies and I think her comments-- it is not a portfolio company of mine, but I think it has great bearing on the subject, so I will include that, if you will, in the written record.

MR. WANDER: Thank you very much and we would be delighted to have her comments.

I will now move to this table, to Wayne Kolins.

MR. KOLINS: Thank you, Mr. Chairman. I am Wayne Kolins and I'm national director of Assurance and chairman of the board of BDO Seidman, a national accounting firm. I am also on the executive committee of the AICPA Center for Public Company Audit Firms.

My prepared remarks here today are on behalf of the Center members. The Center was established by the AICPA basically to provide a focal point of commitment to the quality of public company audits and provide the SEC and PCOAB with comments on their proposals. There are approximately 900 Center member firms in the U.S. that collectively audit 97 percent of all SEC registrants. There are approximately 97 firms that recently audited companies that filed Section 404 reports, and 93 of those are Center members.

Members of the Center are appreciative of the SEC's efforts in acknowledging that while benefits of compliance with Sarbanes-Oxley are significant, careful consideration of the associated costs are necessary to achieve those benefits most efficiently. The Center's most significant charge is to enhance audit quality which will contribute to the overall restoration and maintenance of investor confidence and trust in the capital markets. In that regard, we believe in open dialogue with the regulators to assist them in carrying out their public interest responsibilities. Given the depth and breadth of our membership, many firms view the Commission's actions in establishing the Advisory Committee as acknowledgement of the burden smaller public companies bear in complying with the complexities of the Act. We appreciate the opportunity to assist the committee in considering methods that may scale securities regulations for smaller public companies to ensure that the costs and burdens of regulation are commensurate with the benefits to the investing public.

Since passage of the Act, behaviors and requirements have changed. To name a few, there is an increased focus on internal controls by company management, audit committees are more engaged and appropriately focused on effectiveness of internal controls of financial reporting, companies are becoming more focused on providing reliable and more transparent financial information, enabling investors to become more involved, and external auditors are more engaged with audit committees, all of which contribute to more effective audits. These changes and others collectively contribute to the overall restoration of investor confidence in the capital markets. However, these benefits don't come without an associated cost of compliance.

The cost benefit analysis of the Sarbanes-Oxley Act has been a topic of many surveys and articles. First year implementation costs are easier to quantify and articulate compared to the related, less transparent but potentially very significant benefits. These benefits include the thousands of control deficiencies remediated in the process of compliance with 404. Benefits also include transparent disclosure of material weaknesses to investors. The events that led to the creation of the Act and the PCAOB didn't happen overnight, though. Accordingly, the process to improve investor confidence in the financial reporting process will take time.

This past year, thousands of auditors devoted an enormous effort in implementing Section 404 of the Act during audits of accelerated filers. We believe the PCOAB will have the opportunity, through its inspection process, to provide firms insight and clarity in the application of the internal control auditing standard. We also believe that efficiencies will be developed through this experience as auditors refine the process of the integrated audit and can use this information on the 404 audits of smaller public companies that are required to comply in the future.

While we don't believe that any revision to the Sarbanes-Oxley Act are needed, we do believe there may be ways for efficient and effective implementation with regard to smaller public companies. To that end, we recommend the following. First, the market value definition of accelerated filer should be increased to $700 million to ease the reporting burden on smaller public companies. In connection with the Commission securities offering reform proposal, its Office of Economic Analysis performed a study identifying issuers with a wide market following and seasoned offerings. This study indicates the market capitalization level at which issuers widely followed by investors, whose interest in accelerated filers is likely to be the highest, is $700 million, not the $75 million reflected in the current accelerated filer definition. In that regard, the study shows that companies with market caps of $700 million or more account for about 95 percent of the U.S. equity market capitalization. Therefore, we believe the Advisory Committee should consider recommending an increase of the current $75 million threshold to 700 million. If an issuer is not widely followed, we believe the cost of meeting the accelerating filing deadlines is overly burdensome and exceeds the benefits.

Next, the Center suggests that the Advisory Committee consider whether the accelerated filer deadlines for smaller public companies should be permanently extended. These due dates are scheduled to be reduced to 60 days after year end for annual reports for years ending on or after December 15, 2005, and 35 days after quarter end for subsequent quarterly reports. Extending the accelerated filer deadlines would alleviate time pressures that smaller public companies face. The Center believes additional time would be an important factor in a smaller company's ability to produce reliable financial and internal control reports given their human resource and other constraints.

If the SEC does not raise the threshold to the $700 million level as we suggest, we believe that the results of the SEC's office of economic analysis study of market following, which I just referred to, at least warrants retaining the current due dates for periodic reports of these issuers. That is, 75 days after year end and 40 days after the quarter, and not accelerating them further to 60 and 35 days respective.

Thank you for giving me the opportunity to share with you the Center's recommendations for assisting the committee in this very important endeavor. This concludes my prepared remarks as a representative of the AICPA Center for Public Company Audit Firms and I would be pleased to answer specific questions the committee may have on behalf of myself and my firm, BDO Seidman.

MR. WANDER: Thank you very much. Our last two speakers now, the money people, the bankers. The first is Bill Loving, chief executive officer of the Pendleton County Bank in West Virginia.

MR. LOVING: Thank you, Mr. Chairman and members of the Committee. Good morning. My name is Bill Loving and I am executive vice president and CEO of Pendleton County Bank in Franklin, West Virginia. I am representing the Independent Community Bankers of America, or ICBA, trade association with approximately 5,000 community banks and bank holding companies, many of which are publicly held companies.

Pendleton County Bank, chartered in 1925, presently has assets of 165 million and is a wholly owned subsidiary of Allegheny Bank Shares, whose stock is not listed on any exchange, thinly traded and has few institutional investors. Like many publicly held community banks, Allegheny Bank Shares is a good example of a publicly held company that should not be subject to reporting requirements of Section 12 of the Securities and Exchange Act and to all the regulatory burdens of the Sarbanes-Oxley Act of 2002, or Sarbox.

Allegheny has 653 registered shareholders, the majority residing in or related to residents of Pendleton County. Our shareholder base has grown to over 500 not because of mergers or public offerings; rather, our original shareholders have distributed their holdings among their descendents. With 53 employees and three branches, it is a severe strain for a bank and holding company to comply with all the reporting and disclosure requirements of the Exchange Act and internal control attestations of Section 404. To date, we have spent approximately 50,000 and 160 staff hours to comply. Next year an additional 1600 staff hours and 50,000 relating to control testing, increased internal staffing and escalated audit cost, which could increase 50 percent due to Sarbox requirements.

Finally, due to the law's complexity, we found it necessary to add one senior management employee to coordinate and oversee the project. While our estimates for compliance are below those reflected in ICBA's recent Section 404 survey of community banks, the costs are certainly substantial. We have considered going private to avoid the significant increase in cost. However, considering our small community -- Franklin's population is less than 1,000 and Pendleton County's population is approximately 8,000 -- it would be a significant loss to our community and to the bank's reputation if we were to go private and repurchase most of our stock or participate in reverse stock split. Many of the local residents who have proudly supported the bank would cease to have ownership in one of the two publicly held companies in the county, both of which are small community banks.

I appreciate the opportunity to testify today and will summarize my thoughts in written testimony on regulatory relief and the recommendations of ICBA. I believe that each of these points reflect appropriate ways to scale the securities regulations in a way that costs and burdens are commensurate with the benefits to the investors and public alike.

First, in my opinion, the registration threshold in Section 12 of the Exchange Act should be increased. The current threshold of 500 shareholders has not changed since 1964. The Commission, however, did note in 1996 that it intended to update the 500-shareholder requirement at a later date. I believe the later date should be now.

Pendleton County Bank, with assets of 165 million was considered a medium size bank in 1964. Today we are in the small bank category and significantly below the average U.S. bank size of 1.1 billion. Using 1964 as our base, the collective market value of 500 shareholders holdings and adjusted for inflation would be equivalent to what 3,000 shareholders would hold today. Consequently, we recommend that the 500-shareholder requirement under Section 12 of the Exchange Act be increased to 3,000.

We also recommend that Sections 12(g)(4) and 15(d) of the Exchange Act be updated so that the threshold for deregistration is increased from 300 to 1,800 shareholders.

The second recommendation would be to exempt community banks and bank holding companies with less than 1 billion in assets from Section 404 requirements. Banks have been subject to the internal control attestation requirements of the Federal Deposit Insurance Corporation Improvement Act, or FDICIA, since 1991. Those requirements exempt banks like Pendleton County Bank with assets of less than 500 million in assets because the federal banking regulators recognized the burden these requirements would have on smaller companies in light of the other regulatory requirements.

The FDIC is currently considering raising the FDICIA threshold to one billion and new rules may be issued as early as this summer.

We encourage the Advisory Committee to consider recommending a similar exemption from Section 404 for community banks.

ICBA's final recommendations are adjust Auditing Standard Number 2, or AS2. While the recent guidance concerning AS2 was a good step in reducing unnecessary cost, ICBA recommends that application of AS2 be tiered to a company's size and complexity. AS2 is still complex and a one-size-fits-all standard. Consequently, smaller companies are subject to higher audit costs and are unable to find qualified firms to fulfill AS2 requirements. For many of ICBA's members that qualify as accelerated filers, filing on a accelerated basis presents an undue burden.

The complexity of today's accounting standards in the new Section 404 requirements create an immense amount of work for community banks. ICBA recommends that the SEC significantly raise the $75 million public float threshold in the Exchange Act 12(b)(2) to an amount closer to 700 million, which was suggested by the SEC's Office of Economic Analysis, and that the SEC not proceed further with acceleration of filing deadlines.

Finally, ICBA's recommendation would be to revise the current definition of Small Business Issuer under regulation S-B by increasing the $25 million public float and revenue test. Given the explosive growth of the stock market and inflation that has occurred, it would be appropriate for the SEC to raise this threshold.

We would also like the regulation to be revised so there is more streamlined disclosure process for smaller companies like Pendleton County Bank.

As CEO of a community bank subject to the disclosure requirements of the Exchange Act and Sarbox, I am concerned with the regulatory burden facing community banking. The time and the effort taken by regulatory compliance diverts resources away from customer service. Even more significant, the crushing weight of regulatory burden is causing many community bankers to seriously consider selling or merging with larger institutions, taking the community bank out of the community.

I urge the Advisory Committee to recommend to the SEC ways to relieve community banks like Pendleton County Bank from the regulatory burden of Sarbox and other security laws and regulations.

In closing, I thank you for this

opportunity to testify and the efforts that you are taking in this regard.

MR. WANDER: Thanks very much, Bill.

We will now turn to Dan Blanton, Chief Executive Officer and President of the Georgia Bank Financial Corporation.

MR. BLANTON: Thank you, Mr. Chairman and good morning. Thank you for allowing me to be here.

Before I go to my prepared comments, I want to say how much I appreciate the opportunity to be here. I am deeply concerned with the future viability of community banks. These are your banks that lend to the small businesses in all the communities. Like my colleague, I am deeply concerned with where their future viability will go if they cannot get some relief under this Act.

I am here representing the Georgia Bankers Association. As their written statement set out fully, ABA is the larger banking trade association representing community, regional, money center banks and holding companies. I am the CEO of a $770 million bank. We have 5.3 million shares outstanding and 700 shareholders. I am one of the members of approximately 100 bankers on ABA Community Bank Council and this represents over 90 percent of the banks and savings institutions in the country.

The ABA is on record in support of many of the important measures adopted under the Sarbanes-Oxley Act. However, we have long maintained that banks are different from the rest of corporate America and that they are already subject to extensive regulation and that the business of banking is unique, producing assets that do not accurately reflect bank size relative to the assets of other types of businesses. For these reasons, ABA was instrumental in urging Congress to craft an exemption for banks from the insider lending prohibition of Section 402 of SOX as these are already subject to strict regulatory oversight.

The ABA strongly supported the New York Stock Exchange and Nasdaq requirement that list companies having a majority of independent directors seated on their boards. In this connection, we worked extensively with Nasdaq and the New York Stock Exchange to ensure that a listed company's directors will continue to be considered independent, despite having an arm's length lending or deposit relationship with a bank or holding company of which it is a director.

In connection with considering methods to reduce regulatory burden for small public companies, the ABA would urge the committee to consider our proposal made earlier this year to Chairman Donaldson to update the 500 shareholder threshold under the Section 12(g) of the Exchange Act. As explained more thoroughly in our written statement, the 10 million asset test has little relevance to the banking community as only 1 percent of all banks, 105, have assets less than $10 million. We would urge the committee consider raising shareholder level to a number somewhere in range of 1,500 to 3,000.

It is well documented that the cost of compliance is relatively great for small companies that are large issuers. This increase in cost has caused Georgia Bank Financial Corporation's directors to consider delisting as it would save our company at least $250,000. Deregistering would force this company to buy back its stock from more than 400 current shareholders. We are reluctant to do this because the bank was founded on the belief that the Augusta area needed a locally owned and operated relationship bank. Most of our shareholders live in our market and all but few do business with our bank. This localized ownership is quite common in community banks across the country. Oftentimes, investing in local banks is the only remaining investment opportunity someone has within their community. As he said, he has two publicly traded companies in his market. I have three. They are all banks. This is the way corporate America is now. If the 500 shareholders threshold would be raised, therefore easing the burden associated with the Exchange Act reporting, we would not have to reduce community investment in our banks.

Investor protection should not suffer under our proposal. Most community bank stock is held by members of the local community who are users of the bank's services and tend to buy and hold their investments in their local financial institutions. Like many community banks, Georgia Bank Financial stock is traded very thinly over the OTC Bulletin Board.

Moreover, banks and their holding companies are also subject to strict regulatory oversight. Georgia Bank Financial is supervised and examined under the Federal Reserve System. Its subsidiary, Georgia Bank and Trust is examined and supervised under the FDIC and Georgia State Banking Department. In addition to raising the shareholder threshold, we also urge the definition of Small Business Issuer eligible to use the short form 10-KSB and 10-QSB under Regulation S-B be revised. One of the criteria for using these abbreviated forms is the small business issuer must have revenues less than 25 million and a public float of less than 25 million. My company can no longer use this form because our market capitalization is roughly $176 million even though we had net income of 8.7 million last year.

96 percent of all deposit institutions

have net income less than $25 million. Adjusting these numbers upward would reduce the regulatory burden for those publicly traded community banks that have a public float greater than 25 million.

Finally, we would urge that the 75 and 40-day time period for filing Forms 10-K and 10-Q, respectively, not be reduced further to 60 and 35 days as currently contemplated for those publicly traded companies that have in excess of 75 million public float.

In conclusion, many of my peers expressed concerns that significant costs associated with complying with the Commission's periodic reporting requirements may cause them to expend significant resources to deregister or, alternatively, put their institutions on the selling block. Either way, local communities suffer because less cash is available to lend or the larger, acquiring bank is not equipped to bank local small businesses. Making target adjustments to the definitions laid out in the Exchange Act can, the ABA believes, alleviate some of the significant regulatory burdens for community banks and allow these companies to continue to serve their local communities.

Thank you for giving me the opportunity to present my remarks.

MR. WANDER: Thank you very much, all of you, for your very helpful observations and information.

We are now open for questioning by members of the Advisory Committee.

Why don't I start up top there, Mark?

MR. JENSEN: Mark Jensen. This is a question for -- I am sorry, I am struggling with everybody's names here. I guess, Mr. Knight and Mr. Wolkoff and Alan Patricof.

I would like to switch the discussion for a minute to quality of compliance with 404. I think all of you in your remarks cited difficulties in obtaining auditors of quality in smaller companies and smaller companies being constrained by their own resources in their ability to comply.

I guess the question, to be somewhat provocative to solicit your thoughts on it, do we have a law in 404 that effectively is impossible for small companies to comply with quality and, therefore, they basically are going through a check the box kind of exercise and, in fact, we are not achieving anything with the law because of lack of resources and focus? Mr. Knight?

MR. KNIGHT: That is a tough question. I don't know that we have enough information at this point to reach a conclusion. I think the small companies, one, are taking it very seriously. Where the quality issue I think is affected is in terms of the advice that is available to them. What we are finding is, they are having a hard time retaining one of the national firms that has access to a national office and resources to help them in that regard. In particular, the capital raising function is tied to, often, underwriters wanting one of those national firms.

So I think quality is affected by the advice available and there is a lack of competition, if you will, in this area. There are few accepted firms, and that is constraining the ability of small companies to perform in this area. They need more time, they are telling us. They are getting dropped by auditors. They are losing employees, so they are not able to deliver in that respect.

The question of quality is the one that is defined by the PCAOB in terms of the standards they are establishing. It is a fairly high standard and I don't think anyone has a problem with that per se, but there is a question of the benefits that you get from that. Is it worth the costs associated with that? The COSO task force, as I understand, is trying to come up with a practical framework that small companies can use in applying their model and, hopefully, some relief will come through that.

MR. PATRICOF: I am not sure exactly the thrust of your question. And I don't think people are just going through the check the box. I think they are taking it very seriously. That is the problem. They are taking it so seriously that it occupies virtually all their time. As I said, internal audit functions which should normally be going on have to be put aside in order to focus on this. I think it is also becoming increasingly difficult to keep internal people and accountants, I think, are finding difficulty keeping people who deal with these issues because it is just -- it is process and no one likes to just deal with process all the time.

And I will reemphasize the fact that the way the world is going, we used to deal with a Big Eight and that was a very competitive, open negotiation. If you didn't like one auditor, you had a chance to go to someone else. Today the relationship between auditors and companies has changed dramatically. It is a oligopoly. You can't negotiate fees. For a small company, it is virtually impossible. You take what is told is the price. You don't have the opportunity to go to someone else. First, the other person isn't interested because they are going through the same process and they know the drill. And the second thing, it would look poorly on the company to be changing auditors. What we really need is a lot more auditors -- that there is moral suasion to accept a Big Eight, Big Ten -- as many as you can get or to accept more regional auditing.

How that comes about is dependent on how the regulatory bodies talk about this and encourage it. I think the bully pulpit and moral suasion and letting people know there are a lot of accounting firms out there who have good quality people beyond the Big Four.

MR. WANDER: Rusty and then we'll take Janet next, and Dan after Janet.

MR. CLOUTIER: I wanted to ask the two bankers a question. I wanted to go a little further in the comments you made because I think it is very important that the committee understands and the SEC understands that community bank something a little bit different.

Correct me if I say anything you disagree with because I think I can speak for all trade organizations on this question.

Community bankers, both of the gentlemen here I am sure sign call reports every 90 days with the FDIC, file Y9's with Federal Reserve Bank. That information is made very public. You can get it on FDIC.gov and it is verified every year when you are examined by the FDIC who comes in your bank and does a very thorough examination of the statements you have filed to make sure they are adequate and correct versus any other organization of checking that.

The other thing is, if there is any problems within the organization, there are memorandums of understanding, cease and desist orders which are also filed, which are also a public record and made very available to the public and very easy to get.

It certainly seems like we as a committee should encourage the SEC to take all this into consideration when we talk about public disclosure. And the other factor you mentioned is that most community banks are owned pretty much within the community, which they pretty much know what is going on in Georgia and West Virginia with that bank better than any research firm does, and I would assume that neither one of you all have any research. Most community banks do not. As the gentleman spoke of very clearly, most banks under a billion dollars just can't pick up research.

I just think that we need to ask the

SEC to take all this into consideration. I know it is tough to ask for carveouts for different companies, but certainly in this instance there should be a consideration of a carve-out because of the amount of regulation and verification -- remember, verification. Not only regulation but verification. As I tell people, I worry much more about signing a call report than I do about the SEC attestation. Nothing against the SEC, but the OCC has all the power in the world to come after me. They don't need any additional rules or regulations. I would like it if any of you would comment on that.

MR. BLANTON: I completely agree. Our industry has for many years been held to a much higher standard and we are very proud of that. We go through an extensive amount of regulation and review and examination all the time. I wouldn't even say -- it is a regular process that we have examiners of some group within our institution examining us.

The burden this year -- this past year to comply with SOX 404 was unbelievable, in the pain and anguish it bestowed on our staff. Our staff is a bunch of A-plus people who really want to exceed everything they are given and it was all we could do to try and hold them back enough. They were working 20 hours a day in cases complying with SOX.

We think SOX is very worthwhile. There is a lot of good, important things in it. But we do really urge to be given some relief and some consideration for the already heavy regulations and examination burden that we currently bear.

MR. LOVING: And I, too, agree with my colleague, Dan, that the banking industry has been held to a much higher standard for many years and a standard we are very much proud of. We are regulated by, in our case, a state banking association regulator, the FDIC, our holding company is regulated by Federal Reserve. As Rusty indicated, a cease and desist order is something no one wants to have filed upon them, so we are concerned about the controls that are in place today.

We would ask that there be some

consideration given because of that, because, as was mentioned, the call report that's filed quarterly, it is signed, it is attested to by the directors and executives of the bank. With the Call Report Modernization Act, it will soon be available immediately to the public once it is filed, so there is a form in which the public can get that information instantaneously, if you will, as well as most community banks being owned by community residents in small communities. They know very well what is going on within the bank. So I agree wholeheartedly with your comments and statements.

MR. WANDER: Janet?

MS. DOLAN: Thank you, Mr. Chairman. First of all, on behalf of all the members of the 404 subcommittee, I want to thank all of you for your comments and particularly your suggestions. If you heard our summary yesterday. We are already considering many of the suggestions you have made. I do have a question for Mr. Kolins, though.

One area we are very interested in getting input on is the area of how do we achieve what everybody is trying to achieve, which is to turn this from a one-size-fits-all to tailoring 404 for small companies, if we can, especially in the area of risk profile. That is, can we do anything to help PCAOB or the SEC to help get us to the point where rather than just saying either you are on one side of the line or the other -- in other words, either you comply with everything or we exempt you -- can we identify which are the A controls and which are the D's? Which should be done every year and which, perhaps are not as significant or could be done on a staggered basis? Some way to try to actually bring a rational look to what should be required to provide and create confidence in the 404 process and what is just being done that doesn't provide that much value especially for small companies?

So, you represent the people that are doing the auditing. Has your association done any reflecting on that knowledge you have been through the first year or do you have a mechanism to do that? Do you have some way where you could give us some substantial foundation and input and professional judgment on, if you ran the world, how you would be able to tailor this so we don't have a situation where, as I said, it is all or nothing, but we can tailor something that helps get to what that I think the PCAOB was urging your industry to get to in their pronouncement in May, which is let's not over-audit, let's use a risk-based assessment and find a way to tailor audits to the companies involved. Can you give us input? We are really interested in feedback in that area.

MR. KOLINS: I hope so. Before I get into the response to the question more deeply, you have got to look at the perspective and the environment in which the auditors were first looking to comply with 404, as well as the companies looking to comply with 404, because they are both basically were doing it almost the same time. It was a real-time audit environment that was being created over a period of a year or so versus the 90-some-odd years that auditing standards and financial statement audits were developed. So, you had some people on the shore of the beach looking at the tsunami coming in, not knowing quite what to do until it was a little late.

So, right now you are into the retrospective part, which I think has become very useful. People are sharing experiences. There was the meeting of a standing advisory group of the PCAOB last week devoting two full days to analysis of 404 and what can be done about that. Certainly a big focus there was on the risk-based approach, which I think the Q and A's that came out in May from both SEC and PCAOB were very helpful in pointing the auditors and companies because they are both looking from the same perspective, to more of a risk-based approach in both assessing their own controls and reporting on those controls.

There are groups within the AICPA task force dealing just with 404. They get together on a regular basis and they will certainly be focusing on this effort.

One of the big concerns that was raised and I think a potential large deficiency would be to what extent can the audits of internal controls be integrated within the financial statement audit, so you can at least take credit for more that has been done in the financial statement audit for the comfort that you get out of doing a 404 engagement. I think firms did not have sufficient time to get those integration mechanisms into place last year. Things were happening too quickly. I think now those things are happening.

One idea I could bounce around that I think has some merit is looking at what are the A controls and the B controls, as you mentioned. I think if I recall Moody's had done a report some months ago indicating what it would consider as to something that might affect credit rating, looking at the controls affecting the control environment, the entity level controls, that if those were considered to be material weaknesses, that would have a significant effect, whereas application controls, the more detailed controls that are more easily correctable wouldn't give them as much concern.

I think that was probably borne out by and large in the marketplace when material weaknesses were reported as to what kind of material weaknesses there were. It might be appropriate for these smaller companies, however defined, to, perhaps, have a mechanism in place where every year their controlled environment, their entity level controls are reported on, then every two years, whatever time period it would be, perhaps more detailed application controls could be reported on because at the end of the day I think what probably has been the underpinning of many of the financial statement frauds is not a detailed application control as to whether John or Mary did on an invoice, but what the tone at the top was and what the potential for management override was.

MR. WANDER: Dan and then Scott.

MR. GOELZER: Thank you, Mr. Chairman. Let me say, I thought there was a terrific amount of food for thought in everyone's statement and I appreciate you coming here today and making them.

I wanted to ask the same kind of question Janet did, but from a little different perspective. Ed Knight, I think the first suggestion concerning 404 in your statement was that steps be taken to, as you say, incent the CPA firms away from overauditing. I wonder if you had any specific thoughts in mind as to how that might be done? Certainly the sort of thing, at least from my perspective that the PCOAB grappled with in its May 16th statement and also that we are grappling with as we try to structure and operate an inspection program in a way that won't drive people to dysfunctional behavior, but will, in fact, focus on serious quality issues.

I was wondering if you had anything more specific in mind there. And kind of a corollary to that, at the end of that section of your statement you say this, meaning, I guess, overauditing continues to be the case even after the most recent PCAOB guidance, which I think raises another question that has come up at this meeting. Everyone seems to like the May 16th guidance, but opinion seems to vary considerably on whether it will really have any impact on the audit process. I was wondering if any panelist -- Wayne, I am afraid to overwork you, because you work on our SAG also, but maybe you would be the best person to comment on whether what the regulators said on May 16th will have a significant affect on the year two reviews or the first year reviews for new companies that come into the system.

MR. KOLINS: I think it will. There was a lot of discussion last week at the SAG meeting focusing on the risk-based approach and top down approach and focusing on a really important area within the framework of AS2, which is what is a significant account, and whether something is scoped in or scoped out. I think there was clear consensus about what that really means. It is the same for audit of financial statements as for internal control audit.

What came out of the meeting loudly and clearly, which wasn't so clear before that I think in practice, even if you consider an account as significant, it doesn't mean you have to beat it to death. You don't have to do everything with it in terms of nature, extent and timing, and the less risk there is of material misstatement within that account, the less audit work you can apply to it, rather than looking at every significant control relating to it, you can reduce, again, the nature, timing and extent, and I think that will drive practice during this next season.

MR. KNIGHT: I don't know that I have any magic bullet here. What we are hearing is that accounting firms, when they in turn are audited by the PCAOB and particular audits are being examined, the PCAOB is identifying rather, for lack of a better description, minor issues as troublesome in that accounting firm's overall quality control approach. And so then the firm is extrapolating from that to their work on 404 and saying, "I want to avoid any of those issues." And despite being told to take a risk-based approach, I have got this real world experience in my last examination that they are extrapolating to how they deal with clients going forward. That is one issue.

The other is just taking the concept of 404 and applying it to an economy like ours with its complexity is a daunting task. And to do it with any ability for people to be able to be confident around what are huge risks for an institution is very hard without, I think, creating clear, safe harbors. And that is what people want to know I think both in the accounting area and in the public company area. People want to do the right thing. They want to be told what is a safe harbor, but then you say, "Well, what is material?" And you have to fill a room with lawyers and have a debate.

I know the government -- I've served my years in the government. They need to retain some flexibility and some discretion and they are concerned that if they establish that safe harbor and the economy evolves in a certain direction, that somehow they will be condoning behavior they will later feel is troublesome. I just think it is necessary in this area to have some safe harbors for people that are practical in the world.

MR. WANDER: Scott?

MR. ROYSTER: As one of the guys who has spent the last twelve or eighteen months writing a lot of checks to outside auditors and consultants to pay for all this, I want to explore the issue Mr. Patricof has raised, look a little at the oligopolistic structure that exists with regard to public companies relative to their outside auditors and then come back to you, Mr. Kolins, and ask you a little about your business, the business of being not one of the Big Four, but, perhaps, one of those Big Ten that Mr. Patricof would like to see.

I have been mystified by how this structure can continue to exist given that 97 percent of all public companies and thousands of public companies beyond the large ones are basically requiring four firms, through some sort of funnel mechanism, to process all this work.

How do we go about addressing this issue of the oligopoly that exists in the accounting industry and have you at BDO Seidman seen some progress with regard to taking on more public company clients, seeing, perhaps, a bit more of a willingness in the marketplace for your firm to expand its market share? Hopefully, the answer is yes, and what can we do to hopefully see other firms increase their shares over time?

MR. KOLINS: I am not sure I can help you in terms of what to do about an oligopoly. That is a very macroeconomic question. In terms of the response to the second part of the question may help with the first.

We have seen more inroads into the larger, at least from our perspective, larger public company clients over the past year, year and a half. And I think it comes down to very much of a supply and demand situation. Clients want service, they want service today. They don't want to hear about resource constraints if they can't get that service. So we are seeing clients that are larger than some we have seen before. I believe that when the client discusses with us what the tools are we bring to bear in focusing on what the tone at the top is at the firm, who is on the board at the firm, what is your governance at the firm, what technical resources do you have, what industry expertise do you have? Those are the things that really matter to the company when it gets right down to it.

All of the companies have audit committees. Some of the audit committee members are on other audit committees. People start to talk. Jawboning could be part, morale suasion could be part of it. I don't know what mandates can be brought to bear, but we have seen more opening up in the marketplace for companies in maybe the bottom part of the Fortune 500. You are not going to get the Fortune 100. There are logistical issues in terms of doing an audit that certain firms just can't handle because of size. You can't be in a hundred different countries with a hundred people on staff at every one. There are certain constraints.

But beyond that, I think there are possibilities for openings, and some of it has to do with bias against the firm that perhaps an investment banker says, "No, you can't go to that particular firm." And in many cases the smaller firms have the technical ability and the resources to perform those engagements.

MR. ROYSTER: Just a quick follow-up, because one of my issues also has been the investment banks and the law firms who either take these companies public or represent these companies after they are public, perhaps otherwise being resistant to listed companies or soon to be listed companies doing business with firms outside of the Big Four. So you obviously have seen that resistance, that bias. Are you doing anything to try to address that and are you seeing some loosening of that?

MR. KOLINS: We actually, about six months ago, got a call from one of the major investment banking houses wanting to speak with us to find out what more we could do with them because they were having problems getting service with the normal channels that they were dealing with. Again, I think it is a question of supply and demand. Oftentimes the clients themselves are saying, "No, I don't want to change firms. I want to stay with the firm I have. Maybe I will change investment bankers." In that case you have a reputation established with that particular investment banker. Problem is they don't necessarily talk to the one down the hall or across the country.

MR. DENNIS: Sorry, Drew. I just have a follow-up to Scott's question to Wayne. Really, also to Alan and Ed. I am wondering if there are things this committee can do or the SEC can do, the exchanges can do, to promote what Alan had talked about of trying to broaden the number of firms that are viable options for smaller public companies.

MR. PATRICOF: Let me answer that one. We all saw in the paper today that the Justice Department is concerned about, it looks like, bringing, perhaps, an appropriate action against one of the Big Four because of their concerns of going down to the Big Three. They weren't concerned when they did that with Arthur Andersen or, perhaps, they would have done that differently. If they can be concerned at this stage and express it in some fashion of going down to three, there should be a way of expressing attitudes that encourage the formation of acceptable accounting firms.

For example, this Commission, when it reports, could have a section which devotes itself to this subject and says it is the committee, Commission's attitude that there should be encouraged by the investment bankers -- and it's the investment bankers that count -- that regional firms should be considered, that other firms that have a national presence that are not of major proportion should be considered. I think that mere statement can be referred to and will be referred to frequently, I am sure, by young companies who resist changing their auditors in order to go public and by investment bankers who feel they are in a comfort zone of using companies that are not necessarily household words.

I am speaking from intimate knowledge of the circumstance and I assume Scott knows exactly what I am saying. I am sure everybody else does. We have all faced this every day of this problem of if we don't have one of the Big Four, investment banking firms are concerned and they will encourage you strongly to change accounting firms, particularly if it is a local or regional firm.

So I think you need at some level somebody that makes it acceptable without making regulations, but just an attitude.

MR. KOLINS: I think it is a question of getting the right audience to listen to this because it is probably a very narrow -- you are dealing with the money people, basically, that would have that concern, and maybe want to go the course of least resistance in picking a firm with a certain name.

Short of regulation, jawboning could be a difficult mechanism to get something done. Perhaps pointing out in cases where a large firm, a large company has a non, call it Big Four firm doing the audit and looking at that particular experience and having symposiums where the management of that company talks with management of other companies about that particular experience. You are talking CEO to CEO about relevant experience, which may be helpful.

MR. WANDER: Drew and then Dick and then Steve.

MR. CONNOLLY: Mr. Chairman, thank you. I am very mindful of the time. I will do my level best to be brief. I would like to thank Mr. Laporte and Office of Small Business Policy within the SEC and your good self, sir, for providing us the resources of these witnesses and a panel that I am truly in awe of and grateful to for the overall information they provided.

Where to begin? Mr. Knight, I am mindful, having reviewed your career, sir, of your government service under the Clinton Administration and the Treasury Department and for that I am grateful.

I am, however, concerned. Currently my subcommittee is Capital Formation within this overall Committee. And there are a host of issues. I am going to be brief about the most current ones deeply concerning to me and, perhaps, as a matter of full disclosure, I should tell you, you did regulate me, actually the NASD did regulate me for 17 years, so I am, perhaps, aware of what I speak.

I am deeply concerned about the current proposed eligibility rule. I have read and I did hear your remarks and I am concerned that perhaps we are saying one thing and, from a public policy perspective, doing another. Transparency, good governance, investor protection, and information disclosure are all objects to be pursued in the public marketplace but the eligibility rule, which perhaps many of us are not familiar with, is a proposed rule by the NASD at the moment, or Nasdaq, considerably, to essentially punish a late filer on a couple of occasions. Whether it is Sarbanes-Oxley late or whether it is late because they can't find auditors or for whatever reason it is late, a public company would be late in its filings of Ks and Qs on a sequential basis or two or three time basis and essentially be punished, delisted, thrown into perdition as we often call the Pink Sheets.

My concern with that is that, thinking as a potential public company executive, I have no incentive whatsoever to come current or comply with those disclosure rules for that entire period of a year.

I am wondering if public policy and disclosure would not be better served with some other form of sanction, without essentially putting someone in a penalty box for a year because I think that is kind of a negative assertion or way to do things.

The other comment, very quickly, is

that Chairman Donaldson, upon appointing us, was kind enough to take under advisement a comment I had and I know Mr. Coulson will propose as a rule, and that is if you are listed on the New York Stock Exchange, the American Stock Exchanges or the National Market System, there is a mechanism for both collecting and reporting monthly short interest. There is no such method or requirement to provide that disclosure and that visibility on either the Bulletin Board or the Pink Sheets. And since it is regularly reported that Nasdaq would like to get out of the Bulletin Board business, I would like your comment, sir, on whether or not that is in fact true, whether the regulatory costs of the Bulletin Board are sufficient that Nasdaq as a for-profit company -- I don't own any stock; I guess that is additional disclosure -- would like to basically get out of the Bulletin Board business and how do we do that and maintain a small company marketplace?

MR. KNIGHT: It is a very good question and I appreciate it. Let me back up here a little bit in history and describe a period. January

2003, the year after the Enron/WorldCom issues, there were no IPOs in this country. None on the American Stock Exchange, none on the Nasdaq, none on the New York Stock Exchange, for the first time in 20 years. Basically, the capital markets in terms of creating new ventures, public capital markets had shut down. We had a real crisis of confidence in this country.

Last year, we had 140 IPOs on Nasdaq. It is coming back. But part of the reason is, I believe, that the public, again, has confidence in

the public disclosures and in the enforcement of the rules of the stock markets and certainly the SEC.

That is a very fragile matter and it is something we have to work on every day. And we believe passionately at Nasdaq in the importance of public disclosure. Our board, in looking at the Bulletin Board, found that there was a troubling phenomenon and that was that hundreds of companies were what I would call serial offenders of the obligation to make public disclosures. In a period of a year or so, they were not reporting on time three or four times a year. We felt that we needed to get tougher in this area, and so did, frankly, the SEC.

Now, the rule we propose is three strikes and you're out. That is, if you continually are late with these filings, that you are given a time out. We think it is fair. It is the subject of public comment right now. Obviously, there is comment on that and we will take that and act accordingly. But it is something our board felt very strongly about and we feel very strongly about in Nasdaq in terms of the importance of our enforcement of the obligation of public companies to disclose and on a timely basis.

In terms of the Bulletin Board, we are committed to the Bulletin Board. We and the NASD are vigorous in our oversight of it. We are approaching exchange status at Nasdaq and that status requires us to change the legal structure of the Bulletin Board. I do not expect there will be any pause in the provision of that service to the investing public. It may be under a different legal structure. It has nothing to do with the profitability of Bulletin Board whatsoever. It has to do with Section 6 of the Exchange Act and whether we can operate the Bulletin Board as an exchange.

MR. CONNOLLY: Mr. Knight, just so you are aware, our committee has some sympathy to the overwhelming regulatory cost to maintain a Bulletin Board and we have had some discussion. I am not sure where it will end up in terms of recommendation, but listing fees, initial and potentially ongoing, are not out of the question. But for that consideration, I suspect we may ask for some other Nasdaq-oriented negotiation or, perhaps, discussion as to how that offsets one another and becomes fair.

MR. KNIGHT: We have a listing venue for small companies. It is called a SmallCap. We were not -- again, this was the board's decision -- to not create a lower standard in terms of listing standards in Nasdaq for the Bulletin Board, which was the direction some were urging us to follow. We feel, in terms of public companies, one who lists with us, we are vouching for those companies to the public. We have a set of well thought out corporate governance standards. They should apply to all companies. We are not interested in lowering them.

MR. CONNOLLY: Thank you, Mr. Knight.

Finally, Mr. Patricof, firstly, I am honored to be in your presence. Again, I have attended over the years the New York Venture Group breakfasts at the Rainbow Room if we can go back that far. I would just like to point out to the room that Mr. Patricof, perhaps unlike some of the others here as witnesses, has actually testified on behalf of, taking his testimony into account, the lessening and the right-sizing of some of these regulations while simultaneously running a $20 billion private equity fund, putting that money deployed into the marketplace.

Quite frankly, if that that kind of money says -- and our mandate is investor protection and the investors are saying, "Hey, let's look at some of these regulations from the standard of the benefits of those regulations," I think that kind of, for me, outweighs a number of the potential regulators, banking trade association individuals, who I am very sympathetic to your duplicative regulation and I think this administration is probably very sympathetic as well.

Mr. Patricof, thank you very much for being here. Would you consider taking a portion of that equity fund and dedicating it to microcaps and can you persuade my friend Susan Strausberg to consider appearing before us in Chicago, as I believe that EDGAR OnLine has materially benefited public disclosure in this country?

MR. PATRICOF: I can't specifically speak for Susan Strausberg, who is out of the country at this particular moment, but I am sure she would be very happy to speak before the Commission. I can't speak for her, but I am pretty sure she would, in Chicago or any other place, because I think she believes in this issue.

As to us -- we don't trade in stocks. I would tell you, we have microcap stocks. We didn't necessarily intend to get there. As I said, I think it is very important to understand my numbers may be wrong, but research can be done. You cannot go to an underwriter today and bring your company public at $75 million in value because the underwriters want a certain percentage of the float to be trading after they take an underwriting and they want, in order to make sufficient money and to create a sufficient market. As a result, the initial offerings today -- not what they used to be. I remember you used to have public offerings a million or $2 million on a full Nasdaq listed stock. It wasn't that many years ago.

Today you have to do a public offering -- I am not just making a number. I am saying a million or $2 million would have been a public offering back in the seventies and as late as the early eighties. Today you have to have a public offering of 20, 30, $40 million to get anyone interested. So the only ones who fall in the category of small caps under market cap are people who, after they got traded, not necessarily because they did badly -- it may be they did badly but because of lack of coverage, as has been discussed, or other exogenous reasons -- the market cap has gone under there.

So I think market cap has absolutely no applicability to size of company. We have several companies in our portfolio with market values of a billion dollars that don't have a revenue level because they are in the biotech or research area that have great promise for the future and have very few employees. They are spending all their time on research and complying with the regulations of being public.

MR. CONNOLLY: We take that very much seriously within our subcommittee and looking at the revenue test versus potential market cap.

MR. WANDER: Drew, we are going over our time and we have got two more speakers.

MR. CONNOLLY: Certainly, Mr. Chairman. I ask that these witnesses conceivably make themselves available throughout the course of this committee to help shape the recommendations and not be a one-off.

MR. WANDER: I am sure they will.

Dick and then we'll finish with Steve.

We will run a few minutes over, but I did want to let everybody have their opportunity to ask questions.

MR. JAFFEE: In the interest of time, because the question I was going to ask really has been discussed, I will pass for the moment.

MR. BOCHNER: Thank you. This is really directed at the whole panel, but maybe Mr. Wolkoff and Mr. Knight in particular.

Delisting -- as kind of a follow-up to Drew's question -- it has to do with de-listing-- that is a powerful remedy, so I know that is not done lightly. I think one of the situations it is appropriate for is when somebody is not getting information in the market because a market can't function ultimately if there is not good information flowing, but we have heard a lot about the problems of 404 compliance, that resources aren't available, that the costs have increased.

I am noticing in Ed Knight's testimony that delistings are way up. Sixty delisting letters due to failure to file Form 10-K, 14 last year. I think there is some uncertainty out there.

Maybe I will ask it more in question form. Is there uncertainty out there and would it be helpful to get guidance, get a recommendation from thiscommittee and maybe guidance from the SEC on the relationship between 404 failure to comply with 404 in various forms, whether it is a disclaimer, an adverse opinion and so on, and being timely?

So in other words, continuing that line of thinking, would you think that a decoupling of 404, at least until we figure out where things are going to land from a cost and compliance point of view, a decoupling of 404 from the idea of whether or not one is timely filed if there is various 404 problems. Is that a good idea or from a self-regulatory organization point of view do you think we have that covered and understood?

MR. KNIGHT: No. It is a good idea. It is something we are having ongoing discussions with the SEC about. We are looking at interpretive room in our rules to give company more time, and we are given companies more time because of these issues.

It is not clear whether this is solely a 2005 issue or something we are going to face regularly. You are right; the delisting remedy is a severe one. It is one that is characterized with a lot of due process at Nasdaq in terms of the opportunity for companies to make a case before an independent panel and to the listing council, then to our board, then to the SEC, all in a very transparent way. But those adjudicative bodies have to date shown a lot of flexibility dealing with these issues. As I said, we are talking to the SEC about how we can put more flexibility in the system.

MR. WANDER: Thank you. Any other questions before we take a short recess?

If not, I want to thank each of the panelists for the excellent presentations. All of you were extremely well prepared and we value your comments. As Drew said, we may call upon you in the future and you should feel free to provide us with comments at any point during our deliberations.

We will come back about, let's say, five minutes after eleven.

(Recess.)

MR. WANDER: Why don't we reconvene? We will begin our second group of guests.

A couple members of the Advisory Committee have come up to me and said because of the information we were provided earlier and I am sure as a result of the information we will hear from our next group of panelists, that it might be useful for all of us to stay around for an extra ten or fifteen minutes just to make sure we highlight those things we want to follow up on. For our future meetings, I have already had a couple of suggestions, which are excellent suggestions, that we actually hold our meeting after we hear from the various panelists so we have an opportunity, while it is fresh in our minds, to dissect it.

With that remark, if everybody could, please, stay just for a few minutes afterwards?

We will begin the second set of panelists and we will start with Bill Carney, who is a professor at Emory University Law School. I pointed out to everybody that in his article which he so kindly sent me a few months ago, his closing line is "and we will say good-bye to the community banks, if all this takes place." Right?

MR. CARNEY: Something like that. I think it was community ownership of community banks.

Thank you, Mr. Chairman and members of the Committee, for inviting me. I apologize for the darkness of the presentation there. I guess as a competitor I might say this shows up much better at Emory Law School than at Columbia Law School.

What I have done is a study on the cost of securities regulation generally, with particularly emphasis on the increased cost imposed by Sarbanes-Oxley from filing of Schedule 13E-3 for calendar year 2004. As I indicate, as a chance for free advertising this will be forthcoming in the Emory Law Journal 2005 later this year.

In order to be consistent with the methodology of earlier studies, I focused on companies that filed their initial 13E-3, not amendments, during calendar year 2004.

Let me begin by mentioning something the other witnesses already mentioned. Not all the cost increases have been related to Sarbanes-Oxley. SEC has continued to add to the regulatory burdens by accelerating timetables for traditional filings, including 10-Ks. Accelerated 10-Ks, 10-Qs, 8-Ks and expanding the contents in particular of the 8-Ks are among increased costs imposed on registered companies.

But that is only part of the cost. More executive time is spent on these matters than was formerly the case. We also have increases in D&O insurance premiums, increases in auditing fees. The last study I saw indicated a 58 percent increase in auditing fees. A company with which I am familiar is looking at trebling of auditing fees right now. Those are the hidden costs I suppose of Sarbanes-Oxley that you don't get out of the 13E-3 filings I have looked at.

The number of 13-E filings has gone up steadily since 1998, from a low of 25 to a high of 114 in 2004. This has been accompanied by a steady increase in number of leveraged buy-outs. These are the numbers here from 115 in 2001 to 521 in calendar 2004. I don't have data for 2003 but I do have dollar amounts for those years. If you look at that you can see the dollar volume of LBOs has had a very steady rise, roughly 400 percent from 2002 to 2005 projected numbers. I used the first quarter numbers for LBO's for this year and simply projected from that.

I have no way to separate those LBO's that may be partly explained by avoidance of regulatory cost from those that are driven by other motivations. But given the evidence I provide below, it seems likely avoiding these costs explains at least part of the LBO trend. The average size of the LBO in 2004 was $261 million.

A striking figure on 13E-3 filers is their very small size. The median gross revenues of these companies were only $25 million. There are some larger companies in the set but not very many. I have got a distribution of those companies and you can see that out of the 114, actually, 111 -- I didn't have dollar amounts on three of the companies -- 66 of them, over half, had gross revenues of less than $50 million. On the other end of the scale, there were ten companies that were in the 500 million revenues and up. At least one of them, Cox Communications, I think, was in the 7 or $8 million range. It is a big company and even it mentioned -- I shouldn't say the cost of compliance. I should say the regulatory cost imposed by securities regulation generally.

One has to assume that of these firms, 114, 44 of them, or 39 percent, not only listed compliance costs generally but specified the compliance costs as a reason for terminating registration. Those companies provided cost estimates. One has to assume these firms were facing further cost increase as they proceeded with their implementation of Section 404. Some of the other firms -- well I think I said that. Excuse me. I am getting ahead of myself.

I think the numbers in the filings understate the cost of compliance and include only out of pocket cost such as increases in auditing and legal fees, as well as cost of hiring additional employees in a few cases, but they do not include increase of executive time and other employee time devoted to these tasks. In some cases it appears that firms seriously underestimated the anticipated cost of compliance. One firm estimated cost of compliance with SOX at $25,000 while two others put the cost at $34,000 and $36,000 and I have to believe they were getting out so early that they hadn't looked very hard at what they were really going to incur.

I excluded one very large 13E-3 filer from my numbers because it seriously distorted the numbers. The number I have now is 43 reporting companies that indicated average compliance costs with securities laws of $291,000, of which 174,000 was added by Sarbanes-Oxley compliance, at least that was their estimate. These are very small companies, average net profits of just over half a million dollars, and the compliance cost as percentage of net profit was over 50 percent. These companies are clearly rational in deciding to exit public markets. Sarbanes-Oxley raised their compliance costs by 148 percent.

Next, I would like to address the identity of these companies. I don't know how well this will show up. There are 44 companies on that list. Obviously, they are relatively small. I have highlighted those companies that appear to be community financial institutions in blue. Fifteen, or over one-third appear to fit that category. This means community banks and thrifts will no longer be owned by the community in many cases. This bears out that this is having a significant impact on institutions such as that.

In some cases, stock that declined after the bubble burst in 2000 may have found being public was no longer attractive regardless of the increase in compliance costs imposed by SOX. I have attempted to compare the rising number of going private transactions, shown in the bar graph in yellow, and Nasdaq composite in the blue line. What is interesting there, the number of filings began to rise before the market collapsed and it was already on its way up. As the market began a recovery in 2003 -- hard to say 2004 was a recovery, but at least it was up from the bottom -- the number of filings on 13E-3 continued to go up. This suggests to me that compliance costs rather than stock prices or stock levels generally were the stronger driver in this recent trend.

This isn't the first time we have had a going private movement. It's happened before. I am old enough to remember one in the early 70's. I think others in this room may also remember there was a flurry of IPO's and then a disappointment in the market and then again in the eighties we saw the LBO movement. All that suggests caution, that there may be other forces that create going private movements from time to time. I don't think we have ever seen one where the 13E-3 filers were specifying the compliance costs with the securities laws generally and Sarbanes-Oxley in particular as a reason for doing that.

I should point out as, has been pointed out by others -- this is the website where you can find the paper if you wish to. Terminated registration of the securities laws has an odd set of consequences. It only requires that shareholders drop below 300. It doesn't require that trading stop. We have Pink Sheets. We have broker-dealers who are at least in theory supposed to maintain comparable information on these companies. There is some testimony that maybe they don't do that as well as they ought to.

What we are doing by driving the companies out of this system is driving them into an inferior disclosure system where they may still be trading. I think this may very well be a perverse result. I am not sure investors are better off with a one size fits all regulation that imposes such costs that companies are forced in effect to exit the public markets.

It has already been mentioned that financial institutions are already regulated heavily on their controls and in that sense Sarbanes-Oxley just duplicates what's already happened. I want to second what the other witnesses have said about that. It seems that it truly is duplicative and adds a layer of cost that really doesn't benefit anybody.

Thank you.

MR. WANDER: Thank you very much, Bill. We will now go on to Cromwell Coulson and we can probably turn the lights up again.

MR. COULSON: Thank you, Mr. Chairman

and members of the committee for having me here. I am not really going to talk about the implementation of fixing the nuts and bolts of Sarbanes-Oxley. Instead, really what is happening is, with Sarbanes-Oxley having imposed a cost or tax upon issuers, many issuers are voting with their feet and coming to the Pink Sheets. I look at this as an opportunity for two things. One, the historic viewpoint of issuer disclosure has always been through the SEC, through the reporting mechanism. And the position of companies which are exempt from SEC reporting, there has never really been guidance to truly say you need to disclose into the market. It is this gray area. Quite often you heard Pink Sheets companies don't have to disclose, we can't make them disclose. But actually that is wrong.

Hopefully members of the committee will all read the written statements we submitted because they go much more into depth and build what we would like to see come out of this, which is taking a dark part of the market or a splotchy part of the market more transparent through existing securities laws. That is going to be a great improvement for this space of the market if the committee can get some recommendations to be made by the Commission.

Now, a lot of people don't know what's happened to the Pink Sheets because they remember it was this paper-based phone process. It was not very technologically advanced. But that has changed today. The Pink Sheets is a fully electronic marketplace. We have electronic firm quotes from market makers, we've got depth of liquidity. All the market maker quotes are electronically linked. We have the largest market makers. UBS Securities, CitiBank, Knight Securities, TD Waterhouse, Jeffries and Company, RBC Dain Rauscher, Hill Thompson, large financial services firms. They are automated, they have capital, and they are completely interested in making this market transparent and efficient and providing their customers with best execution.

We brought out two years ago PinkLink, which was electronic linkage of the market makers. This was private. The marketplace decided they needed it. At PinkLink, we now do the bulk of interdealer trading in Pink Sheet stocks but also Bulletin Board stocks. Of orders sent on PinkLink the average execution response time between broker-dealers is 14 seconds. The average fill rate is 90 percent for orders. This is a good market with good, transparent pricing, and I think I have done a lot to fix the process.

Now market makers and broker-dealers are in discussion about limit order display. This market is moving forward. The problem is the product that is trading on the market. Because we are the farm leagues and we provide a marketplace for shares, the only real thing that defines them and links them all together is they don't want to be or can't be or are too small to be listed on an exchange. That includes emerging growth companies which are too tiny or too new and where the opportunity is, but also most of the regulatory problems. Closely held companies, who have minority investors -- and as you have heard from so much of the going dark debate -- some of these closely held companies are looking to treat their minority investors fairly and some are not. Some are wanting to cut off the information flow and squeeze out the minority investors.

We also have the economically distressed. We provide a place for securities to trade when they have fallen off an exchange. And some of those securities fall off the exchange and don't come back. Others, like HealthSouth, fell off an exchange, was delisted from the exchange at 20 cents and they fixed, and is now a $5 stock. And investors have been better for having access to a transparent, efficient market for those shares. And exchanges are better because they have the ability to delist securities but not totally shut down the market for the minority investors.

Now, the effects of Sarbanes-Oxley is, we have got more companies come to the Pink Sheets. It is a good thing for me, for my business, and I can't say it is not. We have been picking up a lot of high quality listings. And we have really been picking up two types. One type says this is a cost and we are making a case to our shareholders that this money is better spent on the business or in dividends or buying back stock. And these guys have wanted to continue disclosing information to the marketplace.

We have another group that has said, "We are delisting and we are not going to tell you anything." You can tell that they are just looking to prey on the minority shareholders to buy out those shares and by going dark they are going to manipulate the secondary market price, and they have been very successful that if you look at those stocks, they have gone down.

Now, we have created what I call a third path for disclosure. The SEC has EDGAR. Of being a reporting company, there is two tiers, the large and small companies. We have created a service called Pink Sheets News Service where issuers can supply their financial information to the marketplace in a low cost basis, and it is displayed for free for investors on our website. We have had great interest in companies that are delisting for Sarbanes-Oxley and wanting to keep transparency of information.

Now, we have also had great success

with the SEC has been using information displayed in the Pink Sheets News Service for enforcement actions and it cut short potential fraudulent activities. We have made statements in court cases they have done. So, it is very good to know that even if you are disclosing outside the SEC EDGAR system, there are still consequences if you lie to investors.

But it is not all so bleak. We have heard all day about nobody on earth would become a reporting company, and that is completely wrong. Companies are becoming reporting all the time. And that is because of another dynamic that's happened in the market: the changes in the financing environment. As Mr. Patricof said earlier, small issuer offerings are not being done anymore. The demise of the underwriter for small companies is well known. Part of that is that there are problematic underwriters, otherwise known as boiler rooms, that the NASD has done a very good job of running out of business. The other side is, the profitability of that space of business has been removed and the small underwriter does not sell to the public.

However, the small broker-dealer and others are providing financing for issuers and that is being done via the PIPES market, Private Investments in Public Equity Securities. PIPES are based, though, on secondary market liquidity. The funds buying PIPES are only going to buy a PIPE if they think they can eventually access the secondary market.

Also there is the demise of research. Demand is now being created by IR firms, paid research and promotion. And this is not a bad thing if done well, but also there is the problem that promotion can be done to spread lies, and that is an enforcement issue.

The secondary market liquidity comes from a self-directed investor. There are not brokers pushing these securities to individual investors but instead investors are finding these investments. It is good for companies that need the capital. It is a complete shame if they are buying an investment thinking it offers potential for growth and instead the money is being routed into some fraudster's pocket instead of some company that needs capital and can use it to grow and hire people.

Now, the world has changed with demand and distribution coming from different sources but the base problems are still out there. There is still fraud and deceit by insiders upon outside investors. The games are still the same and the underlying premises of securities laws are still applicable. But we do need to adjust securities laws and interpret them to fit the different players because much of the demand and distribution of securities is coming from unregulated entities outside the system.

Promotion and distribution of securities is occurring via the secondary market without adequate current information being made available to investors and conversely companies are going dark to squeeze out minority investors.

Legitimate issuers are given no guidelines by the Commission on how to disclose information if you are not a reporting issuer.

Historically under 144, issuers would -- 144 has a requirement that there be adequate current information publicly available. Issuers are turning and saying, "My issuer has distributed their annual report to their shareholders, to any broker-dealers who requested it, to the market makers in any statistical services. Under those facts and circumstances is the issuer making the information publicly available?" And the SEC would write back and say yes.

Well, in the early eighties the SEC replied to one of those letters and said, "We are not able to make a determination on this issue and any of our previous communications cannot be relied on." So people are left in this darkness. How do I make my information available? And that was a trend which was saying everybody should become SEC reporting. If you are not SEC reporting, become voluntarily SEC reporting. That was an interesting trend because it didn't cost that much.

Sarbanes-Oxley changed that. It cost a lot to be SEC reporting. There is a value quotient but there is a certain size that value becomes a tax that makes you want to move to a lower tax venue.

Also, with changes in the way financing is done means the disclosure needs to be more marketplace governed by the Exchange Act and it is more relevant than disclosure in an offering document because the truth is that offering document is the stock is going elsewhere after that security is becoming freely traded. Disclosure rules, therefore, need to focus on the needs of small cap investors when companies are publicly traded rather than when the stock is initially issued.

I look at this Committee as an opportunity to fix two problems. One, you have the ability to put forward regulatory clarity for nonreporting issuers so this section of the small company marketplace becomes more transparent and more efficient when issuers are interacting with the secondary market

Two, you have an ability to protect investors when companies go dark with a malicious intent to squeeze out their minority investors.

I am going to go through it at 30,000 feet of various areas I think general principles that should be put toward in securities laws to clean the system up, and we can move forward. A few of the examples are going to come from the AIM Market, which has been I think the most successful small cap market. I would very much ask the committee to take a look at the AIM Market and how it works because more and more companies worldwide, including American companies, are going to the AIM for access to capital.

I have done a very good job of improving the Pink Sheets trading and if you have got a stock and you are disclosing to investors and you are not looking to raise capital, the Pink Sheets is a great system to have your securities traded on. There is lots of market makers. Anybody can buy it through a broker-dealer. They are best execution, there is great compliance in the trading process. This is a good thing but we need to work on the issuer disclosure.

We have two problems because we -- three problems. One, we can't force issuers to disclose all the time. But on the flip side, we can force them to disclose if they are interacting with the market. Two, we have a problem that some issuers can use not disclosing to try and kill the secondary market so they buy people back. That is just as bad as selling someone an overpriced security is stealing something they have. Three, we have a bunch of unregulated entities who are interacting in the market and we don't know what they are doing.

So what I look for is, one, disclosure. Investors need to be protected with disclosure by nonreporting issuers when the issuers or its insiders and affiliates are interacting with the secondary market. That is a principle 10b-5, antifraud. The belief is the uninformed may trade with the uninformed; those that are informed may trade with each other; but the informed may not trade with the uninformed.

After they fall out of the SEC reporting regime there is no guidance for non-SEC reporting disclosure. There needs to be a correspondent to Reg A, which is an offering you can do without being SEC reporting and get free trading stock; 144; and there is the Rule 15c2-11 has information disclosure standards, but it is wrongly written because it should be the issuer, not the broker-dealer.

The AIM model really looks for disclosure of annual and quarterly financials, market activity by insiders, holdings, and they have a broad idea of any interim information that could affect the stock price.

That is the general -- and I lay out in my written statements more of the meat of the details how to get there. I would really love to have all you read it instead of going into detail and pushing it forward.

Another question. The size of the reporting company. Based on the number of record holders in this day of electronic book entry is ludicrous. The committee should look at market cap, public float, round lock beneficial holders, but 300 for beneficial holders is way too low and the committee should really look at for what size of company the tax of Sarbanes-Oxley compliance is worth it. That is being a reporting company, but don't say you don't have to disclose if you check out.

I also believe -- everybody is throwing numbers at you left and right. Really the SEC needs to implement that numbers need to get adjusted over time. There needs to be a process. Markets change and there needs to be every five years or ten years the SEC goes through and decides what are the rational numbers. We have been very lucky that our economy has expanded, the amount of equity on the exchange has expanded. To stick these things up is the same debate we had with the alternative minimum tax. The numbers need to move forward with the prosperity of America.

Another area, which is broker-dealer relationships with issuers. The secondary market and the Pink Sheets and the Bulletin Board has changed to firms that are doing the supermarket approach where they trade every security. They are much more interested in providing best execution for their clients and they do not have a relationship with the issuers. In fact, the NASD has a rule which says broker-dealers cannot be paid by a issuer to make a market, file a 15c2-11 form or other actions or engage in due diligence of that issuer, which is incredible. That is a leftover of the time when a fraud was done by a boiler room that made a market in it, that had a relationship with the issuer.

Today it is different and I think it is a good thing that we have lots of big financial services firms trading these securities. But on the other side is, we don't want to drive away the regulated broker-dealer from providing advice to small issuers because in England, on the AIM, they have the NomAd example. To be on the AIM really all you need is a Nominated Advisor, who is a broker dealer or in some places an accounting firm who vouches for you, and that guy has a business of understanding his clients and he is not going to blow up his business for one client. Of course, there should be protections that a market-maker -- if a NomAd has a question, they cease being a NomAd --

MR. WANDER: Cromwell, since we have

three more witnesses, can you sort of wrap up?

MR. COULSON: Real quick wrap up.

The other one is 15c2-11. Its history is it has been reproposed three times. It is an awful rule. I write about why it is. The short reason, you are asking a broker-dealer to do a pro bono merit review with the idea that if they see something bad they will stop trading it. That is the idea of turning the water off in your house if your pipes leak. It is also bad because it is in the Market Reg part of the SEC. It needs to be in Corporate Finance. It needs to be in Gerry's office.

The other areas, the small ones are finders. I think we need to fit them into the broker-dealer area, which are you are going to hear a lot on. Promotion. Promotion needs disclosure of when it is happening because it is happening outside of the system. And also securities received for promotion need to be made restricted. We also need regulation of broker-dealer transactions. The point to regulate broker-dealer transactions with issuers is not at the market-maker point but at the transactions with insiders and affiliates because that is the point under Know Your Customer, you are going to be able to tell someone is accessing the market and doing something bad.

That is my quick wrap up.

MR. WANDER: Thank you so much. Next we will go to Michael Taglich. Welcome.

MR. TAGLICH: Thank you very much. That was some speech there.

My name is Michael Taglich, President and founder of Taglich Brothers, which is a broker-dealer focused on microcap and small public companies. We invented paid-for research. We are the only NASD member firm I know of that conducts that business. We were ranked number in United States according to Investars for research performance for 2004 and number 2 in the country for the four years ending December 31, 2004 by Investars.com, as well as number one in the United States in research performance for the 24 months ended March 31, most recent quarter.

We are engaged in leveraged buyouts.

We also are engaged in public offerings of small public companies and we assist institutional investors, generally hedge funds, and individual investors in investing in small public companies. I also am the chairman and have been from time to time of different small public companies.

We invented paid-for research as a solution for a market anomaly which is effectively small public companies that under the old model didn't offer the opportunities of a corporate finance transaction in the near term to finance their research report or generate enough in the way of trading volume to get a research report out there; just didn't get research.

We thought it was a very inefficient way to allocate research. When you are a small public issuer, what you really want is everybody in the world to have an understanding of what your future looks like, your risks and rewards, and have a best guess of what the next 18 months looks like. And if everybody in the world had that understanding, they would be able to price your stock appropriately and your securities would be --

you could do more with your stock than just buy it back.

It has been a very effective program. There are people skeptical with regard to conflict of interest. They are involved in that. We think we managed that very, very well. It is an area of the marketplace we think will grow. I've also argued it is much less conflicted than the larger firms in a typical research model.

That being said, one of the main reasons I am here is to bitch and moan about Sarbanes-Oxley which may not come as a shock to you folks. Frankly, I think it is a really silly regulation. 404 expenses provide dubious value, which I have yet to see anybody really put a number on, academic or otherwise. It is terribly frustrating for management teams to be wasting, especially at small companies where assets are limited and capital is difficult to access, to be wasting what would be the cost of one, two, three or four engineers or otherwise a material dividend to shareholders on regulating, effectively, the honest.

I would argue, and anybody in the accounting business or law business will attest to it, if someone is dishonest they can find a way to fool their auditor. You can put all the controls in the planet on them. This is effectively a tax on the good.

If the shareholders had an opportunity to vote on it, or the board, whose fiduciary responsibility to make sure things are correct in the first place anyway had its say, none of these expensive controls would be laid in the way they are. There is really no productive reason to do that.

That being said, it is a terrible handicap which pains me as a patriot because the access to capital is a great strategic advantage for small American companies versus the rest of the world. And the reason why our markets work as well as they do is not because of the SEC or any law body. It is because we generally have a populace that is generally honest and we have got directors of public companies who are generally exercising a fiduciary responsibility and investors that will to take a bet thereof.

I would support and I think it is something the commission should consider, eliminating Sarbanes-Oxley for Bulletin Board companies. Pushing companies to the Pink Sheets -- which there is nothing wrong with per se, and will become a better market -- it doesn't really matter where a stock trades at the end of the day. It is going to trade based on what people's perceptions are of what the future is. You want a better market if you can. The Bulletin Board is a better market than what the Nasdaq was six years ago. If you are looking for a way to cover yourselves, make the Bulletin Board SOX-exempt and anybody who buys a stock there and loses money based on what the existing fraud statutes were, it is a caveat emptor market.

Let the good money find out where they want stocks listed and get yourself out of the business of doing it. Worst case scenario, let the Commission say, "Look, you are a sucker. You bought a Bulletin Board stock," which I don't think will be the case. The Bulletin Board is a very efficient market, getting better every day and shouldn't have the stigma that it has.

You tend to think, from a Commission standpoint, about stocks exchanges as buildings. I don't think the investors care. I don't think you get a premium valuation if you are more SOX compliant than otherwise. I would like to see opportunity for issuers to vote themselves out of SOX and disclose it. If the board decided to recommend to shareholder they voluntarily exempt themselves out of SOX I think it would be a terrific thing.

I think the SEC does a lousy job and can never do a good job of rooting out fraud in the marketplace. I think the marketplace would do a much better job, specifically if restrictions placed on short selling were lifted. Short sellers, for all the supposed abuses -- and by the way, I am not in the short selling business. I do nothing on the short side. I don't believe in it as a great long-term strategy but there is plenty of money out there that plays the short side of stock. They perform a great public service, far more efficient in rooting out fraud and keeping fraud from happening. If there weren't certain regulations in place, many of the excesses that happened, the so called boiler rooms, would have been wiped out by the marketplace without a finger being lifted in Washington.

I think those are all things to consider. I think it is okay to have a CFO sign in blood on the numbers. That is well and good. But these additional regulations don't make anybody richer. They make the country poorer. And since we are all patriots here, we should look for a vibrant market with as many companies as possible being public. And it shouldn't be based on all the regulations the SEC drops but on it but should be what the board and shareholders agree is appropriate regulation. Again, if you lifted regulatory burdens on Bulletin Board companies and let these marketplaces compete side by side, you would find, I believe, that there would be more and more interest and net-net, I think the marketplace would be happier.

We are very close to reaching a tipping

point where the marketplace for small company equity is going to be moved off shore. I'd consider making a major effort creating an off shore marketplace for American public companies. If SOX gets implemented like the timetable says it will be, I think there will be a great move off shore for markets. Lastly, the least you could do if you keep the regulations in place is certainly extend beyond '06 and the size limit should be raised too, say $150 million.

MR. WANDER: Thank you. Did you submit a written statement?

MR. TAGLICH: No.

MR. WANDER: Could you provide us with some of your recent public offerings and some of your research?

MR. TAGLICH: I would be happy to.

MR. WANDER: So that we can circulate it. Just get it to Gerry.

We thank you very much.

Next, Gayle Essary, Chief Executive. I appreciate the opportunity. I am not here to talk about Sarbanes-Oxley. I am waiting for the applause.

I am here really to talk about research. I know that that is something that is significantly interesting to many members of this committee. Appreciate the fact that Mr. Schacht is here and he represents, I guess, the largest contingent of credible professional analysts in the world. I hope it is self evident that the proposals that we have been advocating for standards of transparency and credentialing, conflict resolution, equal distribution and research conduct are the antithesis to our purely business interests. We are surrounded in our industry -- picking up a little bit where Cromwell left off -- by promoters and so called research providers that are producing substantial revenue and profits for their owners and shareholders by shunning ethical practices. Therefore I hope you realize our advocacy rather than being self serving is quite the opposite and predicated on long term opportunities that might exist if there were an ethical playing field and if the public continues to respect the shareholder empowerment platforms that we and others like us produce.

I am also Executive Director of the First Research Consortium, which promulgated a couple years ago the standards for independent research providers and I submitted that as part of our written statements for you all to look at.

We agree that the road to liquidity and capital raising ability for smaller public companies rests on analyst coverage, which after all is simply an informed proxy for individual and institutional investors. However, that coverage must be believable, it must be free of conflict, it must be transparent and it must be professional.

Ten years ago Investrend Research -- seems like only yesterday -- established a model which remains the standard today. Investrend Research does not produce research. Investrend has no clients. We provide no services to a company. A company enrolls in our program on behalf of its shareholders-- and that is understood with the company when that occurs -- and pays Investrend an enrollment fee. Investrend then facilitates assignment of an analyst from a pool of around 70 that are prequalified, most of them have gone through the exacting CFAI programs.

The analysts and the company then work through the research product after which the analyst signs off on the report and submits it to the Investrend research syndicate, which then is obligated to publish it to the largest possible distribution base to ensure equal and full access to all classes of investor. The analyst is paid in advance for his or her initial report by Investrend and not the company, to eliminate any connection between the fees and the analyst. The analyst may not own or trade in the shares of a company under coverage and neither may officers of Investrend nor our company itself.

Investrend has adopted the CFAI analyst guidelines and, more importantly, the standards for independent research providers promulgated by the First Research Consortium. We held public hearings and received public comments over our procedures and each of some 7800 reports all had a statement inviting submissions from the public for any better ideas or better procedures.

In the period between our May 24 comments which we submitted in writing and today's testimony -- you can see how fast this industry is moving -- two new enterprises have emerged with some hoopla. Both have been invited to adopt the standards for independent research providers. One did not respond. We are engaging in discussions with the other. However neither have proposed anything new or superior to the practices now in effect or have been in effect for the past ten years and neither have put forth any proposal that has as its basis anything other than the company pays for the research.

We remain poised and ready to work with any group or entity, including your committee, to develop a different or more creative model to pay for the cost of coverage, including some ideas which we submitted in writing to you. We have not clearly formulated our attitude towards an exchange engaging in a for profit enterprise to provide investment recommendations on its own listees or whether that is a conflict. But the book should not be fully closed until that is evaluated by the community.

If there were going to be a serious effort to provide alternative funding for research coverage for companies listed on a particular exchange, we would have gravitated to all or part of that paid out the listing fees with such an exchange to ensure investors have negative research as well as positive research from those who voluntarily -- which primarily are those who believe that they can meet the test of an independent professional analysis. But it appears that at least one exchange sees this as a revenue generator rather than as an investor service.

However paid for, distribution is key to investor attention. If smaller companies as well as institutional investors cannot have timely and equal access to published research, then the system is flawed. Today, although having our own financial wire distribution channels to reach the disclosure points, the Investrend research syndicate also uses paid press release distributions. However, some press release services do not allow tickerization unless sourced by the company due to what appears to be a rather overriding policy instituted by Yahoo! To keep third party promotions and pump-and-dump campaigns off its site. At least one press release service will not even discuss or disclose its policies, which appears to us to be sort of all over the place.

Sourcing by the company does not suit the standards since it provides a covered company with a veto over a negative report or update. We would work with any group to help Yahoo! and legitimate press release services establish a policy that achieves the distribution standard. Distribution of one class of investor and passing along a headline regarding a recommendation or rating to the public without disclosure and access to the full report is really a form of institutionalized pump-and-dump and should not be tolerated.

A word about our standards. We've long advocated to CFA Institute and National Investor Relations Institute that it is a fatal conflict to allow analysts to hold a stake in their ratings, so far without a great deal of success. New York Attorney General Elliott Spitzer does not see this as a problem, he recently told me in a private conversation, because many institutions ban their analysts from holding stock in the companies they cover, to which I responded, "Doesn't that make the case why it should be banned altogether?" He then had some other thing he needed to attend to.

The standards for independent research providers prohibit this practice but to completely engender confidence in the analyst profession this needs to be addressed on an industry-wide basis.

Finally, we need to discuss the proliferation of questionable research profiles, reports, analysts comments that confuse investors in the marketplace. At one of the CFAI-NIRI events one of the co chairs of the committee that worked out the program talked about the faxes received. We are a part of Junkfax.org and these are faxes we received over the past four or five months submitted to us by the public and that we exposed over 125 companies that have either used these or some unnamed third party has used these to apparently sell out of their stock.

Even some otherwise legitimate research providers take stock for their coverages, making substantive amounts if their coverages results in price appreciation. They fail to provide any information about analyst credentials, take advantage of the SEC loophole that seems not to require the real person payers behind promotions to be absolutely identified under regulation 17(b), take advantage of 17(b) loopholes that let companies issue reports without any disclosure as to payments, use spam emails and junk faxes.

Stock should not be used to pay for promotions, directly or indirectly, since that is essentially using shareholder resources in a way that is at odds with shareholder interest. However, stock pooled in a central repository or sold prior to the institution of coverage should actually be explored as an alternative means by which shareholders might pay for a service for which shareholder value is the objective.

Again, I thank you for the opportunity

and that completes my comments.

MR. WANDER: Thank you very much. Could you also supply us with some examples of the research product? Your letters have been very interesting and I have read them, but it would be useful to see those.

MR. ESSARY: I would be glad to do that.

MR. WANDER: Next, David Feldman.

MR. FELDMAN: Thank you very much, Mr. Chairman and good morning, ladies and gentlemen. Our law firm represents issuers, investment banks, investors and deal makers, primarily in combination financing transaction, including reverse mergers and PIPE transactions. Among other things, we have the unique distinction of having completed more PIPES representing investors than any other law firmin both 2003 and 2004.

We also represent a number of publicly held entities that have periodic and other reporting obligations and I am honored to be here today to express our views on the direction and agenda of the Advisory Committee to our experiences in the private bar.

In general I believe the committee is setting the right tone and seeks to focus on the main areas that are ripe for attention. My hope is simply to ensure the committee looks especially closely at the smallest public companies, those under one hundred million in market cap or less than a hundred million in revenues and not adopt too broad a definition of smaller public company so as to dilute the interest of those most in need of assistance, namely the smallest of the small.

Some argue these smallest companies probably should not be public in the first place since they wouldn't qualify for a traditional IPO. I strongly disagree. I believe other measures of going public are legitimate and acceptable methods of obtaining a public market for an issuers's securities. In fact, to some extent contrary to Mr. Patricof's comments, we are seeing the increase in popularity of what I have been calling the new small cap IPO, which is a reverse merger together with a contemporaneous PIPE transaction. I think even greater confidence in the reverse merger market is coming soon with pending rule-making activity through Mr. Laporte's office.

In the end, any company of any size seeking to grow by acquisition using publicly traded stock as currency, reward executives with valuable stock options, seek greater and easier access to capital or simply provide liquidity to founders and investors can benefit from being publicly held as part of a long term strategy. Congress, the Commission and the Committee will, I hope, will seek ways to ameliorate the more draconian burdens on these smallest companies, to improve opportunities for growth through publicly traded stock rather than simply write them off as not needing protection from those who believe they were premature in going public in any event.

Many of the foci of the committee, including reviewing the challenges, internal controls, corporate governance and so on, are strongly applicable to these smallest companies as well and I am not here also to talk about Sarbanes, but the burden on a $50 million company that is growing and profitable of developing and testing internal controls is much more significant in terms of its relative impact on and cost to the organization than the burden on a $200 million company in the same situation.

In addition, some of the challenges faced by all smaller public companies in the area of capital formation apply also to the smallest. Thus, while the topics chosen are generally of significance or importance to all public companies, I am hopeful the committee will seek to distinguish even within the smaller group to analyze the effect on the smallest.

I believe you are hearing from many commentators as to the potential changes in Sarbanes. I would focus on five areas I would respectfully propose you include in your focus beyond or within what you proposed in your agenda.

First, form 8-K reporting. In many cases it is difficult for a smaller or smallest public company to bear the cost of constantly monitoring its compliance with the new four day 8-K reporting requirements. I believe the Committee should review whether they should be provided the opportunity for additional time or the right to extend time in certain situations, comparable to current Rule 12b-25 so as to avoid inadvertent noncompliance or particularly burdensome costs such as overnight, speedy or EDGAR filing services .

Second, Regulation S-B. With due respect to the authors and their intentions I do not believe there are valuable or significant differences between Reg S-B or Reg S-K other than the one additional year of reporting under S-K, which is really only a burden in the year a company goes public. I believe the Committee should review the possibility of a major overhaul of Reg S-B with a view to more clearly streamlining disclosure problems for smaller companies. And I believe you should focus more on materiality of disclosure much as we do with Reg D offerings to non-accredited investors, and less on rote disclosure of categories of information that may have no absolutely no significance to a particular company.

Third, short form registration. I believe the committee should look at streamlining the concept of "seasoned issuer" for eligibility for short form registration. A strong company that has been public a year or two and just happens not to have significant market capitalization but which which has been following all applicable rules and making all necessary disclosures should be able to avail itself of short form registration to improve its ability to raise capital and grow.

Fourth, the Pink Sheets. As Cromwell mentioned, in my view there remains significant fraud on the Pink Sheets, though lots of great opportunity. I would propose, in order to improve confidence of investors that you seek some rule changes in this area. These rule changes could in my view begin the process of requiring minimal public filings by these issuers. For example, I think most Pink Sheet traders don't provide the 15c2-11 information to their market makers. One change could be to require the issuers to file that information either with the SEC or with the Pink Sheets controlled website so any investor can obtain the information and so that compliance can be better monitored by the Pink Sheets or

Commission staff.

In addition, I suggest requiring the reporting of insider trading and stock accumulation by making Section 16(a) and Section 13(d) applicable to Pink Sheet traded companies even if not registered under the Securities and Exchange Act.

Fifth and last, Capital formation. A key area is treatment of brokers and finders as discussed. I am hopeful the Committee can assist in providing stronger guidance to practitioners and issuers as to treatment of these critical intermediaries especially for smaller companies. For example, staff guidance has not always been consistent from the SEC with regard to the definition of a finder. I also believe that broadening exemptions from registration will significantly aid in the growth of these smaller companies.

For example, Regulation D should be broadened to permit larger numbers of nonaccredited investors so long as disclosure and non-general solicitation requirements are met which would protect these investors.

I also believe the Committee should examine the effective prohibition on conducting private offerings while public offering registration is pending. Technically private offerings may continue through financial institutions, but as a practical matter this does little to help a small company seeking to bridge its operations through a public offering. These private offerings should be permitted so long as the investors are accredited and general solicitation is avoided other than through the filing of public offering registration statements.

In conclusion, I believe the proposed agenda does represent a very positive step in analyzing the dizzying array of burdens, requirements and brick walls which are making it more and more difficult for the smallest public companies to see benefit in remaining public or going public in the first place for that matter, despite the benefits to be gained by these companies in many cases. If the goal of the committee is to make going public more attractive, I think the proposed agenda represents an excellent place to start and I thank you very much for your time.

MR. WANDER: Thank you, David.

Now our last witness, John O'Shea.

MR. O'SHEA: I would first like to express my appreciation for being invited here to testify in front of the Securities and Exchange Commission Advisory Committee on Small Public Companies. I speak from a dual perspective: First, as President of the New York Stock Exchange, an NASD member firm that has small business issuers, SBIs, as clients. Secondly, as an individual who acted as officer and director of and invested personally in many SBI's.

I have been working with SBIs over 20 years now and witnessed numerous changes in regulations aimed at smaller issuers that have successfully improved market transparency. By contrast, the Sarbanes-Oxley Act, SOX, has placed a broad based burden on public companies issuers of all sizes. While there are many positive aspects to the act, the audit review standards are particularly onerous. In the case of larger companies, I believe the burden can be absorbed with minimal impact, with the benefit realized by a majority of investors. In the case of smaller public companies, I believe the cost, both financial and by use of management resources, has a disproportionately large effect and these expenses are not commensurate with the benefit received by the smaller number of investors.

In response to this I note two negative trends. First, many issuers are choosing to terminate their registration or go dark. Second, an increased number of issuers are choosing to go public in markets outside of the United States. Both of these fall under the law of unintended consequences, having an effect the exact opposite of what SOX attempts to accomplish. Rather than increasing disclosure and providing stronger controls, many issuers are terminating previously available disclosures or, by going public elsewhere, not providing them at all. Approximately 200 companies petitioned to delist their stock in each of '03 and '04. This compares to just 67 companies in '02 prior to the implementation of SOX. This has resulted in an estimated loss of 4 percent of smaller companies from the public arena per year. Short of taking costly legal action against the issuer and further burdening our courts, investors in such companies have little recourse. The securities are either moved to the Pink Sheets or stop trading all together, often reducing share prices to fractions of prior value and leaving investors in the dark regarding the company's operations.

The second trend is the growth of competing, non-U.S. marketplaces catering to small cap companies, particularly the Alternative Investment Market, the AIM, in London. In 2004 the number of international companies listed on AIM was 116, nearly double the 60 from '03. By contrast, over approximately the same period, the number of issuers across the Nasdaq, Small Cap index and OTC BB has remained even. Among the listed companies AIM incudes 17 U.S. companies and 28 Canadian companies. Some abandoned their U.S. trading status in order to join the AIM, and some never pursue trading at all. Coming to its tenth anniversary this Sunday has been praised in international press for its continued growth beyond expectations with limited scandals. Our own investment banking clients, including Chinese, European and even U.S. issuers have requested that we consider the AIM as an option for them, an alternative to U.S. markets. Additionally, our customers who invest in small cap stocks are expressing an interest in purchasing securities in non-U.S. markets.

Further emphasizing this attraction is the fact that newer markets are being formed that are emulating the AIM rather than Nasdaq. In the past two months alone two markets were launched, the Irish Enterprise Exchange and European Alternate Market. Each focused on small cap companies. As these alternatives become increasingly available and credible, issuers both U.S. and international will have less incentive to face the complexities and cost of comparable U.S. markets.

In light of these two trends I offer the following specific recommendations which are further detailed in my written statement:

Definition of smaller public company. I find the $700 million threshold discussed in other comments to be appropriate with respect determining whether accelerated filings should be required. An alternative would be a market capitalization of 500 million, the average of the companies on the Amex and also the competing AIM. Companies falling short of these thresholds already face difficulty meeting their current deadlines as auditors routinely push them to the back of their queue as they service larger, higher profile and higher paying clients.

I further recommend the definition of SBI to be expanded to include companies with market capitalization beneath 100 million and standards be customized for them. SBI's are the companies with the greatest potential for growth, that create the most jobs and fuel our economy. These often grow into larger cap companies or become acquired by larger cap companies, thereby fueling additional growth. If we do not nurture our SBI during their incubation we will continue to lose that innovation to markets outside our borders.

Disclosure requirements. I believe the current periodic reporting requirements for SBIs are appropriate and beneficial to the marketplace. In addition to giving SBIs more time than accelerated filers to file their reports, thus giving them greater attention from their auditors, I would suggest the SEC work with the PCAOB to encourage non-December 31st year end fiscal years.

I do believe the four day 8-K reporting period can be burdensome for most SBIs particularly in two situations. For major corporate events vents such as mergers and acquisition Form 8-K should have a complete description of the transaction and related financial statements. Due to limited resources of SBIs, the four day limit may cause an incomplete filing which provides uncertain information to the marketplace and then needs to be amended. Additional time would help that ensure all pertinent information is released simultaneously.

The second situation would be for sales of unregistered securities. In private placements or PIPES securities are often sold at discount to market. Upon announcement of a closing of a PIPE frequently the stock price has a negative reaction. If multiple closings are held many announcements within four days while the offering is still open may hamper ongoing selling efforts in the event market price declines in response to the announcement. This could cause the result of not raising the additional funds that the company may have needed to continue growth. I would propose instead that an 8-K not be filed until after the offering has been completed or terminated.

Modification of Rule 15c2-11. Our firm has filed numerous applications on behalf of issuers since inception of Rule 15c2-11. I agree with the idea that more information needs to be placed in the hands of the investors, not in our filing cabinets. The Pink Sheets implementation of a form in which companies can post information has been a very important step. I would suggest that the SEC or NASD support them in creating rule changes requiring companies to post this information and/or creating a separate public depository.

Regarding approval process of 15c2-11, I recommend that a revised list of standards and requirements be published. As the current application items do not encompass the qualitative standards that examiners review in the course of most applications. I further support the position, subject to disclosure, broker-dealers be allowed compensation in connection with assisting companies to become traded. As scrutiny of companies attempting to become quoted has increased, the number of firms filing these applications has declined. Allowing compensation for broker-dealers would create incentive for firms to reenter this space and devote resources to support them. Perhaps then, like the AIM, which has a paid Nominated Advisor service, the OTC can break free from its current stagnation and begin to grow.

I thank you again for the opportunity to express these views.

MR. WANDER: Thank you very much, John.

We have probably 15 or 20 minutes, so the floor is open for questions from members of the advisory committee.

MR. DENNIS: One question.

Very interested in Michael's comments about the investors and your thoughts about their willingness to not comply with SOX if given a choice of a vote. I guess I want to clarify that.

What you were saying is that, I assume, a company that is listed on Nasdaq, faced with that stockholder vote, would elect to go to Bulletin Board and not comply with SOX, or would you propose that they remain listed on Nasdaq? Does the Bulletin Board become the AIM of the U.S.?

Then I would like also John's comments around those same kind of thoughts as to how he sees that concept working on his clients.

MR. TAGLICH: The Sarbanes-Oxley before it was Sarbanes-Oxley. The board always had the opportunity to make their internal controls as strong as they would like to. Audit committee of a public company always had the power, if they wanted to, to hire all the controllers they wanted.

Historically they hadn't chosen to lay on all these additional costs, beyond where they are right now.

Then Sarbanes-Oxley comes along. I believe the individual investors would much prefer the marginal dollars that are dropped in Sarbanes-Oxley to otherwise be spent in the business or paid out as dividends. And if we made the Bulletin Board our AIM so to speak, where it was back to the pre-SOX regulations, pre-SOX costs, I think you would see a flowering. It would be much easier -- first, it would be -- we'd have a direct comparison. You would see some companies move from the Nasdaq to Bulletin Board.

Ultimately what makes a market work well is the demand and the supply of stock and the ability of people to trade, and the Bulletin Board is a very efficient market at this point. I would argue sometimes it is at least as good a market as say the American Stock Exchange, for example. I think you'd see a drive toward that lower cost. The marketplace would vote with its feet to a significant extent, and then it would be caveat emptor.

MR. O'SHEA: I would express my answer from the standpoint of dealing with institutional investors as opposed to retail investors because that is we do. The institutional investor has been able to make an intelligent decision prior to SOX and after SOX and they are simply following the money. The issuers are finding the burdens of going public so onerous they go elsewhere and so the institutional investors are following them.

MR. WANDER: Rusty?

MR. CLOUTIER: Thank you all for your testimony. I thought it was very, very good. A lot of great, great comments this morning.

Michael, we have known each other fifteen years. I will do just that for public disclosure. I always appreciate your honesty. I know you have been down there -- I will use a word, on Wall Street, the belly of the beast, so you kind of know what is going on day to day.

My question is, I have heard a couple of comments about following the money. I heard it from Seidman, that auditors follow the money. Obviously, on Enron and WorldCom -- I made these comments yesterday -- you can follow the money.

My question is, on research, have things changed much since Sarbanes-Oxley? Supposedly there are still the Chinese walls in the investment firms, but I think really if you do business with somebody, if they take you public, if you do some investment banking, the Chinese walls most probably aren't any stronger than they were before.

I guess my fear is that with the large investment companies, we still have the fear of another WorldCom or Enron out there. As a friend of mine says, the big gets the gain and we get the pain. It is the smaller getting all the pain.

My question to you, Mike, you have always been honest and blunt, you got your ear to the ground on Wall Street. Have things really changed that much since Sarbanes-Oxley was implemented, particularly on the large companies, the Enrons, and the large investment banking firms, or just changed in our part of the world?

MR. TAGLICH: There has been a change. WorldCom and Enron were frauds. That had nothing to do with analyst or research reports. Every market cycle there will be some frauds. There is X amount of dishonest people and every once in a while somebody gets away with it.

Getting to research, paid for research and such, I don't think that there really was a problem with the way if was beforehand. When a firm did an investment banking underwriting and fifteen minutes after they did the deal, a few weeks after they came out with a buy recommendation on the stock, I think the marketplace at the time took that into account.

I think there is in general an underestimation of how efficient the marketplace is. Research is only credible based on whether it is right or not at the end of the day. Markets put out of business people that aren't credible. If you get a fax -- you showed a sheaf of faxes before. Some over the counter heaters or whatever. If you get something on your fax machine that tells you to guy some moonglow stock or whatever, it can't have any credibility, it can't have much effect in the marketplace. The marketplace will --

the marketplace shut the Reg. S business down long before the SEC did anything about it.

I think at the end of the day research's credibility, the firms have a proclivity to be right. At the end of the day, if there is one thing you want people to understand is how right is analyst X. Our analysts don't get paid in stock, we don't take stock as a payment, our analysts can't own the stock, although I think all three of those are dumb policies. I think it is a terrific when an analyst owns a stock. I don't allow it because everybody else doesn't. At the end of the day it doesn't really matter. It is is the analyst right or not that is important. The bucket shops and the brokerage firms that have egg on their face, they have egg on their face because they were wrong. If people understand where the market is going around and everything is disclosed and they can make their bets and take their chances. They are all grown up people.

MR. SCHACHT: Another question for the two research guys. I think one of the issues we wanted to explore with you two is, is there a solution to this reduced and reducing coverage of small issuers that is sort of going on in the marketplace? Is there a private market solution to that through the sort of services you provide and others are coming to market, or is there something this committee should consider from a regulatory standpoint to try to address the reduced coverage?

MR. TAGLICH: I think we offer a private market solution that is cheap and a viable issuer can afford at this point. I do think that the ability to pay for research out of investment banking revenues as opposed to effectively disguising that fact, if you will, would be a recognition of a potential reality. Specifically, if you do investment banking for an issuer, you should be able to throw in research coverage. You should have to disclose that you did investment deal X and earned a fee off it, but issuers still expect when you do an investment banking deal for them for you to provide some sort of research coverage.

At the end of the day if the money is disclosed and people know who it is coming from, the buyers are going to decide whether the research is good or not based on whether the analyst has got any credibility and where the story is. A lot of people that complained about the conflicts in research coverage, I thought it was fairly amusing because none of those people ever paid for that research. There were people at discount firms complaining about Merrill Lynch's research. I don't see why Merrill Lynch owed them any fiduciary responsibility.

MR. ESSARY: Within the industry we have divergences of views. One of the things we look to is that we don't let our analysts, for example, be price predictors. One of the reasons for that is that if you were to judge -- again, I go back to Mr. Spitzer because he once suggested that analysts should be paid according to how accurate they are. If that was the case Mr. Grubman should have been the highest paid analyst on the Street.

We look at it really from the standpoint of the analyst deciding what the fair value of a company is, dividing that by the number of shares they expect to be outstanding twelve months hence, and if that is more than what the company is currently trading for, so be it. If it is less, so be it. If it is three times as much or half as much, it is insignificant. Whether or not the market ever trades to that is really not our business. Our business is simply to give them the valuation.

As far as how to expand that, that is really difficult. We have done our best to try to create -- actually, it is a six tier but it winds up being a 17 tier price point opportunity because our belief is that even though we covered NYSE companies and we have covered penny stocks -- I mean less than a penny stock -- we believe that every company should be covered. One of the problems is shareholder education. If shareholders went to their companies and said, look, you can be covered. You can pay $5,000, you can pay $50,000 if you are a larger company, and you can have coverage and you can have something that we can rely on that is an objective, professional opinion and a benchmark -- some benchmarks are set and then a company has to arrive at those benchmarks or not. Those are the kind of things that could happen.

And also, investment bankers could, instead of doing it internally, they could allocate monies to the various independent research houses that would allow there to be a broadening of coverage. Also, I think there are some new rules that prevent in house analysts from going on road trips, and so forth. There is nothing wrong as far as we can see -- we don't do it but we are thinking about it -- having independent analysts be able to be available to be able to go on road trips and give their true opinion. Something that they've already issued to the public, of course, but expound on that when necessary.

There are other opportunities to create some funds where actually public stock could be perhaps even attributed to that so that the cost is zero to the company. Why not do that? As long as it is not held and used as price appreciation but is sold in advance of coverage, why not do that and allow those companies that are standards-based to participate in some sort of a round robin type of coverages? Because it is, after all, in our view, it is the shareholders that we report to, not the company. So, those are perhaps some solutions. We have suggested some of those in the papers and are willing to help work on some others.

MR. WANDER: Mark?

MR. JENSEN: Hopefully I am going to keep this really short because I am hoping I can get two questions in. I have one for David on PIPES.

Specifically the practice of short sellers, the arbitrage situation, what I like to refer to as death spiral preferreds.

What do you feel about that practice? You must see it a lot. Is there something that could or should be done about it?

MR. FELDMAN: I think the good news it has pretty much gone by the wayside. The death spiral deals are a thing of the past for the most part. The SEC is looking into, I think, practices from two or three years ago. But for the most part now, the deals are fixed price, they're not adjusted when the stocks price adjusts. They may adjust for future financings. So we are pretty lucky in that the PIPEs we're seeing now,we're actually seeing PIPE investors become investors, not arbitrageurs as much, which is one of the reasons we are seeing a greater trend being done along with reverse mergers because there is not as much immediate liquidity in a reverse merger. Yet the PIPE investors are saying, "That's okay. We're willing to do due diligence, be careful, meet with management and not just ask the one single question, which they used to, which is, "how much does your stock trade?"

Now it has changed. It really has and we are happy about it. We told our clients, if you short the stock going into the deal, you are going to jail. We think it is important to make sure every one does their business on the up and up and I am glad to say in the last few years -- hopefully John will agree -- that trend has pretty much gone away.

MR. JENSEN: I would hope so too. If not, it should be something that's addressed somewhere.

This is a question for the entire panel, whoever wants to comment on it. A number of you mentioned a lot of small business issuers are moving off shore. I guess the question I would like to get some clarity on, do you see that as a factor of Sarbanes requirements, and specifically 404, or the entire regulatory requirements and overlay of the entire regulatory system causing that? I am just curious whether it is one thing or all of it?

MR. COULSON: Since I was visiting the AIM two weeks ago, they were quite gleeful about Sarbanes-Oxley in general. That is their biggest selling point now. Actually, as you look at businesses, the fourth leg of Pink Sheets quotations is ADRs of large foreign companies like Nestle, Heineken and could easily be companies on the AIM. One of the big reasons -- there is two big reasons they have been successful. They are very much geared towards the capital raising process and they look at issuers, new issuers coming in as getting them access to capital.

Two, I believe the Nominated Advisor, of having these issuers who are raising capital have a disclosed relationship with a broker-dealer is a good thing and it has been highly successful. That is something which we don't have in the U.S, is almost illegal on the market making side in the Bulletin Board /Pink Sheets space.

MR. WANDER: Drew?

MR. CONNOLLY: Thank you, Mr. Chairman. Once again as full disclosure, I have had a 25 year relationship with Mr. O'Shea, I've worked for him twice, we are better friends than I am an employee. I have had a long and continuing business relationship with Mr. Essary.

The concern I have is that this committee absolutely has heard this testimony. We have an awareness that these issues are being responded to by significant professionals. The Pink Sheets, for example, Mr. Coulson and I have had multiple conversations and I have to take my hat off. I was a stockbroker when those Pink Sheets were pink sheets and they were stapled together and in order to get a trade done you literally had to make three phone calls to get three different quotes and prices. Had I been approached to be a member of his LLC and be privileged to be an investor side by side in Pink Sheets LLC, any day. If in fact he follows the lead of New York Stock Exchange and Nasdaq and chooses to go public, I certainly want to know about it. His performance in creating a truly transparent marketplace, his continuing testimony both to Congress, the Small Business Foundatoin Forum annually, his support and help to the CEO

Council and his continuing awareness of his both privilege to be in the space and his public duty therefore to clean up the space.

I think we are both very much committed to removing the term fraud from the phrase penny stock fraud. For that I am truly grateful. I hope we pursue this marketplace and its potentials in the capital formation process.

I was unaware until this morning that there is an Irish Enterprise Exchange. With a last name like Connolly, god am I glad that is happening. Maybe I need to do a tax deductible trip to check it out.

Mr. Taglich, the only thing I am concerned about, and I certainly am aware of your research, sir, and I consider it first rate. I follow a lot of it and I am moved by it.

My big concern is the comments you made about short selling. The recent removal of an up-tick rule is deeply concerning to me because I have been on the other side as both an investor and capital formation specialist for public companies who are up against sometimes unlimited, often off shore and virtually opaque investors who have more money than they do patriotic support of some of these issuers. By virtue of their outsized economic impact they have the ability both to legally and illegally short these issues into the ground.

I don't think it is free and unfettered and I'd be more concerned about that, I think, than we may be.

MR. TAGLICH: I appreciate that and I can see how short sellers could be seen to be abusive. Again, I have no revenue on the short side. But most of the companies I have seen complaining about short sales are of speculative value -- short sellers of speculative value and the short sellers may very well be right. In my opinion they do an inordinate amount of homework versus longs, and in my opinion they are the far more efficient as far as policing the markets than the regulatory agencies, and no offense to the regulatory agencies.

One thing I would stress to the Commission, the endeavor, especially with small companies, is something you guys really need to work on. We need to have the lowest cost of capital for small companies in the world. If it is not done here it will be done offshore. The cost of capital, net net the return that one has to offer an investor to raise money is terribly important, and if American companies have a cheaper cost of capital than their competitors and better access to the public marketplace, you have created a lot of wealth for society.

Part of that cost of capital is the fact that the numbers that investors are buying are the numbers that the investors are buying. Specifically, enforcing five or ten years ago's fraud statutes and also minimizing regulatory costs. The cheaper you make it to go public and stay public, the more public companies there are going to be. And public companies today have a much lower cost of capital than private companies. You can look at the multiples of small companies that are public versus private. There is a much higher valuation thereof and therefore there is a lower cost of capital.

MR. CONNOLLY: Thank you, Mr. Taglich. To finalize my comments, Gayle Essary, as you know, I have been persuaded, albeit reluctantly, that the methodology of valuation actually is a superior one to a price prediction. But I would like to salute you and make folks aware that First Research Consortium and the principals, in my judgment, differentiate Investrend's research in the marketplace and hopefully the investor community will look at that.

Finally I want to say in terms of AIM and the offshore venue, the venture capital trust propounded over in the England and the AIM marketplace are often tax driven in some regards. There are substantial tax incentives for British companies to be listed and for long term investment in those companies and I know that is not our mandate. We are very clear to act within the realm of what we can do. But in terms of small company capital formation the tax policies of this country perhaps would have an impact as well. Thank you.

MR. WANDER: Any other questions before we adjourn?

If not, I want to thank everyone for spending time with us, for your excellent presentations and the thought that went into them and your preparation time. We will stand adjourned. However, those who are still here from the Advisory Committee, if we could just talk for a few minutes I would appreciate it.

Thank you all very much.

***** These minutes reflect the last 25 minutes of the public meeting of the SEC Advisory Committee on Smaller Public Companies held at Columbia Law School in New York City on June 17, 2005.**

This portion of the meeting began at approximately 12:45 p.m. after a temporary adjournment of approximately 15 minutes.

Mr. Wander presided at this session.

Mr. Jensen stated that the Committee needed to elevate Section 404 to the top of its agenda because delay and indecision will cost small business significant amounts of money. He urged the Advisory Committee to be bold in its thinking and recommendations. He also suggested that the Committee hear from accountants experienced in working with smaller companies as witnesses at the next hearings of the full Committee in Chicago in August. He stated that such witnesses could authoritatively discuss where the burdens in Accounting Standard No. 2 can be reduced and applying the COSO framework to smaller companies.

Mr. Wander said that Mr. Royster, before leaving for the day, had told him he wanted to hear from more reporting company witnesses in Chicago.

Mr. Coolidge suggested that the Committee consider reducing the length of time between meetings and wrapping up its work sooner rather than later.

Mr. Brounstein said that people are really interested in entity level controls, rather than application level controls, and that the Committee should urge regulators to focus on this level. He said the Committee should try to find ways to prevent companies from going dark and moving their trading abroad. He also said the Committee should look into what it takes to move to a risk-oriented approach to regulation.

Mr. Connolly suggested that the Committee needs to be assertive and should consider recommending changes to SEC Rule 15c2-11 to provide more transparency. He also suggested that the Committee consider inviting Chairman-Designate Christopher Cox to to meet with the Committee as soon as appropriate.

Mr. Dennis suggested carving out the smallest of the small and reporting out some recommendations applicable to this group for adoption at the Committee's August meeting.

Mr. Wander directed the SEC staff to circulate these minutes right away and get the reaction of the Committee members.

Mr. Connolly asked whether it was possible to put one item on the agenda and have it implemented. Mr. Wander stated that Chairman Donaldson had encouraged the Committee Co-Chairs to consider adopting interim recommendations.

Mr. Brounstein suggested that the Committee consider recommending that regulators work on refining materiality standards. He said that there is something inherently wrong when you can get a clean audit opinion with a material deficiency in internal control over financial reporting.

Mr. Cloutier encouraged the Committee to consider recommending that the SEC staff to meet with banking regulators from the OCC and FDIC in an attempt to decrease duplicative regulatory burdens. Mr. Brounstein asked whether there are other areas of overlapping regulation.

Final adjournment occurred at approximately 1:10 p.m.

CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the SEC Advisory Committee on Smaller Public Companies.

Herbert S. Wander
Committee Co-Chair

September 12, 2005
Date

Exhibit A: List of Members of the Public Who Provided Written Statements and Presentations

Jun. 17, 2005	Professor William J. Carney; see also slide presentation
Jun. 17, 2005	Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, Inc.
Jun. 16, 2005	Murray S. Cohen, CEO, Epolin
Jun. 16, 2005	John P. O'Shea, President, Westminster Securities Corp.
Jun. 16, 2005	David L. Cox, Chairman, President and CEO, Emclaire Financial Corp., Farmers National Bank

	LLP
Jun. 14, 2005	Gayle Essary, Managing Director, Investrend Research and CEO, Investrend Communications, Inc.
Jun. 13, 2005	Andrea Psoras, Principal, Strategic Advisory; Member, New York Society of Security Analysts
Jun. 12, 2005	Samuel J. Yake, Paoli, Pennsylvania
Jun. 10, 2005	R. Cromwell Coulson, Chief Executive Officer, Pink Sheets
Jun. 08, 2005	William (Bill) A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank on behalf of the Independent Community Bankers of America
Jun. 08, 2005	Stephen J. Nelson, The Nelson Law Firm LLC
Jun. 08, 2005	Philip V. Oppenheimer, Oppenheimer & Close, Inc.
Jun. 08, 2005	Steve Nagel, President, Kolorfusion International, Inc.
Jun. 08, 2005	Karl Kirwan
Jun. 08, 2005	Victoria Duff, CEO, Bold Ventures Group
Jun. 07, 2005	Michael Ramos, CPA
Jun. 07, 2005	Karl R. Barnickol, Barbara Blackford, Linda K. Wackwitz, Subcommittee on Smaller Public Companies, Securities Law Committee, Society of Corporate Secretaries & Governance Professionals
Jun. 06, 2005	Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial Executives International and Member of the SEC Advisory Committee on Smaller Public Companies
Jun. 06, 2005	Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial Executives International
Jun. 01, 2005	Deloitte & Touche LLP
May 31, 2005	Karen Kerrigan, President & CEO, Small Business & Entrepreneurship Council, Washington, District of Columbia
May 31, 2005	Robert J. Kueppers, Chair, Center for Public Company Audit Firms
May 31, 2005	Ernst & Young LLP
May 31, 2005	Charles W. Barkley, Attorney at Law, Charlotte, North Carolina
May 31, 2005	Ronald J. Simpson, Chief Financial Officer, Minefinders Corporation Ltd.
May 31, 2005	Debra Fiakas, CFA, Managing Director, Crystal Equity Research, New York, New York
May 31, 2005	Stephen M. Brock, CEO & President, Public Company Management Corporation, www.PublicCompanyManagement.com , www.PubcoWhitePapers.com
May 31, 2005	Joel Jameson, President, Silicon Economics, Inc., Cupertino, California
May 31, 2005	BDO Seidman, LLP
May 31, 2005	KPMG LLP
May 30, 2005	Michael T. Williams, Esq., Williams Law Group, P.A., Tampa, FL
May 30, 2005	David N. Feldman, Managing Partner, Feldman Weinstein LLP
May 26, 2005	Peter Chepucavage

May 26, 2005	Steven J. Sharp
May 26, 2005	Phillips W. Smith, Ph.D., Paradise Valley, Arizona
May 24, 2005	Kathryn Burns, Vice President and Director of Finance, Monroe Bank
May 24, 2005	John B. Williamson, III, Chairman, President and CEO of RGC Resources, Inc.: RGCO; Director and Audit Committee Chairman of Optical Cable Corporation: OCCF; Director and Audit Committee Chairman of Botetourt Bankshares Inc.: BORT.OB
May 24, 2005	Gayle Essary, Managing Director, Investrend Research (http://www.investrendresearch.com), CEO, Investrend Communications, Inc. (http://www.investrend.com)
May 24, 2005	Brad Smith, President, WBS&A, Ltd.
May 23, 2005	Scott Shaw
May 17, 2005	James A. Brodie, Managing Director, Carr Securities
May 11, 2005	Frederick D. Lipman, Blank Rome LLP, Philadelphia, Pennsylvania