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23rd ANNUAL SEC GOVERNMENT-BUSINESS FORUM

ON SMALL BUSINESS CAPITAL FORMATION

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SEC HEADQUARTERS
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21 Gerald J. Laporte
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23 John D. Reynolds

24

1 P-R-O-C-E-E-D-I-N-G-S

2 MR. LAPORTE: If everybody could take their seat,
3 that would be great. I'd like to call to order the 23rd
4 Annual Government-Business Forum on Small Business Capital
5 Formation, which we're holding this morning in accordance with
6 Section 503 of the Omnibus Small Business Capital Formation
7 Act of 1980.

8 First of all, I'd like to thank all the members of
9 the -- all the people who helped to make this possible,
10 especially the members of the planning committee and the
11 people in the Office of Small Business Policy here at the
12 SEC. All of them are listed in the binders that you got if
13 you are a registered participant when you entered the room.

14 Before I introduce Commissioner Campos, I'd like to
15 give the standard disclaimer, so that we don't have to repeat
16 it throughout the day, which is that anything of substance
17 that anyone from the SEC says here today represents his or
18 her individual views only and doesn't necessarily represent
19 the views of anyone else at the Commission or of the
20 Commission itself.

21 To open the forum, I'd like to call upon SEC
22 Commissioner Roel Campos. Commissioner Campos joined the SEC
23 in August, 2002, less than a month after passage of the
24 Sarbanes-Oxley Act, so he doesn't know what it was like to be
25 here B-SOX, which in this building stands for before

1 Sarbanes-Oxley rather than the Boston Red Sox.

2 Before joining the Commission, Commissioner Campos
3 co-founded El Dorado Communications, a radio broadcast
4 company, so he has firsthand experience at what it's like to
5 run a start-up company. He also had a distinguished career
6 as an Air Force pilot, a federal prosecutor and a lawyer in
7 private practice.

8 Since he's been here at the Commission,
9 Commissioner Campos has been a friend of small business and
10 entrepreneurship, and we're very glad to have him here today
11 to officially open the forum. Commissioner Campos?

12 (Applause)

13 COMMISSIONER CAMPOS: Thank you, Gerry. It's great
14 that you refer to me as a pilot, but you know, that was my
15 dream when I went to the Air Force Academy, and my eyesight
16 took a nose dive my last year, so I had to be a ground
17 as they put it in the Air Force parlance. I only went through
18 the first part of my Air Force training for a pilot.

19 But it's a pleasure to welcome all of you today to
20 the 23rd Annual -- how about that, the 23rd Annual -- SEC
21 Government-Business Forum on Small Business Capital
22 Formation.

23 We've been conducting these meetings every year
24 since Congress passed the Omnibus Small Business Capital
25 Formation Act of 1980. That's a mouthful. But this year has

1 special significance as it's the first time -- I'm not sure
2 why, but it's the first time this event has been held at our
3 SEC headquarters.

4 So accordingly, I'm proud to welcome you,
5 representatives of small business, to our home, the building
6 and the very room where we pass all of these exciting rules
7 that -- including the implementation of Sarbanes-Oxley -- that
8 the newspaper writers and many of you who are interested in,
9 come to see.

10 Gerry mentioned that I joined the Commission --
11 that's really that I took my oath a month or so after
12 Sarbanes-Oxley was passed. In fact, four of the
13 Commissioners were confirmed at the same time with
14 Sarbanes-Oxley being passed on the floor of the Senate.

15 So I always tell people I feel like I'm the son or
16 maybe the brother of Sarbanes-Oxley, in that all of us, at
17 least that's the way I view it, came in together at the same
18 time. And Gerry's quite right. I don't know a time when we
19 didn't have the business of Sarbanes-Oxley to implement, and
20 the rules, and dealing with all of the monumental issues of
21 trying to balance the goals of Sarbanes-Oxley with the
22 business community and making sure that the community at
23 large can prosper, you know, in spite of the necessity to
24 improve investor confidence in light of the scandals that
25 occurred.

1 Gerry also mentioned that I founded with partners
2 what amounted to a small business. And our particular
3 business had to do with raising capital, venture capital and
4 purchasing assets. In the case of my particular business, it
5 was radio assets. And I used to tell people it was a little
6 bit like having a mortgage that was due every three years.

7 And essentially, every three years or so, and you
8 have to start thinking about it quite a bit in advance of
9 your due dates, it was either time to refinance and pay back
10 your investors and hope -- and not hopefully -- it required a
11 return on their investment, or it was time to sell. And
12 support profits and do that sort of thing.

13 It's a very difficult environment when you're in
14 the start-up or early stage company, and I've lived it. I
15 know what it's like to go to venture capitalists or angels,
16 or others, and make a presentation. And unfortunately, most
17 small businesses to get capital have to present a plan that
18 creates a very high rate of return for that capital, or else
19 no one is willing to take a risk at such an early stage.

20 So I personally have been very interested and it
21 remains a passion of mine to figure out how government can
22 facilitate this. We can't get into the business of capital
23 raising. Obviously, we're -- you know, we're just government
24 after all, and we're just regulators.

25 But I'm very keen on learning how we can facilitate

1 the access to capital by smaller businesses, and how we can
2 essentially make appropriate accommodations in our
3 regulations when required. All of us -- that's the whole
4 Commission, the agency, believe that small business capital
5 markets are integral to the health of the economy in general.

6 I believe I've read recent studies that show that
7 60 to 70 percent, it depends on exactly the study, of new
8 jobs created in America every year come from the small
9 business sector. A significant percentage of the growth
10 comes from the small business sector.

11 One of my privileges as an SEC Commissioner has
12 been that my colleagues have allowed me to represent
13 them with the International Organization of Securities
14 Commissions, which is the international group where
15 securities regulators meet and gather and talk about
16 international issues.

17 And one of the things that I've noticed that's most
18 evident that makes the U.S. economy different from the
19 economies of other countries around the world is our small
20 business sector and our venture capital. Frankly, I was in
21 Europe last week -- the European model is essentially still a
22 large company oriented partnership with government to create
23 the objectives of growth.

24 And I maintain that this is a very difficult thing
25 to do. We've seen the risks of central planning. We've seen

1 the risks of large companies that end up being essentially,
2 in many cases, very stuck to a government situation. And
3 again, I asked my colleagues in Europe, you know, what about
4 your risk capital. What about venture capital?

5 And it's an interesting observation that one of
6 them made. In fact, this was Commissioner Bolkestein who
7 is -- has been -- the Commissioner for Internal Markets for
8 the EU. And he said, "Well you know, that's a very good
9 point. You know, we never seem to have the entrepreneur
10 activity that you have in the U.S. There's something cultural
11 in Europe about that. You see, in Europe, if you attempt to
12 start a business and you fail, that's a taint on your life
13 for the rest of your life, and you can never get away from
14 that.

15 "In America, you know, you seem not to worry so much
16 about it, somebody trying to raise capital and then failing
17 the first time and maybe coming back the second or third time
18 and then being successful."

19 And I said, "Well, that is true. We certainly have
20 a great number of success stories of people being successful
21 only after they've had initial failures or just weren't
22 successful on their first or second times."

23 So maybe that's a blessing that we have. And that
24 unpredictable, unregulated energy that produces growth in the
25 small business sector, that creates new businesses and new

1 vitality is something that's part of the genius of America
2 and our economy.

3 And today, we are open to listening to those of
4 you, especially from the private sector, who have ideas and
5 who understand the struggles that you have day to day, and
6 understand where regulators like ourselves can do better.
7 We have tried, and I'll just quickly refer to my note here
8 for a second.

9 We have tried to make significant accommodations to
10 small business, but like anything else, this is a work
11 in progress and I'm sure we can improve. And we're very open
12 to your ideas and your input in this area.

other

13 In Regulation S-B for small businesses -- and in
14 small business initiatives -- we at the agency have created
15 significant accommodations for small business. Small
16 business issuers can file two years' worth of financial
17 statements, rather than the three years' required for non-S-B
18 issuers.

19 Well, we have created additional modifications for
20 issuers that are unable to obtain two years' worth of
21 financial statements. They can use shortened registration
22 forms for securities offerings, while the Exchange Act reports
23 have reduced narrative requirements.

24 In the context of exempt offerings, small business
25 issuers have several means by which they can raise capital or

1 compensate employees with securities without triggering
2 registration.

3 I believe that most would agree that these
4 initiatives have significantly reduced the hurdles facing
5 small business as they try to access the capital markets.
6 The world today presents additional challenges for small
7 business. In the wake of the significant upheaval of
8 securities markets caused by the corporate scandals of 2001,
9 and the sweeping reforms of Sarbanes-Oxley, the complexities
10 of our rules and regulations have increased significantly.

11 The question is: How is this affecting small
12 business? Are there new disclosure reforms and auditing
13 standards that are too burdensome for small business? Is the
14 cost of reporting becoming too costly for small business
15 issuers? Are there special issues that new regulations pose
16 for small business issuers that can be addressed without
17 compromising investor protection?

18 Your input today, again, is so crucial. And I hope
19 that you will not hold back and that you will hit us with
20 your ideas and your thoughts. We have a very busy schedule
21 today. I don't want to take too much time.

22 I will mention one positive thing that I saw
23 recently. In a recent survey, the U.S. was second only to New
24 Zealand in the ease of regulation for starting a new
25 business. And that's actually quite amazing, considering the

1 size of our economy, the complexity and so on of our economy.
2 And that is something that I take great pride in.

3 Now it doesn't mean that we're there, but it does
4 at least give us a perspective. Europe, Asia and others --
5 there is much more paperwork to be done all around to start a
6 business. So again, let me personally tell you how welcome
7 you are, and I'm very pleased. On behalf of the Commission,
8 there's two of my colleagues here today, Commissioner
9 Goldschmid, Commissioner Glassman and others will be
10 attending the sessions today during the different panels.

11 And again, let us have it. Thank you very much.
12 (Applause)

13

MR. LAPORTE: Thanks, Commissioner Campos. I'd like
14 to take a couple minutes to talk about housekeeping matters
15 before we get into the roundtable discussions. We have two
16 roundtable discussions today. The first one is on auditing
17 matters and the second one is corporate disclosure, corporate
18 governance and market regulation matters -- lot of things in
19 the second roundtable.

20 The participants for these roundtables were chosen
21 with the assistance of the members of the Planning Committee
22 for the forum as directed by Congress. Most members of the
23 Planning Committee represent professional and business
24 organizations concerned with small business capital
25 formation.

1 We solicited suggestions for topics to discuss from
2 the general public, and we got a wide range of suggestions.
3 We thank everyone who sent in suggested topics. We weren't
4 all able to accommodate all suggestions. In some instances,
5 we decided not to talk about a specific topic because we've
6 covered that topic extensively in recent years at the forum.

7 This, for instance, was the case of th topic of
8 general solicitation under Regulation D, which a lot of
9 people want to talk about, but we spent a lot of time on in
10 recent years.

11 But just because we haven't scheduled a specific
12 topic for discussion doesn't mean that we don't think it's
13 important for small business capital formation. It just
14 means that we want to have some very focused discussions
15 today.

16 It also, by the way, doesn't mean that it won't get
17 discussed. All these people on the roundtable -- none of
18 these people on the roundtable are wallflower types, and they
19 can talk about anything they want to talk about. So if they
20 want to talk about something that's not on the list of topics
21 that we've raised, they can do so.

22 The roundtable format doesn't provide for direct
23 audience participation, but we'll have a question and answer
24 session after lunch where we will try to answer as many
25 questions from the audience as we can. If you wish to submit

1 a question, there's a box out in the lobby there, with a
2 slot on top.

3 You can write your question down on a piece of
4 paper and drop it in the question box. There's also supposed
5 to be some question cards, both at the question box and, I
6 think, some at the end of the aisles. If you have any
7 questions, if you're looking for a question card, you can
8 ask any of the SEC people with a blue name tag, and they'll
9 try to get you a question card. But you don't really need a
10 question card. You can just write it on a slip of paper and
11 drop it in the box.

12 In addition, after the question and answer period
13 starting -- we're scheduled to start at 2:00, but we might
14 change that around depending on how things go this morning,
15 we have the breakout sessions at which all registered
16 participants for the forum are entitled to submit
17 recommendations for consideration by the final general
18 session at 4:45 this afternoon.

19 Before I turn the program over to Alan Beller and
20 Andy Bailey for the first roundtable, I'd like to remind the
21 panelists that this program is being broadcast to an overflow
22 audience in another room on this floor as well as being
23 webcast. We hope that all speakers will use the
24 microphones so that everybody who's listening can hear.

25 At Alan Beller's request, I'm also suggesting that

1 the panelists use the European system for being recognized,
2 which means that if you want to be recognized to speak, you
3 take your tent card and you turn it on end and you put it on
4 the desk in front of you and you'll be recognized.

5 Finally, I'd like to note that Herb Wander has been
6 added as a member of this first roundtable. He's also
7 scheduled to be on the second roundtable. Herb is an expert
8 on some auditing issues. We had a lot of difficulty getting
9 lawyers who wanted to sit up here and talk about auditing
10 issues, and Herb decided to do it. So we said if you want to
11 do it, Herb, you're welcome to do so.

12 Alan and Andy, why don't you take over?

13 MR. BELLER: Gerry, thanks very much. On behalf
14 of Andy Bailey who's sitting here on my left, for those of
15 you who can't see, Andy is the Deputy Chief Accountant with
16 particular responsibility for auditing here at the
17 Commission. I'm the Director of the Division of Corporation
18 Finance.

19 In light of the time, Gerry, unless you disagree, I
20 don't think we want to shortchange the roundtable, so I would
21 suggest we're going to go the full 90 minutes and take some
22 time out of the breaks and do whatever else. But let's
23 assume that this panel -- it's now 9:40. Let's assume this
24 panel will run till something like 11:10.

25 I want to introduce the participants briefly going

1 from my left around. Commissioner Campos and Commissioner
2 Glassman. Next is Herb Wander, whom Gerry already mentioned
3 from Katten Muchin in Chicago. On Herb's left is Bruce Webb
4 from McGladdrey and Pullen in Des Moines, Iowa. Is it a
5 machine (Laughter)? Next to --

6 MR. WEBB: I'm not a machine.

7 MR. BELLER: -- him is Lawrence Moreau, who is a
8 board member of IntermixMedia, Inc. in Los Angeles,
9 California. Next to -- can't read my own handwriting. I'm
10 sorry. Next to Lawrence is Mark Jensen who is a partner and
11 National Director for Venture Capital Services for Deloitte
12 in San Jose, California.

13 Next to Mark is Lynnette Fallon, who is the Senior
14 Vice President and General Counsel of Axcelis Technologies in
15 Beverly, Massachusetts. Next to Lynnette is Doug Carmichael,
16 who is the Chief Auditor and the Director of Professional
17 Standards at the PCAOB here in Washington.

18 Next to Doug is George Batavick, who is a member of
19 the board of the FASB in Norwalk, Connecticut. And finally,
20 William Balhoff, who is the director of Postlethwaite &
21 Netterville in Baton Rouge, Louisiana. And on Mr. Balhoff's
22 left is Commissioner Goldschmid.

23 Why don't I start off with a question? I guess
24 it's certainly a question that's received a fair amount of
25 attention. How do the -- let me start with somebody who's

1 inside a corporation and thinks about addressing these. So
2 let me start with Ms. Fallon.

3 How do the costs of compliance with Sarbanes-Oxley
4 Section 404, which is the section regarding assessment and
5 attestation of internal control over financial reporting --
6 how do the costs of compliance with that section and with --
7 by your auditors with PCAOB Standard Number 2 compare with
8 the benefits for smaller companies? How would you assess
9 that?

10 MS. FALLON: Well first of all, I think both sides
11 of the equation are unknown at this point. My company like
12 many companies is still discussing with our auditors what
13 404 is going to cost us, and as you can imagine, the numbers
14 keep increasing rather than decreasing.

15 I think, you know, there are internal costs and
16 external costs as the auditor's fees. But there's also the
17 pressure and stress that we're putting on our financial teams
18 within the companies.

19 Our company has hired two new comptrollers and we
20 are currently seeking to hire an internal -- someone who
21 can specialize in internal audit, who can sort of support the
22 404 function, and haven't been able to find anyone in the
23 work force.

24 It's a very difficult time both in terms of
25 staffing internally and in terms of trying to predict what

1 your costs are going to be before we're done. I think on the
2 benefits side -- I think, you know, again are yet to be seen.
3 There are some operational efficiencies that companies will
4 receive as a result of doing all the internal control work.

5 But I think one of the significant aspects of 404
6 that Congress gave us is the concept that auditors need to
7 assess internal control. In other words, it would have been
8 one thing if 404 was just the first half, that management
9 needed to assess and attest as to internal control.

10 But having the auditors play that role means that
11 the internal control work that needs to be done to satisfy
12 404 is very focused on documentation. In other words, it's
13 not -- there's a lot of internal, informal controls that go
14 on within a company, but our auditors need to assume that the
15 control simply doesn't exist if the documentation doesn't
16 exist.

17 So there's a huge amount of documentation work that
18 companies are dealing with in order to create the paper trail
19 that the control exists, that really may not be bringing any
20 operational efficiencies to the company at the end of the
21 day, assuming that there were informal and documented
22 controls in place.

23 MR. BELLER : Mr. Moreau, do you have any --

24 MR. MOREAU: Yes, I do. I think there's a couple
25 things here. There's, first of all, the cost that everybody

1 talks about. That's the financial cost, the dollars and
2 cents.

3 But if you're a small company and one that's
4 growing, there's another huge cost and that is management time
5 and focus. You can quantify, although it's very, very
6 difficult at this point, how much dollars and cents are
7 going up. But in my experience, frankly, I spent a lot of
8 time in venture capital and investment banking by -- for
9 quite a few years.

10 My experience is that not only do the costs of the
11 internal control on the financial end, that being that you
12 have to hire more people, have to put in more regulations,
13 but also management. And by the way, I don't disagree with
14 some of this, because some these managements needed to
15 take a good, hard look at what was happening in their
16 organizations and become aware of their regulatory and, more
17 importantly, fiduciary duties to their stockholders.

18 But it is huge. Before I came here, I called up,
19 oh, maybe a dozen of my friends in D.C. in investment banking,
20 just kicked it around with them, and no one said they
21 thought the benefits were worth the costs, for whatever that's
22 worth.

23 So I think there's two important things that need
24 to be addressed here, and the benefits seem to be, at least to
25 me and some of the people I talked to, kind of hard to get

1 their hands around. The costs are there and they're growing.
2 I think I saw a study that the cost went up better than 30
3 percent -- estimates from January to June of last year --
4 this year, I mean.

5 And we all know budgets -- you never come in under
6 budgets. So I think they're going to be horrendous, both in
7 dollars and in management and company focus time.

8 MR. BELLER: Anyone (inaudible) --

9 COMMISSIONER GLASSMAN: I have a question about the
10 benefits. Is what's happening that there -- that controls
11 exist -- effective controls exist, but they're informal. And
12 so what the requirements are doing is making sure they're
13 documented so that there's some institutional history of
14 these controls? Or -- which means relatively fewer benefits
15 than if the controls really don't exist and they're being
16 created as well as documented.

17 Which of those two do you think is happening?

18 MS. FALLON: I think both are happening. I mean,
19 it obviously depends on the company. There are companies
20 with certainly things -- even big companies with situations
21 where an internal control should exist and simply doesn't
22 exist.

23 And therefore, as part of 404, that control would
24 be brought into being. But there are -- though it's probably
25 the minority situations in most -- most companies that are

1 reasonably well run that have gone through the public
2 offering process, that have a couple of years, at least, of
3 audited financial statements are going to have some controls
4 over probably material items that can materially impact their
5 financial statements.

6 One of the issues with 404 is that there doesn't
7 seem to be, and maybe someone can correct me if I'm wrong,
8 but there doesn't seem to really be a materiality
9 judgment going on about whether a particular control is
10 likely to have a material impact as opposed to a number of
11 small problems that could come together and become a
12 reportable event and, ultimately, a weakness.

13 So there are a lot of details. There really are.
14 There's a lot of time spent on a lot of details.

15 MR. MOREAU: Uh huh.

16 MR. BELLER: Mr. Moreau?

17 MR. MOREAU: Sure, should I do this?

18 MR. BELLER: Yes, that's fine.

19 MR. MOREAU: Okay. Also, let me say, getting the
20 formalities -- when you work with small companies, it's
21 mainly the management. I think I couldn't agree with more --
22 and it's coming up in the next round, that the internal
23 control was the governance, the independence, the having
24 somebody look over management's shoulders and overlook the
25 directors.

1 I think that's been the huge -- and I know for a
2 fact improvement in internal controls, especially vis-a-vis
3 outsiders. Now, when you get to a situation though, that
4 you're looking for a process, maybe -- I'd say form
5 over substance in a lot of cases -- that's where we run into
6 real problems, like I said, both financially and also
7 management time.

8 And I'm not sure what the benefits of writing it
9 down are. For instance, my personal opinion is that a lot of
10 the problems that we've had with these companies is that the
12 persons at the top were crooks. I'll guarantee, they knew
13 what was going on. Fastow knew what was going on; Sullivan knew
14 what was going on. They had good internal controls, and they
15 were crooks.

16 And internal control, when I was in auditing, never
17 can control the top management. It's the board's
18 responsibility to hold their feet to the fire, and it's
19 management's responsibility signing off on these reports.
20 That, I think -- I know three cases that all of a sudden,
21 when the CEO had to sign and realized what he was signing
22 criminal (sic) -- all of a sudden internal control and proof
23 (inaudible).

24 MR. BELLER: Okay. We've got a number of cards up.
25 I think I'm going to go with Mr. Balhoff, then Mr. Carmichael,

1 and then Mr. Webb.

2 MR. BALHOFF: Okay. I'll be quick. From a cost
3 benefit perspective, we practice in Louisiana, and we have
4 some clients that actually used to file with the SEC that
5 delisted because of -- and from their perspective, their
6 reasons were the cost of Sarbanes-Oxley, primarily the 404
7 reporting.

8 So from their perspective, they felt like it wasn't
9 an actively traded stock. They had over 500 shareholders.
10 They just had to buy down to 300. So these companies
11 themselves, just in our practice, we saw that affect. And we
12 --

13 MR. BELLER: Just out of curiosity, how many?

14 MR. BALHOFF: Two. But we don't -- I mean, we
15 don't do that many public companies, either. And secondly,
16 there are a number of clients of ours that were planning on
17 going public, and they have put those plans on the back
18 burner, definitely to address and see what some of the impact
19 has been of Sarbanes-Oxley, and primarily their concerns are
20 404, also.

21 Not necessarily that having the controls and
22 implementing the controls are inappropriate, because they
23 certainly are not. It is absolutely appropriate. But the
24 actual documentation, the testing and the paying people to
25 come in.

1 And just one more quick point, because I think
2 Lynnette made the comment about getting the staff. I think
3 that we're finding a tightening market for staff right now,
4 and it's for a lot of different reasons. But everybody talks
5 about this being an employment act for accountants.

6 But the national firms are taking up staff. The
7 clients need staff. As local firms, we need staff. It is
8 across the board, creating maybe not a crisis, but a
9 significant issue.

10 MR. BELLER: Okay, thanks very much. Mr.
11 Carmichael?

12 MR. CARMICHAEL: I just wanted to point out some of
13 the benefits -- when you look at the costs and benefits, the
14 costs, of course, are immediate and out of pocket. The
15 benefits are more intangible.

16 Before I started at the PCAOB, I did a study of the
17 bank. It had experienced an \$8 million defalcation. This
18 bank had an average net income of \$10 million. So it was a
19 big hit.

20 Their insurance company wouldn't renew their
21 fidelity insurance without an independent study of their
22 controls, saying that they were good. The study we did of
23 the bank disclosed a remarkable lack of ownership of controls
24 in the departments doing operating and marketing.

25 They thought their job was to do those things, and

1 they didn't think they had any responsibility at all for
2 controls. So one of the benefits that can come is from the
3 operating people understanding their ownership of the
4 controls in their area.

5 I think that ties in to the documentation as well.
6 Unless those controls are documented, those people aren't
7 going to realize their responsibilities, and they have a very
8 good chance that they are going to see their main
9 responsibilities as operating ones and not ones that require
10 controls.

11 Also, I'd just point out that in the way of the --
12 a lot of the major frauds that occurred, they were done
13 through journal entries. Management can always override the
14 controls to get those unsupported journal entries made, but
15 it is much more difficult to impose on an employee who has
16 the direct responsibility for making the entries that charge
17 to do it, if there are good documented controls saying that
18 they should not do it.

19 Another intangible benefit, of course, is the
20 ability to market securities and the effect that the
21 knowledge of good controls may have on that market.

22 MR. BELLER: Mr. Webb?

23 MR. WEBB: Our firm audits a number of smaller
24 issuers. As a matter of fact, of our slightly over a hundred
25 issuer clients, we only have I think, 13 to 15 that are

1 accelerated filers. So they do tend to be smaller. We also
2 are consulting with a number of issuers in -- audited by
3 other auditors in implementing management's assessment of --
4 under 404.

5 I think what we're finding in both cases is that as
6 clients are going through this assessment process, they are
7 finding gaps, as Commissioner Glassman sort of suggested
8 they might, and then are able to remediate those controls.
9 So that definitely is a benefit of this.

10 On the other hand, the cost is very high, and I
11 think it's proportionately higher for small issuers, both
12 internally and externally. I think the smaller companies
13 have less ability to complete the management assessment
14 process internally, and therefore are having to outsource
15 many of those services as well as seeing their audit fees
16 perhaps as much as double, because of the audit of internal
17 control.

18 And you do have to ask yourself whether the
19 benefits to investors are as great when you're dealing with
20 small cap or mid cap, lightly traded entities versus the
21 larger highly traded companies.

22 MR. BELLER: Mr. Jensen?

23 MR. JENSEN: I was just going to try and give you a
24 perspective from the venture capital community side, based on
25 our conversations with them and how they see it. I would say

1 right now they don't see a cost benefit relationship in
2 companies that they are behind or that they're investing in.
3 And part of that is that, to some extent, venture capitalists
4 don't like to be told what to do, so they're being
5 told what do to here, so that's a bit of a problem in and of
6 itself.

7 But if you put it aside for a minute, I think that
8 in the early stage company, the early stage venture backed
9 company, whose long term plan may be to approach the capital
10 markets in one way or another, either through an IPO
11 or being acquired, these rules really have to be
12 applied in those companies long before they approach
13 the capital markets.

14 Because they -- it's the way that internal
15 control structures work; they have to be in place and they
16 have to be operating effectively in order for an auditor to
17 attest to them.

18 So what's happened through 404 as we've backed up
19 into private companies, a lot of public company requirements.
20 I think further, just to broaden this out a little bit --
21 most of -- I'm not an attorney, and so the attorneys on the
22 panel can talk about this. But my view is, very quickly,
23 Sarbanes is becoming the standard of due care in corporate
24 governance today, whether you're public or private.

25 And we're seeing D&O insurance providers who

1 increasingly want to see the kinds of things that -- you
2 know, 404 kinds of attestation reports. They want to see
3 that in their companies that they insure today. We're seeing
4 lenders who are starting to want that. And then we're
5 starting to see -- you know, every state has standards of due
6 care or of due diligence of board members.

7 And as Sarbanes continues to evolve, it quickly is
8 going to become the standard of due care. And so I think we
9 have to be cautious what our standards in small companies
10 are, because I think it can become very difficult for small
11 companies to comply with all these rules.

12 And if it truly becomes standard of due care in
13 these companies, it's going to increase the cost for
14 everybody. I guess my final comment on it is, I do believe
15 there's benefits to these kind -- to 404 kinds of attestation
16 -- in larger companies.

17 When you move into smaller companies, what really
18 happens in the internal control environment, and especially
19 in very small companies, but companies that are even of
20 modest size, the CEO/CFO play an incredibly important role in
21 the internal control structure in those companies, are
22 involved in every major transaction. They authorize every
23 major revenue contract.

24 They are basically involved in every major decision
25 that is going on in the company, either formally or

1 informally. From an auditor's perspective, that's a very
2 good internal control in the sense that the CEO is involved
3 in it.

4 From the other side of the coin, it's not a control
5 you can rely on. So at the end of the day, you still have to
6 go back and pull all of that documentation, pull all the
7 information and satisfy yourself that the correct decision
8 was made.

9 So in some cases, we've put a lot of structure in
10 place, but it's not really operating the way we think it is.

11 MR. BELLER: I want to --

12 MR. WANDER:: Can I make a comment?

13 MR. BELLER: Of course.

14 MR. WANDER:: I just -- our experience has been that
15 the fees to the outside auditor are going to be 80 to
16 100 percent of the fees for the regular audit. And
17 that's for both large and small companies. The larger you
18 get, they maybe a little bit less, but they're very sizeable.

19 And that doesn't include the fees to the outside
20 consultants whom many people are bringing in, because you
21 can't rely on your regular auditor to establish these
22 practices and procedures. And that's also not including the
23 staff time that's devoted to this, which is, you can imagine,
24 enormous.

25 I do want to emphasize what a couple of other

1 people have said. That is, I think there is a growing crisis
2 for qualified people in this area. I think you have a drain
3 by all the big accounting firms hiring people here. The
4 PCAOB is hiring people; that is taking away from firms. And
5 there aren't that many qualified people.

6 And particularly if you're in a smaller community,
7 where it's more difficult to attract somebody with an MBA or
8 some other degree like that, it's going to be very hard to
9 get them.

10 In terms of the benefits, I think it's too early to
11 tell right now. I don't think we know what's going to happen
12 at the end of this year, how many companies will not receive
13 a favorable opinion, what that means in the marketplace,
14 what it really means to the control environment. And I think
15 it's going to take some time before everyone has an idea of
16 whether the cost is really worth all the benefits that people
17 perceive.

18 MR. BELLER: Okay. We've got a number of questions
19 to cover. Mr. Batavick, I want to come back to you. But I'd
20 like to throw another question on the table here, at
21 least one more on this general subject, which is sort of in
22 the area of: What, if anything, should we and others be doing?

23 The SEC, the Commission, in its adopting release
24 and the Commission staff in its set of frequently asked
25 questions about this subject of internal control, both

1 identified an acceptable framework for evaluating
2 internal control as that developed by the committee of
3 sponsoring organizations, or COSO, back in the early 90s.
4 And also left open the possibility and, indeed, in the
5 staff questions, provided a little encouragement to COSO
6 or others to think about whether there is a more suitable
7 evaluative framework for smaller companies, since that's
8 really where the internal control exercise begins.

9 In addition to the other subjects we've been
10 talking about in this area, does anyone want to take a
11 shot at whether that's a sensible approach? Whether there's
12 another sensible approach at addressing what kind of a
13 framework there should be?

14 Mr. Jensen in his recent -- in his remarks a couple
15 of minutes ago -- suggested that the structure of smaller
16 companies, with CEOs and CFOs playing a large role, and
17 almost everything, is kind of a little bit different
18 structure than, or a very different structure than, larger
19 companies. Any thoughts on that subject?

20 MR. JENSEN: Let me -- if I could just start it.
21 I'll kick it off. If you look at the COSO framework, the
22 comments on it when it was originally issued, there were a
23 number of comments made to the committee at that time that
24 they didn't feel that it was properly tuned to smaller and
25 mid-sized companies.

1 As an accommodation to that comment, there was
2 basically about three paragraphs put at the end of each
3 section of the framework that talked about how it applied to
4 small and mid-sized companies. And if you read those
5 sections carefully, it basically says small and mid-sized
6 companies' controls are entirely different than what's above
7 here.

8 They felt that that was good enough and left it at
9 that. The PCAOB, when they first issued their auditing
10 standard, they too had a separate section on small
11 businesses. Ultimately, that was not in the final rules, and
12 they had indicated or put a small section in their report
13 that said that they thought the COSO framework covered
14 small businesses by these two or three paragraphs that I
15 think were really probably put into the original framework as
16 an afterthought, trying to accommodate a comment there.

17 A number of comments were made about how it may not
18 be applicable to small businesses or mid-sized companies. I
19 think the internal control structure of those companies is
20 radically different, and the kinds of things you rely on are
21 radically different.

22 And I think there probably needs to be more work
23 done in that area. Now, whether it's within the COSO
24 framework or not, I'll leave that for other people. But I
25 think that, certainly, there's not enough in it right now to

1 help small business and mid-sized companies understand what
2 they need to do, and to help auditors understand.

3 MR. WEBB: I think I agree with Mark, that it
4 would be a worthwhile endeavor to revisit COSO and see if it
5 could be more tailored to smaller companies, and provide both
6 issuers and auditors better guidance in making the
7 assessment.

8 However, I would also observe that the components
9 of internal control described in COSO, as a control
10 environment, risk assessment, monitoring control activities,
11 information and communication, I do think apply across the
12 board. The financial statement assertions are the same
13 whether you're large or small. And the activities involved in
14 the various processes, that is authorization, initiation,
15 reporting of processing and reporting -- they're the same.

16 So the way in which those things are actually
17 implemented in small companies versus large companies are
18 drastically different. And if COSO could sort of get focused
19 on the internal control for small companies, then I think
20 that would be helpful. But I think it would be a very
21 challenging assignment.

22 I think it would be -- I would be surprised if they
23 came back with a drastically different model.

24 MR. BAILEY: This is Andy Bailey. I'm going to
25 object. I was on the oversight task force, and I'll tell

1 you, we did take it seriously. What I'm wondering is, is
2 this a problem with the concepts in the framework, or is this
3 really a problem that has to do more with describing case
4 situations where you might adapt the framework?

5 In other words, it's not in the framework so much
6 as it is a series of case descriptions that deal with the
7 specialized circumstances. Now, the problem we have when we
8 start thinking about that is that there are an infinite
9 number of these, and I'm a little bit concerned about how to
10 approach that.

11 Anybody have any idea how COSO might approach this?

12 MR. JENSEN : I would agree with you. I think that
13 having some case examples would be helpful. I agree with
14 Bruce's comments. I don't think we need a new framework, but
15 I think how it applies in small and mid-sized companies is not
16 entirely clear.

17 I think it is going to be problematic for auditors
18 when they -- when you start looking at internal controls in
19 small companies that tend to be less formal. If you look at
20 what the COSO rules, or what COSO says about small and mid-
21 sized companies, a lot of these controls wouldn't need to be
22 documented.

23 They basically say that they exist informally
24 because of CEOs involved in many of -- you know -- in all
25 important transactions and things like that. So they

1 actually -- if you took it literally, exactly the way it's
2 written -- I'm not sure an auditor could audit it. And I'm
3 sure they're not.

4 I'm sure they're telling people that doesn't fly.
5 You've got to put this down. So I think we need -- I think
6 it does need to be adjusted to -- and I think case examples
7 would be an excellent way to do it.

8 MR. BAILEY: Mr. Carmichael?

9 MR. CARMICHAEL: I should say I'm here speaking for
10 myself, not for the PCAOB or its staff members or the board
11 members. But the board did remove the discussion of small
12 business that was there, because it seemed to be causing some
13 confusion. There were issues about whether we were
14 attempting to change COSO, and some people thought we were
15 being more restrictive.

16 Some people thought we were being less restrictive.
17 So it seemed better just to rely on what was in COSO. But I
18 think that the board did agree with the SEC, that it would be
19 a good idea for a body to develop something more specific for
20 small businesses.

21 In fact, in the process of preparing the standard
22 in our discussions with the FEI, we did recommend to the FEI
23 that they consider taking that under consideration. In the
24 standard itself, we wanted to provide a standard that was not
25 one size fits all, and that provided the flexibility in doing

1 the work to allow for differences.

2 The thought was that a smaller business would be
3 less complex, and if it was less complex, that the controls
4 would be simpler, and therefore, the auditing would be easier
5 and the cost would be lower. And we tried to write the
6 standard in a way that would permit that flexibility to be
7 exercised.

8 MR. BELLER: I think we should move on to the next
9 question, but I want to come back to Mr. Batavick whom I
10 didn't give the floor to a few minutes ago, to see if --

11 MR. BATAVICK: What I wanted to do is just mention
12 a perspective from a standard setter, and we heard a lot of
13 comments this morning relative to the cost of implementation
14 of 404, et cetera. And although as a standard setter, we
15 don't really have hands on, not in companies we're not
16 auditing.

17 And the actual experience that I can tell you over
18 the last year or so, based on all of our meetings -- I think
19 you're all familiar probably, with our due process, which
20 means that we are open to a lot of groups coming in and
21 speaking with us. Certainly, when we're looking at putting
22 out new standards or interpretations, we also have exposure
23 drafts to go out and get comments.

24 And I can say over the last year, just about every
25 meeting we have, just about every time we put out something

1 for exposure, the comments that we get back are not only
2 comments on our specific standard, but they're also comments
3 about 404, saying the work is very difficult, our staff is
4 thin, et cetera.

5 So what we're seeing as a standard setter is
6 really a request to slow down in order to give people more
7 time to address the 404. So that's the -- just wanted to
8 give you the perspective from a standard setter, is that the
9 request that we kind of defer some of our work, we kind of
10 slow down some of our work to give companies more time to
11 implement 404.

12 MR. BELLER: Thank you very much. Shall we turn to
13 limits on non-audit services? And I'm going to turn this
14 over to Andy Bailey.

15 MR. BAILEY: Yes, there has been a great deal of
16 discussion, I think in the industry in general, but
17 specifically with respect to small businesses. In terms of
18 the independent --

19 MALE VOICE: Can't hear you.

20 MR. BAILEY: Can't hear me?

21 MALE VOICE: Is your mike on?

22 MR. BAILEY: I believe it's on. I wasn't talking
23 into it. I apologize. Been a good deal of discussion about
24 the independence rules, and the difficulties with complying
25 with the independence rules for everyone, including large

1 organizations, but small organizations in particular.

2 The question is, should further accommodation to
3 the Sarbanes-Oxley prohibitions on auditing firms providing
4 non-audit services to audit clients be made for smaller
5 companies. Now, just to set that up a little bit, issues
6 often arise with respect to secondments from the public
7 accounting firm to say, a smaller firm to perform certain
8 limited functions, bookkeeping services, systems development
9 that relates to financial statements, for example,
10 internal audit outsourcing issues, hiring audit staff,
11 et cetera. Are you encountering these problems in the
12 small businesses? And do you think that there should be
13 further accommodations?

14 MR. BAILEY: William Balhoff?

15 MR. BALHOFF: For the most part, my experience has
16 not been that those have been very onerous, the independence
17 issues. The concerns I have are if a signal gets sent, that
18 from small businesses, that the non-audit services that are
19 permitted are tainted in a sense, because you don't want to
20 use your auditor. It's going to affect their independence or
21 objectivity. That's a concern.

22 I have a concern to the extent that we not have
23 more services. I think it's appropriate, what we have
24 right now, but that we not try to bring more things under
25 the umbrella of what's not acceptable.

1 So I'm not seeing for our clients, or for the CPA
2 firms that I've discussed it with, a lot of issues about
3 independence and the pre-approval and the services that are
4 prohibited right now. I don't think it's difficult for the
5 issuers to find people to perform those services,
6 particularly as it relates to bookkeeping and other things,
7 the implementation of systems and design.

8 But I think if we start setting up a wall and
9 essentially making it look like, or giving the impression
10 that this -- not all services that are permitted right now
11 are not -- basically, we ought to try to avoid them. I think
12 that's the thing we would be most concerned about.

13 I don't think the small businesses will benefit
14 from that exception.

15 MR. BAILEY: What other services do you have in
16 mind here?

17 MR. BALHOFF: Basically to the extent of assisting
18 the clients with implementation -- understanding the
19 accounting standards, for instance, or not deciding exactly
20 how that standard should be implemented, but helping the
21 client understand.

22 Just generally, if a client has a -- we have
23 clients that have tried or they were going to try to
24 expand their business, and they'll have issues and questions
25 about that, that would come to us for -- whereas for a small

1 business, they won't go find another provider that will help
2 them address all the different issues that they need to
3 address before they make that decision.

4 We don't make the decision for them and we don't
5 function as management. We're not auditing our own work, but
6 we actually are there on a consultative basis for the client.
7 Also, tax services, definitely. Probably for most of our
8 clients, we perform the tax services.

9 MR. BAILEY: Lynnette Fallon?

10 MS. FALLON: Yes, I don't know how you could have a
11 different standard on this issue for smaller public
12 companies. I mean, if the idea is that we're restricting non-
13 audit services because they either create a conflict of
14 interest, or I think there was one theory that -- which 404
15 seems to belie -- given that it's doubling what we're paying
16 our auditors.

17 But there was a theory that if companies simply
18 paid their auditors too much, then they were in their
19 pockets. And therefore, we want to reduce that to the
20 minimum, which is audit fees.

21 So I don't think you can have two standards here.
22 But, you know, a couple of observations on this point are that
23 first of all, you should know -- you know -- that the
24 institutional investor community is pushing public companies
25 way beyond what, you know, are on the no no list under

1 Sarbanes-Oxley in terms of non-audit services.

2 And most large institutional investors look at the
3 disclosure and practice statements of audit fees and non-
4 audit fees. And so even things that are permitted non-audit
5 fees properly approved in advance by the audit committee are
6 still subject to attack by institutional investors, because
7 they are of the view that you should simply have either all
8 or most of your fees on the audit and sometimes some say
9 audit and tax side.

10 And so that's a pressure that exists in the world,
11 regardless of what the regulations are.

12 MR. BAILEY: Mark Jensen?

13 MR. JENSEN: You know, I would -- I think I would
14 agree with what was -- what's been said so far. I'm not sure
15 that -- first of all, I don't think you want to have
16 different standards and I'm not sure that the investing
17 public or most companies would have a different standard
18 anyway.

19 I think the one area in small businesses though,
20 and mid-sized companies where I am seeing some real concern
21 and some -- and we probably need to think about making some
22 adjustments -- that is, the audit firms today have really
23 gotten to the point where, you know, we audit what management
24 tells us.

25 And in small companies, they typically don't have

1 the kind of resources a big company has. And so, in a lot of
2 complicated transactions, they simply don't have the
3 resources to determine how it should be accounted for and
4 what the right disclosures around that particular transaction
5 might be.

6 The auditors today would feel that we can't really
7 advise a client on how to do that, and so then the client now
8 has to go find another service provider who may know less
9 about the business in order to have them come in and advise
10 them about the accounting on the transaction, which increases
11 the cost.

12 Then, when you're back in a small and mid-sized
13 environment, you're actually back to where the auditor is
14 going to go in and do that work again anyway, and has to,
15 because there's just not enough control around those kinds of
16 transactions in a small and mid-sized environment for the
17 auditor to rely on it.

18 So you really are starting to duplicate some things
19 there. I think that is an area where we could probably make
20 some improvements, and I think companies would find some
21 value in that.

22 MR. BAILEY: Herb Wander.

23 MR. WANDER: Yes, I agree wholeheartedly with most
24 of the comments earlier that have been said. I think one
25 standard is appropriate. I think the standards that we have

1 adopted all were needed, and so I wouldn't detract from them.
2 And I don't find any of our clients, whether they be small,
3 mid-sized or large cap, that really are looking for sources
4 that aren't available.

5 There are a great many consulting firms who have
6 grown up, and who, in fact, are looking to take away this
7 business from what was a large -- the large accounting firms'
8 business.

9 So I don't really see a need for this to help small
10 business or any other business. I do think the accountants,
11 as was just stated, are tending to shy away from providing
12 advice in areas because they're very concerned that they will,
13 in effect, find some fault and then some difficulty, some
14 error that they find, the company didn't find, and therefore,
15 may harm their ability to give a 404 opinion.

16 I think that's frankly a negative that probably
17 should be avoided, but I don't think it applies just to small
18 companies. I think it applies, frankly, to the larger
19 companies who have more complicated issues who are finding
20 their accounting firms a hesitant system in that.

21 MR. BAILEY: Bruce, and then we'll go with --

22 MR. WEBB: I guess I would have several
23 observations, and I do mostly agree with the comments of the
24 other panelists. I certainly agree that the current
25 restrictions not on the services that are in the SEC's rules

1 are appropriate.

2 I also agree that some people are sort of getting
3 paranoid, and, clearly, that's happening with the investor
4 community and the people that claim to be their
5 representatives or their watchdogs. I served on the
6 roundtable discussion sponsored by the PCAOB on tax services,
7 and it was very clear that many representatives there feel
8 that auditors should not be able to provide any non-audit
9 services to their clients.

10 I think the Sarbanes-Oxley Act and the SEC's rules
11 have specific restrictions, but not overly broad
12 restrictions. And I think it would be a shame if auditors
13 were not -- or were afraid to or felt they were not --
14 permitted to advise their clients on the application of
15 accounting principles, or to advise them on business conse-
16 quences of proposed transactions and that sort of thing.

17 Our firm does not feel we're prohibited from doing
18 those activities, and unless the rules would specifically
19 prohibit it, we would intend to continue to do that on an
20 advisory basis, recognizing that the issuer, of course, must
21 ultimately make the management decisions and implement the
22 actions.

23 MR. BAILEY: Doug Carmichael.

24 MR. CARMICHAEL: I have a comment and a question.

25 The comment relates to advising on accounting principles, and

1 certainly there isn't anything in our standard that I think
2 should impede the ability to do that, although caution is
3 necessary to make sure the auditor is not making management
4 decisions in that area.

5 But we have a frequently asked question that makes
6 some suggestions on how to do that. And then the PCAOB also
7 adopted the interpretation of the Independent Standards Board
8 that deals with giving implementation advice on FASB
9 Statement 133, which is the example of the kind of complex
10 accounting standard that companies probably would find
11 valuable to consult with the auditor on.

12 So there are guidelines out there on how to do it,
13 and 404 and our standards should not cut off giving that
14 advice, provided it's done in accordance with those
15 guidelines.

16 A question I had was on tax services. I wondered
17 what companies find most valuable in the way of tax
18 services and what your firm is providing. Is it just tax
19 compliance or how far does it get into the tax planning and
20 strategy area?

21 MR. BAILEY: Okay. Bill?

22 MR. BALHOFF: Well, we're a relatively small firm,
23 and we have, I think, a pretty well developed tax area. But
24 most of the work that we do for our audit clients would be
25 more tax compliance, if they have questions about

1 it, you know, in terms of we don't sell tax shelters and
2 we're not aggressive about that.

3 So, primarily, there's some tax planning, but
4 primarily it's tax compliance from our perspective. I don't
5 know, Bruce, what is your all experience there?. I
6 called on you.

7 MR. WEBB: (Laughter) Thank you, Bill.

8 MR. BALHOFF: Sorry.

9 MR. WEBB: I think our firm's experience would be
10 similar. We clearly do provide the tax compliance services,
11 that is, preparation of tax returns for most of our audit
12 clients, whether they're issuers or whether they're not
13 issuers.

14 We also provide tax consultation or advisory
15 services to those same clients. They're not highly
16 structured, shrink wrapped tax solutions sorts of products,
17 but rather advice on specific proposed or actual transactions
18 or courses of action that the client may be considering.

19 MR. BAILEY: Lynnette Fallon?

20 MS. FALLON: Just to give you -- first of all, my
21 firm does use our auditor for tax compliance. But one area
22 of significant activity for us and many companies, even very
23 small companies that are global is tax planning for transfer
24 pricing.

25 So that you are structuring your arrangements with

1 your subsidiaries, so that the tax authorities in various
2 foreign countries will respect the amount of income that
3 they're getting to tax. It's a very complex area. You need
4 a national firm to do that, so right away, you're limited to
5 the Big Four, the final four.

6 And you also need a firm that really understands
7 your business. And for that reason, it makes a lot of sense
8 to keep that work with your auditor if you can.

9 MR. BAILEY: Go ahead, Herb.

10 MR. WANDER: This is one area where I think audit
11 committee members are very concerned about what the
12 marketplace and institutional investors have been telling
13 them. And so I think they're shying away from loading up
14 their regular accountants with more tax work.

15 I think whether the PCAOB or the SEC says
16 something, they're more concerned with the market reaction,
17 and, therefore, are lessening the amount of tax work that they
18 give to their regular accountant.

19 MR. BAILEY: Before we leave this area, I attended
20 another meeting recently, where I was surprised by the number
21 of questions that came in with respect to AS2, the internal
22 control standard, and the interaction that the auditor and
23 management particularly -- these were smaller firms, also --
24 can have with respect to the auditors supporting management
25 in some way with respect to the assessment process,

1 documentation, et cetera.

2 I wonder if Doug would just comment on that. We
3 seem to have shifted to the accounting side, and this is
4 really an audit panel.

5 MR. CARMICHAEL: The assistance, of course, is
6 permitted with preparing documentation and identifying
7 weaknesses in the system. In the standard, because this area
8 was so judgmental, the PCAOB did not draw any bright lines.
9 And instead, it relied on the audit committee to look at the
10 particular situation and evaluate whether in the
11 circumstances there was sufficient management involvement --
12 substantive management involvement -- for the auditor not to
13 be making management decisions or performing management
14 functions.

15 So specifically, approval by the audit committee
16 for any internal control related services is required. And I
17 would add to that, though, that the -- merely saying in an
18 engagement letter that management will be substantively
19 involved is not sufficient.

20 And that's why the requirement is there in the
21 standard to have specific pre-approval of any internal
22 control related services by management, because it does
23 depend so much on the particular services that are being
24 provided and what happens in the particular circumstances.

25 MR. BAILEY: Herb?

1 MR. WANDER: The difficulty is, how does an audit
2 committee make that decision. It's almost impossible. And
3 they turn to the lawyer, and the lawyer reads all the
4 releases and comes up sort of, well, on the one hand, on the
5 other hand,

6 And so you ask the accountants literally -- give me
7 a representation that this work won't adversely affect your
8 independence, and they shy away from that. So the end result
9 is you're not using your regular accountant, I think, to the
10 extent you probably can, because of the fear of losing the
11 independence and the lack -- and I don't want bright lines,
12 but I think the PCAOB has been a little bit -- you may not
13 have meant to, but people are reading what you put out as
14 saying you've got to be extremely careful, don't go there.

15 MR. BALHOFF: I'd agree with the "you have to be
16 extremely careful" part.

17 MR. WANDER: And therefore, don't try it. I mean,
18 this is the first year we've had this. Nobody knows what the
19 end result is going to look like. Nobody knows -- you know,
20 God forbid you lose your independence. It's almost
21 unfathomable to think about what that means.

22 And so people aren't going to jump into that area,
23 particularly when their own accounting firms aren't going to
24 represent or warrant that this won't adversely affect
25 independence.

1 MR. BAILEY: Bruce Webb?

2 MR. WEBB: I'm our firm's director of auditing and
3 independence, and, as such, it was my responsibility to
4 develop the auditing principles and methodologies to
5 implement on Standard Number 2.

6 And I will simply say that I agree that there are
7 no bright lines in there, but if you read -- and I believe
8 it's paragraph 46 that talks about the fact that inadequate
9 documentation could be a material weakness -- I had a lot of
10 heartburn with us getting very involved in the documentation
11 process.

12 And as a result, and not knowing how we would be
13 able to effectively control that on a case-by-case basis or
14 agree with audit committees on the extent of our involvement,
15 vis-a-vis the extent of management's involvement, we simply
16 decided that we would not be involved with the client
17 documentation process.

18 On the other hand, I firmly believe that the audit
19 of internal control has to be a continuous audit. It should
20 not be a management goes and does everything and then the
21 auditor comes in and says, "Whoops, you blew it. Start
22 over."

23 So we are certainly encouraging our people to go in
24 as management has completed the phase one planning and
25 identification of significant accounts, relevant assertions

1 and the significant controls, and perform audit procedures to
2 assess that assessment.

3 And then as management evaluates design
4 effectiveness, to come behind them and then again, as they
5 test operating effectiveness. So you do it sort of step by
6 step as management does it. And hopefully, through doing it
7 in that sort of an approach, control deficiencies that do
8 exist can be identified and remediated and a clean opinion
9 can be achieved.

10 MR. BAILEY: Commissioner Goldschmid?

11 COMMISSIONER GOLDSCHMID: Excuse me. This goes to
12 independence and the 404 discussion before. How much of the
13 cost -- that side of the equation that we're worried about,
14 is transitory? Is something new being put into effect, and
15 over a period of time, a great deal of it will diminish.

16 MR. BAILEY: Lynnette?

17 MS. FALLON: I think we just don't know. I mean,
18 we certainly hope -- I know that we certainly hope our 404
19 costs will go down starting in '05 and beyond. We also hope
20 that the -- a benefit of the 404 work will be a decrease in
21 the audit fees.

22 So there should be some synergies there that should
23 reduce, long term, reduce the overall fees. But, you know,
24 one of the issues here is, you know, the general economics of
25 the auditing profession and what 404 has really done to that,

1 and whether we will see, you know, we've talked about the
2 availability of good help.

3 You know, one thing that hasn't really come up is
4 -- and I heard this from peers that I know that are in the
5 industry -- is there's a lack of job satisfaction in the
6 auditing business that's arising out of the fact that the
7 creative side of the work is somewhat curtailed now because
8 of the independence concerns.

9 So if you have to start paying auditors more and
10 there are fewer of them out there, will the fees come down?
11 I don't know. I don't think we know.

12 MR. BAILEY: I think we'll finish this up with
13 Lawrence Moreau, and then we'll move on.

14 MR. MOREAU: I couldn't agree more with Herb. I'm
15 the Chair of our audit committee, and I actually put together
16 a group -- informal group -- of audit committee vote chairs
17 and members out in the LA area.

18 It's very, very different -- we've ended up having,
19 as an audit committee, having more and more experts
20 ourselves because, well, my background is I was an auditor
21 for many years and then an investment banker. So I've got a
22 background.

23 But these areas, when we're being asked to be put
24 on the spot, okaying this or not okaying this, especially
25 smaller and even bigger companies, these things are coming

1 up all the time, it's huge. It's huge for risk.

2 And like Herb was mentioning, the best answer is
3 no. And unfortunately, that's a difficult one. I've had to
4 say no many times.

5 MR. BAILEY: Alan?

6 MR. BELLER: Thanks, Andy. This actually relates a
7 little bit to something that a few of the panelists have
8 mentioned -- most recently, Lynnette Fallon, when she
9 talked about the difficulty in getting good help.

10 We wanted to spend a few minutes talking about that
11 issue, the kind of -- the difficulty of getting good help,
12 particularly in the corporate context and particularly with
13 regard to the cooling-off period that the independence rules
14 require before a company can hire someone from its audit
15 firm.

16 The question really is, is that having an impact on
17 smaller companies? And is it having a disproportionate
18 impact on smaller companies vis-a-vis larger ones? There
19 certainly has been some atmospherics that suggest that the
20 answer is yes, but we could get a little bit further into it
21 than that.

22 Maybe someone wants to start that off.

23 Maybe Bill Balhoff?

24 MR. BALHOFF: Okay.

25 MR. BELLER: If no one else.

1 MR. BALHOFF: I will start it off, but I don't
2 really have a lot of experience with the clients. I am from
3 the CPA firms. My answer would have to be yeah, it's a
4 disproportionate issue for smaller companies, because the
5 larger companies probably have more resources.

6 And speaking from an auditor, I'd just as soon the
7 clients not hire our people. We have the same problem with
8 resources you guys have. So I'm going to make this very
9 brief.

10 My general feeling is, the cooling off period,
11 particularly for smaller companies -- I don't see it as a
12 real -- just personal perspective -- I don't see why that's
13 something that's incredibly needed. It's an integrity issue.
14 I think you'll have the integrity, the size of company and
15 the CPA firm -- I think you'll have -- I know by the rules
16 there.

17 It's not something that I ever thought was going to
18 be that effective. Maybe for the largest of companies it's
19 an issue, but from a personal experience, I have not seen it.
20 So.

21 MR. BAILEY: Bruce Webb?

22 MR. WEBB: Well, I will simply say that had these
23 rules been in effect 15 years ago, we would have probably
24 lost our top ten largest issuer clients many times over,
25 because the fact of the matter is, is that historically, it

1 has been a situation where public clients, as well as --
2 probably more so than non-public clients -- but clients of
3 public accounting firms become familiar with the talent pool
4 of the auditing firm and hire them.

5 And if they go in at a high level and clearly the
6 way the rule ultimately came down being expanded beyond the
7 four name positions into the financial oversight role, you
8 know, it does create a problem.

9 On the other hand, I acknowledge that there's a
10 risk, and it's -- so the ban is one -- is the way Congress I
11 guess, chose to deal with it. And that's what we're stuck
12 with. I think now that our clients and our audit committees
13 are aware of the consequences, they're having to look
14 elsewhere to find that talent.

15 We have not, to date, lost a client because they
16 chose to ignore the cooling off period.

17 MR. BAILEY: Larry Moreau?

18 MR. MOREAU: I'm going to put on my auditor's hat
19 from years ago, when I was with Touche Ross in the small
20 business. I'm for this, because there is a lot of influence
21 that if you want to move from public accounting or private,
22 there is pressure to satisfy, or at least not be at -- you
23 know, difficult to the person you might be hiring.

24 Also frankly, it's a huge network out there, and no
25 news. Best way to get an audit engagement was to get one of

1 your partners or one of your people to be CFO of the company
2 you wanted to audit. Well, once you got in there, it's kind
3 of a network, and now it's both boys and girls, that self
4 feeds on itself. So I think this is a very good regulation,
5 and I think it's best that they know that you know, if I
6 please the person that might hire me, I can't go there for a
7 year if I'm the head audit.

8 MR. BELLER : Yes, I'd like to ask Herb Wander, as a
9 very interested but nonetheless on this particular issue,
10 watching as I did before I got here, watching the
11 relationship between senior finance officials and auditors,
12 is that relationship different in significant ways that
13 make this ban appropriate where the senior finance guys are
14 former partners, senior employees of the audit firms?

15 MR. WANDER: I think it is. And again, I hate to
16 keep saying the marketplace or the investors' view of this
17 is that you shouldn't do it. And therefore, an audit
18 committee who is going to be an active participant in hiring
19 a CFO probably starts off by saying don't go to our
20 accounting firm.

21 I mean, it's just that simple. It's not a problem
22 that we want to face. And I think so far, most people have
23 been able to find somebody outside of their own accounting
24 firm. So I haven't seen any problems with this.

1 MR. BELLER : Any other thoughts on this one?

2 MR. BAILEY : I have one.

3 MR. BELLER : Okay.

4 MR. BAILEY : Because I have to deal with these,
5 it's amazing how often, in fact, smaller firms have
6 encountered this problem. And the question I guess I'd ask
7 is, everybody has commented on a network, just what are the
8 alternatives for a small firm in an out-of-the-way location
9 to attract someone into these top positions that
10 wouldn't conflict with the rule?

11 I mean, we've said that it's not been a problem,
12 but where are they getting them? Where are they getting this
13 talent?

14 MR. MOREAU : Well, even the final four -- there's
15 others -- three others by definition than who you're with,
16 and there are various recruiters and other ways that you can
17 get these individuals.

18 Just because they're on your audit staff, you know,
19 the auditors -- the outside auditors -- yeah, you may have
20 gotten a look at him or her, but like I said, in a way,
21 may be that you're going to hire somebody out there that you
22 think from them that could help you out.

23 So it's just like recruiting anything else. And I
24 think it's good. It keeps things, like I said, from an
25 audit point of view, independent.

1 MR. BAILEY: Mark?

2 MR. JENSEN: I'm not going to try to be
3 controversial, but I may wind up being so (Laughter). But so
4 be it. I think first of all, resources are a problem
5 everywhere. And the Big Four have resource constraints, as
6 we all know, anybody who's interacting with them today knows
7 that.

8 You know, we're trying to build up our resource
9 pool. Obviously, that pool is being drained by companies who
10 need the kind of resources and talent that we have, whether
11 they're our clients or not our clients. Because, you know, as
12 we moved a lot more kinds of advisory services that the
13 accounting firms used to provide into the companies, those
14 companies need better resources.

15 And, as a result, the only place they can look to is
16 firms like ours. And that is a problem right now, and it
17 will be a problem for some time to come. I think -- and when
18 you look at really smaller issuers -- at the much smaller
19 companies -- large companies, I don't see this as much of an
20 issue for.

21 I think in the really small companies, when you
22 have that kind of demand in the marketplace for people with
23 those skills, I do think a small company is at a competitive
24 disadvantage in attracting people.

25 And I think that to some extent, being able to

1 allow them to use their network, which by and large in many
2 of these very small issuers, their network really is their
3 attorneys and their accountants. I think when you prevent
4 them from using that network, it can be a problem.

5 I think there's also an issue around companies
6 thinking about going public. And I'm thinking again -- and
7 I'm just going to put my role on with my firm, which is
8 working with venture capital firms and with what I would call
9 hyper growth companies, the companies that we all like to see
10 grow and become public.

11 You know, those rules apply even when that company
12 is private. And so we really have to treat every company
13 that has venture capital in it as a public company. And we
14 apply all those rules to them, even though it inhibits them
15 early on.

16 A lot of times, they want to hire someone because
17 the CEO may have been the founding CEO. There may have been
18 a very informal accounting structure, and they reach a point
19 pre-public where they now want to improve their resources,
20 and the logical conclusion there is to bring in somebody
21 who's familiar with the company.

22 And at this point, we're telling them you can't do
23 that, because you know, we're going to, if you ever go
24 public later, it's going to be a problem for us, as long as
25 that year is included in the registration statement.

1 So I think there are some areas here that are
2 worthy of exploring, but that's one man's view.

3 MR. BAILEY: Well, the next question, really -- I
4 think we've been addressing this to a large extent, but I'll
5 put it on the table just in case -- over a time,
6 over the last 20 years, the trusted business partner idea has
7 been pretty strong within the profession, and particularly
8 with respect to smaller firms.

9 And I think as I said, we've addressed some of
10 this. But do you see a disproportionate impact on the smaller
11 firms. We've just addressed the issue of hiring from the
12 firms. Any others that we might want to put on the table?

13 (No response heard.)

14 MR. BAILEY: Do you think we've adequately covered
15 most of those?

16 MR. JENSEN: I just want to make a comment there.
17 I'm not sure I've ever used the word "trusted business
18 partner." I have used the words "trusted business advisor."
19 And I still believe that that is a role in small and mid-
20 sized companies that I think audit firms, you know, should
21 apply.

22 I think it's necessary. I think the companies just
23 lack the resources to -- they don't -- they can't access the
24 kind of resources that the accounting firms have, and I think
25 they need to have the ability to do that.

1 So I guess I would just correct it. I'm not sure
2 any audit firms ever used the words "trusted business
3 partner," but maybe they have. I'm not sure I would ever
4 have used it, but --

5 MR. WANDER: But it's a -

6 MR. BAILEY: Go ahead, Herb.

7 MR. WANDER: No, I'm sorry.

8 MR. BAILEY: Go ahead.

9 MR. WANDER: No, but it's even necessary in larger
10 firms, as well, because your capabilities of benchmarking are
11 limited to a great extent, unless you can say to your
12 accounting firm who represents four or five people in the
13 industry, you know, what are other people doing. How are
14 other people attacking the problem?

15 So I don't think this is just a small business
16 issue at all. But I do think you will see the accountant
17 stepping back and not being, as we've said, partnered.
18 They're not a partner. They're independent accountants who
19 have to approach this now, now that we have SAS 99
20 with skepticism, fraud and everything else.

21 And so I think you will find them shying away from
22 being the business advisor as they have in the past. And I
23 think that may be something good, by the way. I don't think
24 that's a negative.

25 MR. BAILEY: William Balhoff?

26 MR. BALHOFF: Yes. As a counterpoint, I think

1 being a trusted business advisor, particularly for small
2 business, is a very important relationship. Certainly, you
3 have to maintain your non-management role and not auditing
4 your own decisions.

5 But the other point I wanted to make quickly as it
6 relates to this is, we've talked a little bit about
7 Sarbanes-Oxley being used as a model for other industries and
8 non-public companies, private businesses. And I think that
9 it is happening, and to the extent it erodes that
10 relationship in those small companies, particularly not-for-
11 profits sometimes and financial institutions.

12 I know the insurance industry has an audit rule
13 that mirrors ours -- basically mirrors Sarbanes-Oxley. I
14 think that there are a number of companies that will be --
15 their financial reporting, their ability to solicit advice,
16 not from a management perspective, but just to help them make
17 their decisions, I think is going to be harmed by it.

18 I think those businesses and probably the users of
19 those financial statements will not benefit from that. So as
20 far as it cascading or trickling down from Sarbanes-Oxley to
21 the non-public companies, I think that's definitely a concern,
22 particularly in the not-for-profit arena, where they already
23 don't have -- at least the small ones, don't have -- many
24 resources to hire and pay consultants to begin with.

25 MR. BAILEY: Bruce?

1 MR. WEBB: I do think that as Mark has suggested,
2 none of us like the word "partner," but "advisor" I'm very
3 comfortable with. And I think it would be our firm's
4 experience that, actually, the fact that a client has a pretty
5 close advisory relationship with their accounting firm would
6 be viewed by investors as a plus, as opposed to a minus, as
7 long as they have -- continue to have confidence in the
8 financial statements.

9 And I think generally, they would view the
10 involvement of the firm as enhancing as opposed to detracting
11 from that quality.

12 MR. BAILEY: Mark?

13 MR. JENSEN: I'm just going to make two really
14 quick comments about it. I think one -- I think in the case
15 of small and mid-sized companies, the role played by the
16 auditor as an advisor, I think actually can become and is in
17 many cases, perceived by the CEO, probably the CFO, as part of
18 their risk management process.

19 That it is actually part of the internal control
20 structure, because they want to understand, they want to make
21 sure the auditor understands all of the ins and outs
22 of the transaction, because they don't. And they don't
23 always understand the nuances of the accounting rules, and
24 therefore, I believe, they see that role as being part of
25 their internal control system.

1 And I understand all of the other issues around
2 that, but I'm just telling you how they perceive it. I think
3 the other thing that from an auditor -- being an auditor and
4 most of my life I've spent auditing early stage start-up
5 companies -- you basically start that audit by understanding
6 what goes on in that company everywhere, and understanding
7 every material transaction they've entered into, and
8 understanding their business risks and understanding what
9 their objectives are and what their expectations are.

10 And I think that knowledge base that you have is
11 critical to be an effective auditor in those early stage
12 companies and other smaller companies. And I think that
13 companies know that.

14 They know that you know a lot about their business,
15 and they want to tap into that knowledge base.

16 MR. BAILEY: Doug, I'm afraid I've got to ask you a
17 question. What is your attitude about the issue raised by
18 Mark with respect to the top management not understanding?
19 It might be not understanding the internal control issues or
20 not understanding specific accounting issues and taking that
21 level advice from their auditor?

22 MR. CARMICHAEL: It's an area that I would
23 recommend great caution in. The dividing line is important
24 there, and it is the case that the auditor cannot be a part
25 of the internal control system, should not be viewed as part

1 of the internal control system, and that has to be crystal
2 clear.

3 There is room for advice on complex accounting
4 issues, as I said earlier. But there are lines there that
5 really need to be adhered to.

6 MR. BAILEY: Lynnette?

7 MS. FALLON: I was just going to say that, you know,
8 this is obviously a cost benefit -- another cost benefit
9 analysis discussion where you really have to say, if our
10 financial auditors are becoming more like IRS auditors,
11 that's a good thing in terms of objectivity, but there's
12 clearly a value loss in terms of that advisory role.

13 And obviously, you can buy advisory roles from
14 other people. And then again there's another financial loss,
15 because you're going to be paying somebody else to come up to
16 speed and someone else to be familiar with the business, and
17 you're going to have to internally manage yet another
18 relationship with a third party vendor.

19 So I think, you know, we'll see down the road
20 whether this cost benefit has been worth it for the investors
21 in the public companies.

22 MR. BAILEY: We have one more question, and so
23 I'll give Lawrence Moreau the last word on this one.

24 MR. MOREAU: Very quickly. I guess I come down on
25 the part of the independence, and I think we see a great

1 example here. Where do you end up advising and becoming, all
2 of a sudden -- because you're the expert, you're the outside
3 auditor. You're the one that's going to have to pass being
4 in effect, as far as management is concerned, telling them
5 what to do.

6 So I think Doug's point, if you're going to go that
7 route, I think 404 says you'd better be extremely careful,
8 because the public is not going to understand. I forget
9 which one, Lay or Fastow, said "Well, when my auditors,
10 Arthur Andersen, said it was okay," bingo, there
11 you are.

12 MR. BELLER: Let's address the last item that is at
13 least on our list. I want to leave a few minutes to go
14 around the table and give everybody about 90 seconds to tell
15 us what we've missed, or leave us with a parting thought or
16 something.

17 But before that, I want to ask, at least briefly,
18 has the passage of Sarbanes-Oxley and the registration and
19 oversight requirements and the other complexities that
20 Sarbanes-Oxley has brought to accounting and auditing, is
21 that resulting in a decrease in the number of smaller or more
22 regional firms who will audit public companies?

23 And if so, is that having an impact on the smaller
24 issuer community? Bruce Webb, do you want to --

25 MR. WEBB: Sure, Alan. I can only tell you -- I

1 can give you my reaction, and I don't have any empirical
2 evidence. But I think what we saw initially was that, based
3 on the number of firms that registered versus the number of
4 firms that were formerly members of the SEC Practice Section
5 and auditing public companies, you didn't see many running
6 for cover.

7 Most thought they were going to continue to audit
8 public companies. I think we're now seeing that the firms
9 are re-evaluating that decision, and they're re-evaluating
10 that for a number of reasons.

11 Some are the complexity of the audit of internal
12 control, for example, and, another, audit and accounting
13 standards applicable to public companies. But secondly, and
14 perhaps more importantly, is the cost of professional
15 liability insurance is -- we're facing a real insurance
16 crisis in our profession right now, and it's forcing many
17 companies to re-evaluate their original decision.

18 And it's all of those things are, as has been noted
19 earlier today, driving up the cost of external audits.

20 MR. BALHOFF: Yes. I get a great deal of oppor-
21 tunity to talk to different firms about the decision on this
22 and consult with them a great deal about whether they're going
23 to continue performing audits of public companies.

24 And a number of firms, as Bruce said, probably
25 initially said we're going to stay in that arena, I think

1 because of malpractice insurance, I think because of the
2 process of the PCAOB inspections, which are going on right now
3 and some of the relative, I guess, pain that's being felt
4 there.

5 I think that firms are definitely re-evaluating.
6 Some large firms - LarsonAllen, I think, probably being
7 the most prominent -- made a decision not to do public company
8 audits initially, and a number of small firms did, also.

9 I think the fact that they registered with the
10 PCAOB didn't necessarily mean that they were going to perform
11 audits of public companies. I'm not sure of the number of
12 firms that registered that don't, but malpractice insurance,
13 I'd say, is probably the biggest, quickest kick that firms
14 are having to evaluate right now to determine.

15 So it's ratcheting up costs for even the smallest
16 of firms. It's ratcheting up costs incrementally for them,
17 and certainly for the registrants in the larger firms -- are I
18 guess not doing audits of firms below a certain amount that
19 is considerably higher than what we saw before.

20 So I think it's much harder for firms. We had a
21 registrant come to us the other day. It was an S-B filer.
22 And, just as an aside, they had not really addressed their 404
23 reporting and documentation to the degree that they needed
24 to. Got that -- light in the tunnel is an oncoming train for
25 them, I believe.

1 But their costs were going to more than quadruple
2 from what they were paying before, and probably should to a
3 degree, but I think it's incredible, the cost of the
4 registrants is also -- and also, the CPA firms, how much
5 they're incurring.

6 (Off-mike speaker - inaudible)

7 COMMISSIONER GLASSMAN: Thanks. And this relates to
8 the number of firms available. Clearly, the costs are going
9 up as a result of the 404 audits. But I'm also hearing,
10 especially from small businesses, that they can't even get a
11 404 review by audit firms. That they're being told that the
12 firms just can't get to them by the deadline.

13 Is that really happening? And to what extent is
14 that happening? And if it is, how are firms planning to
15 handle that if we don't do something?

16 (Discussion held off the record.)

17 MR. WANDER: Well, I can give you one answer.
18 Because the firms are stretched, the Big Four will tell you
19 they've blocked out these many people (sic) in this amount of
20 time. And if you fall off your schedule, the issuer, you may
21 not have the accounting firm staff available to you.

22 So that's one way this is; people are dealing
23 with it. So you can't have any slippage of your own plan to
24 get this done. I think this is an excellent question,
25 because I think what you're going to have happen after the

1 404 opinions come out, or even before, I think the four
2 national firms are going to walk away from a number of their
3 clients, leaving the field for other firms that have to step
4 in and do this work.

5 And that's going to create, I think, a heavy burden
6 on them. I think firms who are not issuers are going to
7 want, frankly, globalized firms, because almost every
8 business, no matter how small you are, has got some foreign
9 operations today.

10 So having only a national accounting firm is going
11 to be a detriment, I think. And so I think this is going to
12 become a very growing problem for the insurance reasons, the
13 staffing, getting enough people. And I don't know the answer
14 to it.

15 MR. BAILEY: Bruce Webb?

16 MR. WEBB: Yes, we are, I think our firm is
17 experiencing an ever increasing number of opportunities to
18 propose on smaller public clients that the Big Four are
19 simply walking away from as a matter of a resource issue.

20 We also, just last week, were asked to propose on a
21 company that is not all that small, where a Big Four firm had
22 essentially terminated the relationship on the basis that
23 they did not feel that registrant was sufficiently far along
24 on their 404 preparedness. And they're an accelerated filer,
25 December year end. And they're being cut loose the middle of

1 September.

2 Clearly, we're also experiencing in our own
3 practice that I would -- we have a grave concern in a number
4 of our accelerated filers are not really where they need to
5 be. And we're trying to send a strong message that they need
6 to get there very quickly, because if we can't do our work by
7 the end of November, there's virtually no chance that they
8 would be able to remediate any material weaknesses that would
9 be detected in the process.

10 So I guess I am very concerned about some of the
11 issuers sort of being abandoned, and some of the issuers
12 simply not being ready.

13 And as Herb said earlier, the market will tell us
14 what the consequences of having an adverse opinion are. But
15 I would anticipate there will be a significant number of
16 adverse opinions on the effectiveness of internal control.

17 MR. MOREAU: Just very quickly on this and getting
18 ready -- I was surprised when I was calling people, how many
19 said that they hadn't even started addressing it. Like I
20 said, most of my contacts are in the small business
21 community.

22 And then I came across this, and as of the 16th of
23 September, this is a survey of a thousand firms by the
24 Sarbanes. Nineteen percent hadn't even started looking at
25 the problem. Just beginning, 29 percent. A plan created and

1 ready, and you know what that means, 14.

2 So only five percent said they're ready. And
3 almost compliant at 11, 16 percent. That's scary. And
4 that's as of the 16th of September.

5 MR. BELLER: Yes it is. We have about ten minutes,
6 and I guess I'd like to go around the table for final
7 thoughts. If you could keep it to about a minute to 90
8 seconds, that would be great. We'll start with Bill Balhoff
9 on my right.

10 MR. BALHOFF: Okay, well thank you. As I mentioned
11 earlier, probably one of my big concerns from a small
12 business perspective is not just the public companies, but
13 the non-public companies, the cascading of Sarbanes-Oxley.

14 So anything that can happen as a result of this and
15 other processes that provide some relief for the smaller
16 companies, the better. My belief is, if S-B filers would have
17 been carved out of some of the requirements of Sarbanes-Oxley,
18 there would have been a cut higher than non-public
19 companies, and people wouldn't necessarily look at it as
20 absolutely best practices for all companies.

21 So, to whatever degree that S-B filer is, you can
22 evaluate whether the limitations are still appropriate, and
23 whether or not there are things that can be carved out for S-B
24 filers. I think that would be helpful.

25 MR. BELLER: George Batavick?

1 MR. BATAVICK: Yes. Just confirming what I had
2 mentioned before, and I think what you've heard around the
3 table is that the system definitely has a lot of fatigue in
4 it right now, from the standpoint of all the work that is
5 going on.

6 And just reiterating what I said before about a
7 potential ripple effect might be the slowing down of
8 improving some financial reporting, new standards, because
9 the system and the pace of change can only be so much at one
10 time.

11 MR. BELLER: Thank you. Doug Carmichael?

12 MR. CARMICHAEL: Yeah, I think the -- I'd certainly
13 agree. There's a great deal of uncertainty up to an extent.
14 A large amount of it is unavoidable in the sense that auditors
15 in the past were not doing enough work to express an opinion
16 on internal control, so in writing the auditing standard on
17 what the auditor had to do, we realized that this was a brand
18 new service.

19 It wasn't something that was just a little add-on
20 to what was done before. So, to an extent, uncertainty is to
21 be expected, and there will be a large amount of sorting out
22 that happens in the first year.

23 MR. BELLER: Lynnette Fallon?

24 MS. FALLON: Well, just -- you know, my feeling is
25 that we are -- we have lost a significant amount of value

1 that was contributed to small public companies by their
2 auditors, individuals and auditing firms as firms in terms of
3 the services that were made available.

4 And I think we are yet to see whether the benefit
5 to investors, which is the ultimate goal of Sarbanes-Oxley,
6 justifies that loss of value, whether there really was
7 equivalent value or greater value delivered at the end of the
8 day.

9 But I'm also hopeful that -- I think there are a
10 lot of unintended consequences of the Act, and I think it's
11 going to impact a number of industries and professions as a
12 result. And we'll see what the -- and they will adapt, and
13 we'll see where we are a year or two from now.

14 MR. BELLER: Mark Jensen?

15 MR. JENSEN: Yes, I would just say, I think that if
16 you took all of the questions that were asked today, the
17 underlying question to the whole thing is: Are the new rules
18 and all of the new rulemaking bodies and everything that's
19 come out, is it somehow starting to limit access to the
20 public capital markets by smaller companies? At least today,
21 my answer to that is, yes it is. I think if you look at the
22 venture capital community, they increasingly look at their
23 companies being acquired, not really going into --
24 or even thinking about them becoming public companies.

1 And I don't know whether that's good or bad. But I
2 do think that we have somehow started to send a message that
3 unless you're at a certain level, you really shouldn't be in
4 the public capital markets. And I think that's bad. We live
5 in an innovative economy. Small business is a big -- and
6 growing business is -- growing small businesses are a very
7 important part of our economy, and I think we need to protect
8 that.

9 We need to be jealous about that. We need to
10 protect that.

11 MR. BELLER: Larry Moreau?

12 MR. MOREAU: Talking about what Mark was
13 saying, I think that's very important. I think one thing,
14 and it's not quite privy of this -- part of the equation of
15 the other side is the investor side. The reason that VC's --
16 my reaction is they felt that there was no, or very little,
17 benefit is because, of course, they're very sophisticated and
18 they know what they're doing. They get in close to the
19 companies.

20 And they don't need all these formalities.
21 Frankly, having had my own registered NASD firm for 15 years,
22 the investors, small investors, shouldn't get involved in a
23 lot of these companies. They are high risk.

24 And I think that's where you can do a service to
25 the company -- to the investor, keeping them -- that they

1 shouldn't be taking this risk. Having said that, the big
2 advantage of the small company is everybody is close.
3 Everybody can see it.

4 And that's why I say -- I go back to the
5 governance. They know what's going on. I spend a lot of
6 time with my companies actually getting to know what they're
7 all about, and have almost weekly conversations, not just
8 with top management, with other people involved.

9 In a big company, impossible. So that's the
10 strength of the small company, is how close it is to its
11 investors -- typically much closer than a large company -- how
12 close management is, how close the auditors are, because they
13 know the management. So that's the other side that needs to
14 be taken into COSO or any other analyses.

15 MR. BELLER: Bruce Webb?

16 MR. WEBB: Well, I would just observe that in
17 addition to, I think, perhaps restricting the access to the
18 capital markets to new potential issuers or registrants,
19 there are also a number of companies that we call orphan mid-
20 caps out there, that are lightly traded -- probably shouldn't
21 have been public companies to begin with.

22 Yet they're not able to raise the venture capital
23 to reacquire shares and exit public reporting requirements.
24 So they're stuck with a significant additional cost of
25 compliance with 404.

1 MR. BELLER: Herb Wander?

2 MR. WANDER: Well, my take away is, first I would
3 continue to maintain the independent standards as they are.
4 I think that's been a significant improvement to the entire
5 system, and I think will eventually help raise capital.

6 I do think we're facing resource constraints, and
7 I think they're going to become more severe before they get
8 better. And I say this both in the individual sense, getting
9 the CFO, getting the accounting staff, in-house as well as
10 providing independent accounting firms, to all the issuers.

11 Perhaps one way firms can do it is outsourcing
12 CFOs. I have seen placed advertisements crossing my desk
13 where firms are providing outsourced CFOs for that.

14 Finally, we talked a little bit about the
15 trusted advisor or trusted partners. And I think everyone
16 agreed, "partner" was not the right term. I also think the
17 word "trusted" is not the right term, either, because trust
18 sort of connotes, at least to me, that I'm going to go to
19 somebody and give them some confidential information or some
20 information that I trust them to use only for my benefit.

21 And I think that's antagonistic to what the
22 accountants are supposed to do. So I think they can continue
23 to be advisors, but I think we have to be very cautious about
24 thinking of them in that sense of a trusted advisor.

25 MR. BELLER: Commissioner Glassman?

1 COMMISSIONER GLASSMAN: As many of you know, when we
2 are promulgating rules, I spend a lot of time worrying about
3 the costs and the benefits as we go into the rulemaking pro-
4 cess. I think it's just as important if not more important to
5 make sure we're monitoring the costs and the benefits as we
6 implement the rules, and look at the unintended consequences
7 as well as the intended ones.

8 So I think this kind of panel is very important. I
9 appreciate the input. It's important that we listen and it's
10 important that we understand the differential impact on small
11 business, another topic that's near and dear to my heart,
12 having worked in this area for over 25 years on small
13 business issues.

14 So I want to thank you all, and hope we do continue
15 to listen.

16 MR. BELLER: I think those points are extremely
17 important for those of us at the Commission. I'd just like
18 to thank the panelists on behalf of the Commission, on behalf
19 of the staff and on behalf of all of the other participants
20 in the forum. I think this has been a really good panel and
21 I think it's been really informative, and I thank you.

22 (Applause)

23 MR. BELLER: We will -- since we are running late,
24 let's try to keep the 15 minute break to 15 minutes. We'll
25 try to start this promptly at 11:25 with the next group.

1 Thank you.

2 (Whereupon, a 15 minute break was taken.)

3 MR. LAPORTE: There's been a slight change in the
4 roster of the panelists for the second roundtable. Marc
5 Morgenstern, who was supposed to be the co-moderator and has
6 been a member of the Planning Committee, his
7 mother died last night, and so he had to fly back this
8 morning.

9 He actually had come to Washington. So Alan
10 suggested that I try to sit on for Marc. I'm not sure I'll
11 do anywhere near as well as Marc would have done, but I'll
12 try.

13 MR. BELLER: Thanks, Gerry. Since I know I won't
14 do nearly as well as Marc, I'm counting on you to take up the
15 slack. This panel is going to be addressing issues of
16 disclosure, issues of corporate governance and related
17 matters.

18 Let me, again, for the sake of those of you who
19 aren't in the room and can only hear us, go quickly and
20 introduce the members of the panel. Starting on my left,
21 Gerry Laporte is sitting here at the moderator's table with
22 me.

23 Gerry is the head of -- those few of you who don't
24 know -- the head of the Office of Small Business Policy in the
25 Division of Corporation Finance. On the panel, to my left is

1 Herb Wander. I guess Herb and I share the distinction of
2 doing double duty this morning. He was on the first panel,
3 as well, as you know.

4 To Herb's left is Denise Voigt Crawford who is the
5 Securities Commissioner of the Texas State Securities Board.
6 After the little machine, Jamie Brigagliano, who is an
7 Assistant Director here with the SEC in the Division of
8 Market Regulation.

9 And to Jamie's immediate left, Brian Bussey, who is
10 an Assistant Chief Counsel, also in the Division of Market
11 Regulation. For their benefits, I think Gerry gave a general
12 disclaimer, but for your benefit, since you weren't here,
13 anything that Jamie and Brian say as a matter of policy, they
14 are speaking only for themselves and their views don't
15 necessarily represent those of the Commission or other
16 members of the staff.

17 To Brian's left is Steve Bochner, a partner of
18 Wilson, Sonsini, Goodrich & Rosati in Palo Alto,
19 California. To Steve's left is Stan Keller, a partner of
20 Palmer & Dodge in Boston, Massachusetts. To Stan's left is
21 Rich Leisner from Trenham Kemker in Tampa, Florida.

22 And to Rich's left is Hugh Makens of Warner,
23 Norcross & Judd in Grand Rapids, Michigan. Why don't we kick
24 this off?

25 We thought we would -- as Gerry said at the

1 beginning, there were a number of subjects that have been
2 discussed in a considerable amount of detail in previous
3 fora, which we decided to leave off the agenda for this year
4 to get some new subjects like Sarbanes-Oxley on, and to focus
5 the discussion on some other things.

6 But there is one subject that certainly has gotten
7 a lot of attention at this event in previous years,
8 including last year, that we did want to put back on
9 the agenda to talk about, for at least a few minutes, and
10 that's the subject of finders.

11 And I guess I'd start maybe with Hugh Makens.
12 Would rulemaking or other guidance about how our broker
13 dealer registration requirements apply to persons who act as
14 -- I guess I would say occasional securities intermediaries,
15 and finders as sort of the classic example -- be of benefit
16 to smaller companies in raising capital?

17 And if the answer to that is yes, sort of how do
18 you square that with the requirement that anything we would do
19 in that area also has to be appropriate in the investor
20 protection sense?

21 MR. MAKENS: The answer is clearly yes.
22 We're at the point now where there's been sufficient
23 recognition of the need for some kind of effective control of
24 finder activity, coupled with a dramatic -- I don't want to
25 say easy, because that's not a fair term -- I think

1 rather a rethinking of the method of regulation
2 of finders. We try to regulate finders now as
3 though they were full scale broker-dealers, and the result of
4 that is that you have a tremendous number of provisions that
5 just don't make much sense in the regulatory scheme for
6 finders.

7 Therefore, if you can change those, I think you can
8 bring in a very effective regulatory system, and my advice is
9 that something be done at the federal level, and that in some
10 instances, the Commission recognize an intra-state
11 finder, and that you permit finders to engage in state-
12 registered activity and consider also the possibility of
13 some kind of regional finding activity as well at a reduced
14 or lower level.

15 MR. BELLER: Let me first mention that
16 Commissioner Atkins has now joined us. And Rich Leisner, any
17 additional --

18 MR. LEISNER: Yes, I'd like to put a little bit of
19 gloss on what Hugh has said, because he and I have both been
20 involved in an ABA project directed towards I think ending
21 what you can best call a "don't ask, don't tell" policy.

22 And I think it's very interesting that we -- the
23 materials use the word "finder" rather than unlicensed,
24 illegal, law breaking (Laughter), compensation taking, deal
25 negotiating broker, which might be a more accurate term.

1 MR. LAPORTE: I think that was the first draft
2 (Laughter).

3 MR. LEISNER: Well, so we are on the same page.
4 But to be quite honest about that, what you're talking about
5 is the thousands of transactions in which unlicensed
6 individuals provide a varying array of services, finding the
7 money and engaging in activities that, under the current law,
8 are almost always going to be broker activities that make the
9 transactions voidable under federal law, and possibly void
10 and certainly voidable under many state laws.

11 And that's -- for people who are providers of
12 sophisticated legal services -- that is a heck of a position
13 to be in. You have a client who can't find the money. He's
14 got someone who can find the money, but oops, the transaction
15 is dead on arrival. And that's the environment.

16 And a reaction to that environment is where Hugh
17 succinctly is coming from when he talks about the
18 desirability of asking reputable people in this arena to
19 become registered. But in a regime that is not as difficult
20 and shouldn't need to be difficult as getting to be a "real"
21 broker-dealer.

22 And in the materials, Hugh sketches out some
23 of the key issues in his materials that are extraordinarily
24 helpful. I think you've got to start at it in that context.
25 And I know we have some folks from Market Regulation, and

1 they probably think I was a little bit tepid in my
2 description of the activities, for which I apologize.

3 MR. BELLER: Rich, thanks very much. One other
4 housekeeping matter. I'm not sure you were all here earlier
5 this morning. I think the best way for me to be able and for
6 Gerry to be able to see whether you want to be recognized is
7 if you would just stick your tent card up on end the way Stan
8 has.

9 And let me turn to Stan Keller next.

10 MR. KELLER: I'll put my card back down. Indeed,
11 some of the states have already dipped their toe in the water
12 and started this. So for example, in Massachusetts, we have
13 a finder registration system. I know -- frankly, I don't
14 know how much it's used. I've never used it.

15 But in concept, it's there. And what really lies
16 behind it are really two thoughts. One: We're really
17 talking in the first instance about capital formation. And I
18 think as -- it was a good segue -- left off at the last panel
19 -- that high on the list of priorities as we're balancing
20 competing interests has to be capital formation, and
21 particularly for smaller businesses.

22 I mean, that's the life blood that drives it. And
23 so access to that capital is key. And how can you get there
24 while protecting investor interests? And I think what you and
25 Richard are suggesting is that with a sensible registration

1 system for -- call it finders, limited broker-dealers -- that
2 works.

3 You get legitimate people, if you will, into the
4 system registered, which can only help compliance, help
5 regulation, and therefore help investors while striking the
6 right balance.

7 MR. BELLER: Stan mentioned the states. And let me
8 segue over to Denise Crawford on that note.

9 MS. CRAWFORD: Thank you, Alan. The states are
10 very interested in this issue. In fact, we've been waiting
11 with baited breath for Hugh Makens' paper, which arrived this
12 morning in your notebook.

13 The states believe that there is a way to address
14 this problem. Obviously, the first step would need to be
15 taken by the Commission, because anything that the states
16 try to do in this area is probably not going to be
17 exceedingly helpful unless we have a federal regime that
18 recognizes that finders are indeed different, and perhaps
19 could be subject to a less rigorous review in the context of
20 broker-dealer activities.

21 The states have talked about this at length. And I
22 think it's fair to say that there's a great deal of sentiment
23 in favor of having a regulatory regime that just addresses
24 finder activities.

25 One of the issues, of course, will be to define

1 what it is that a finder does. We don't want it to be used
2 inappropriately. Also, there are some issues associated with
3 the willingness of the responsible, professional active
4 finder community to comport with rules that are admittedly
5 less, but nevertheless do require them to set forth some
6 information that they may not be all that comfortable in
7 setting forth.

8 So those things would have to be worked through.
9 But conceptually, I think that the states are on board. I
10 think that we could work with the Commission and come up with
11 a viable regulatory scheme for this whole area.

12 MR. BELLER: One unspoken assumption in this
13 conversation is that it's difficult for small companies to
14 find registered persons who would carry out this activity.
15 Does anybody want to talk about the validity of that
16 assumption?

17 MR. MAKENS: I'd be; I'd love to jump in on that.

18 MR. BELLER: Hugh Makens, for those of you who
19 can't see us.

20 MR. MAKENS: I describe small business financing
21 generally as cup of gas financing. That is, you go out to
22 your friends and family and you hold out your cup and you get
23 some money and you put it in your tank and you run for
24 awhile.

25 Then you start to run out of money pretty quickly,

1 and the next step is you go out to your friends, your
2 suppliers, your customers, and you get a little bit more gas
3 and put that in.

4 Well next, you're ready to go to angel investors or
5 to venture capital firms, but those are pretty few and far
6 between in relation to the demand for them. And that sends
7 you then to the broker-dealer community. Well, most of the
8 broker-dealers I'm seeing around the United States have got
9 thresholds of \$15, \$20, \$25 million.

10 Many of them are boutiques. We've seen a shrinking
11 of brokerage firms that do a traditional stock and bond
12 business that has been dramatic. And there just aren't firms
13 in the United States, not remotely enough firms in the United
14 States that are going to provide the kind of service that you
15 need.

16 The risk in relation to benefit is fairly high, and
17 most of the firms that have done that have moved away. Look
18 where your shift has come. If you look at a lot of the firms
19 that I see is -- and my practice as primarily a broker-dealer
20 practice -- what I'm seeing is people going more and
21 more into mutual funds and to variable products and less and
22 less into initial stock products.

23 And that market has been largely delegated to a
24 relatively small set of firms in the United States today.

25 MR. BELLER: And most of them unregistered, Hugh,

1 in terms of --

2 MR. MAKENS: No, no. There's a number of
3 registered broker-dealers that do this kind of activity, but
4 nowhere near enough. And because of that void, people are
5 now turning to the people who used to be in accounting firms
6 or the people who used to be executives of companies, or the
7 people who used to be at brokerage firms and retired and
8 moved on, or used to be in the investment banking business.

9 And now, they will make some contacts and open some
10 doors and get things done, or they may be turning to the
11 accounting firms who, by the way, have been migrating toward
12 full broker-dealer registration over the last couple of
13 years, but who used to do this all on an unregistered basis
14 in order to fill that gap to get the money they need.

15 MR. BELLER: Denise Crawford?

16 MS. CRAWFORD: I wanted to talk just a little bit
17 about one of the other places that small businesses go. And
18 they go to, really, con artists, because they don't realize
19 that these people who say that they can get access to capital
20 for them, for an upfront fee, are really not going to do
21 anything for them at all.

22 So this is a major enforcement problem that small
23 businesses have to contend with. And if we had a simplified
24 registration on the state and federal level for the
25 legitimate folks, one of the things that would be a red flag

1 for the smaller companies would be to find out whether or not
2 the finder is properly registered.

3 And if the finder were registered -- of course
4 that's no guarantee, but it certainly relieves one problem,
5 and it makes this person look a little bit more viable.

6 MR. BELLER: Yes, Brian Bussey, any thoughts from
7 the --

8 MR. BUSSEY: I feel like I'm on the hot seat here.
9 You know, first off, I want to stress that we recognize in
10 the Division of Market Regulations and specifically the Chief
11 Counsel's office, the importance for small businesses to grow
12 and prosper and for the economy to do well and to create
13 jobs.

14 As Commissioner Glassman pointed out last year in
15 her keynote address to this same forum, there's another side
16 to the story. If you look at our enforcement cases, you see
17 a huge number of frauds being perpetrated either by small
18 businesses or involving small businesses.

19 And so, in looking at our mission, which is investor
20 protection, and in looking at this area, both in terms of
21 being concerned about impediments to capital formation, but
22 on the other hand, protecting investors, we believe that
23 regulation is necessary in this area.

24 Now Denny, you've suggested the possibility of
25 lesser regulation, and I think that really is a possibility.

1 But as we've stressed before, this is a massive undertaking
2 to review the regulatory scheme that applies to broker-
3 dealers.

4 It's not just the SEC's rules. It's the states.
5 It's NASD, a very large undertaking. And one of the things
6 that we have asked for in past forums is specific detail on
7 what are really the problem areas in specificity. What are
8 the things that are impeding or --impeding people from
9 registering as broker-dealers to engage in this type of
10 business?

11 Hugh, you made a comment. I'd actually like you to
12 elaborate on it. You said that broker-dealers are moving
13 upstream in terms of the size of deals that they're
14 interested in doing. And you say it's because of the risk
15 versus reward. And --

16 MR. MAKENS: Part of it is risk versus reward.
17 Part of it is the number of people --

18 MR. BUSSEY: Well, what --

19 MR. MAKENS: Yes, I'm sorry. Go ahead.

20 MR. BUSSEY: What's the risk? Why are legitimate
21 broker -- registered broker-dealers not interested in doing
22 smaller deals? What kind of risks are there?

23 MR. MAKENS: The chances of getting sued, whether
24 you do a \$50 million deal or a \$10 million deal are the same.
25 But at least you're going to get paid a lot more if you're

1 doing a \$50 million deal.

2 You're also, with the smaller company, not going to
3 have as good internal controls as we talked about on the
4 first panel. You're not going to have the level of
5 sophistication. You're not going to have the depth of
6 management.

7 You're going to have lesser levels of market.
8 You're going to have a lot more risks with the smaller
9 company than you will in a larger, growing, diversified
10 company.

11 MR. BUSSEY: So if it's not a registered -- if a
12 registered broker-dealer isn't willing to take on those
13 risks, are you suggesting that it be the investors in the
14 businesses who take on those risks?

15 MR. MAKENS: Well certainly, yes. That's the way
16 our country has worked since the beginning of time. And the
17 question is, how do you get it in the right -- into the hands
18 of investors who are sophisticated enough to understand those
19 risks and willing to take those risks?

20 MR. BUSSEY: The question that we have for the
21 panel here is, it speaks of occasional finders. But it
22 sounds like you're talking about something more than
23 occasional finders. It sounds like it's really a new
24 professional class of intermediaries, not somebody who does
25 it --

1 (Simultaneous discussion)

2 MR. MAKENS: Actually, Brian, I'm talking about a
3 very wide spectrum, from the person who might do it once
4 every two or three years to the regional accounting firm --
5 the national accounting firms before they were registered,
6 were doing this on a monthly basis. They'd do a new deal
7 each month.

8 And so the -- it's a very, very broad spectrum of
9 people who do this.

10 MR. BUSSEY: And what about -- I think your paper,
11 which I've reviewed a draft of, speaks both of finders for
12 issuers and also for business brokers?

13 MR. MAKENS: Yes.

14 MR. BUSSEY: You see a need for relief on both
15 those --

16 MR. MAKENS: I see a need for relief on the
17 business brokers. Right now, we've created an artificial
18 solution to the problem in that the business broker is -- as
19 long as you start the deal, advertised as an asset deal, you
20 can do it if it migrates to a stock deal. But --

21 MR. LEISNER : You're sure?

22 MR. MAKENS: Yes.

23 MR. LEISNER : Positive?

24 MR. MAKENS: Positive.

25 MR. LEISNER : Okay.

1 MR. MAKENS: But if you follow the you know, ten,
2 12 directions in the no action letters -- on the other hand,
3 if you instead take the approach that you have -- from the
4 very beginning, conceptually, you are doing a transaction
5 that involves two fairly sophisticated entities, and you are
6 putting those entities together, the need for public
7 protection in those circumstances is dramatically reduced.

8 MR. BUSSEY: You're talking about in the instance
9 of a full business?

10 MR. MAKENS: In the -- yes.

11 MR. BUSSEY: Not a transferred --

12 MR. MAKENS: Right.

13 (Simultaneous discussion)

14 MR. MAKENS: And whether you do it through a
15 simplified registration, whether you do it through greater
16 relief on the no action level, something needs to be done to
17 make a little bit of sense of this process.

18 MR. BELLER: Rich, do you have anything to add on
19 that?

20 MR. LEISNER: Well, I think it's very important to
21 go back to something that Hugh said. And it's that we're
22 talking about a spectrum of activities in which there's very
23 little guidance, with all due respect.

24 We have finders. Those are people who are not
25 broker-dealers and don't have to register, because that -- a

1 finder means they're not engaging in activity that requires
2 registration. Then we have a whole spectrum of capital
3 formation activity that may or may not be finders or may or
4 may not be broker-dealers.

5 And I agree with the Commissioner who says, "Gee,
6 at least if we had a registration process, we'd know that the
7 people who don't have a ticket might be -- maybe we shouldn't
8 do business with." Now, everybody doesn't have a ticket.
9 And when you take a full stop now and look at the M&A
10 environment, that's probably where the larger volume of
11 dollars and transaction are going on now with people relying
12 on the "you know" exemption. You know (Laughter).

13 And I've sat in a room with counsel from the most
14 prestigious firms in the country who said, "Well, they don't
15 have to register to do that, because . . . because no one ever
16 registers to do that."

17 And the canyons of our financial centers are filled
18 with hundreds of firms that are completely reputable that are
19 doing these transactions, mostly with sophisticated clients,
20 and very few of them are asset for cash deals. And there's
21 usually a security floating around there someplace, and
22 they're actively involved at -- like an investment banker.

23 And they're at the table. They're negotiating the
24 transaction. They're providing value. But they're
25 unregistered. And my colleagues who have sat in a room and

1 indicated that they thought the limited broker-dealer
2 registration process was a solution in search of a problem,
3 insofar as they were concerned.

4 That's a very big part of the industry that at
5 least needs to -- you need to decide what you want to do with
6 it. Because that's not a capital formation function in large
7 part, except to the extent that it may be a cash register
8 event for the seller.

9 But certainly, most of the buyers are very
10 sophisticated, and the transactions are usually bona fide
11 private placements from a securities registration standpoint.
12 But the broker activity is there. And I think we just have
13 to sort out what we're talking about.

14 If this is a capital formation focus, we are
15 talking about a different part of the spectrum from the M&A
16 part. But it is part of the complexity of trying to make a
17 solution here.

18 MR. BUSSEY: I would echo that. I mean, I think
19 understanding exactly what it is we're talking about, you
20 know, segmenting the problem and addressing each one of the
21 sub-problems in a way that makes sense from an investor
22 protection standpoint, but also from a business standpoint.

23 MR. LEISNER: Well, but the investors -- the
24 "protection" that the investors are receiving is that they're
25 left to deal with good guys, bad guys. They're all

1 unregistered guys.

2 And so at least on the capital formation side, I
3 think that this is something that would assist the investor
4 protection activity. We're not talking about giving up the
5 anti-fraud rules. We're not talking about giving up the '33
6 Act securities registration rules.

7 But we are talking about trying to put a little bit
8 of lubrication on the wheels of commerce where we have
9 issuers who don't know where to get the money from. And we
10 have people who do know but who are not registered.

11 MR. BELLER: I think we've spent a good amount of
12 time on this. I'm going to give Hugh a minute, and then I'm
13 going to give Denise Crawford a minute, and then we're going
14 to move on. We could spend the whole hour and a half on
15 this, and I don't want to.

16 MR. MAKENS: You're not seeing a lot of these
17 transactions. Most of the transactions we're talking about
18 here are Section 4(2) transactions that don't migrate into the
19 Regulation D environment. So there's no filing.

20 At the state level, they're finding state
21 exemptions, but often they're institutional placement
22 exemptions. And therefore, you're not seeing any kind of
23 filing there. So there is no way of tracking these.
24 Frequently, they're done out of the broker-dealer
25 environment, so when OCIE goes in to take a look

1 and see what's going on, they're not going to see these
2 either.

3 So they're largely happening under the visibility
4 surface, and the accountants and the attorneys are seeing it,
5 but that's about the only place that you're going to get any
6 kind of measure. And that's kind of a collective knowledge
7 and memory, rather than any kind of compilation of what's
8 there.

9 So your challenge is, how do you find this
10 information? And I suggest that it may, in the end, be simply
11 focus groups talking about issues like this that provide you
12 the best information that's going to be available to you.

13 In terms of the finders, right now the conventional
14 finders for cash for small issuers, a lot of those are
15 being done in the 506 context, and your Form D's are
16 reporting that information. And about a third of the states
17 now are starting to go to the Form D's and send inquiries out
18 to the unregistered finders and say, "What are you
19 doing?" And come in and talk to us about getting registered
20 or getting in compliance.

21 So it's a difficult environment to reach the
22 question that you're raising. That's all.

23 MS. CRAWFORD: Thirty seconds.

24 MR. BELLER: Denise Crawford to give us the last
25 word, unless Brian wants the last word.

1 MS. CRAWFORD: Thank you. At last year's forum
2 here at the SEC, the number one suggestion that came out of
3 the forum was to have the SEC issue a concept release in this
4 area so that the kind of information that the SEC staff needs
5 in order to formulate a solution to the problem would be
6 there.

7 And I just wanted to reiterate that, because it
8 seems to me that that's something that we all could work on
9 together this year.

10 MR. BELLER: Okay. I want to take us in a
11 different direction. We have under our regulatory regime,
12 and I think to the extent that listing standards are
13 applicable, there are some differences in listing standards --
14 it's sort of tiering of regulation depending upon the size of
15 companies.

16 I'm thinking particularly of our Regulation S-B for
17 small business issuers, and I'm thinking about a number of
18 our rules, including those that were adopted in response to
19 the Sarbanes-Oxley requirements, where we did make some
20 accommodations for smaller companies.

21 We've actually drawn another line in our regulatory
22 regime for accelerated filers in recent years. Basically,
23 \$75 million companies who filed at least one annual report.
24 I guess with that as background, the question is: Should we
25 be moving more in the direction of tiered regulation?

1 And if the answer to that is yes, sort of: What
2 sizes should we be looking at? And then maybe we'll get into
3 what some of the tiers maybe should look like, at least on a
4 preliminary basis. But first of all, the basic question.
5 Should we move more towards tiered regulation? And for what
6 sized companies?

7 And I guess I'd ask Steve Bochner to kick that off
8 for us.

9 MR. BOCHNER: Sure. Well, I may not be the best
10 person to ask this question, because I've -- although I've
11 worked on you know, probably close to 60 initial public
12 offerings for venture backed technology companies -- I think
13 maybe one of those took advantage of the, you know, the
14 streamlined regs.

15 And I think maybe that is telling. I'm not sure --

16 MR. BELLER: Maybe that's part of the answer.

17 MR. BOCHNER: Yeah, that may be part of the answer.
18 So I think to the extent you wanted to provide some sort of
19 regulatory relief to the capital formation process, I think
20 the standards would have to be defined well above the -- you
21 know, the 25 million threshold.

22 I think the issue affecting, that seems to be
23 affecting, things most in my neck of the woods, Northern
24 California, really is 404, not to get back to that, but to
25 talk about this in the context of streamlined regulations or

1 what can be done.

2 I mean, people complain about governance reform
3 generally, but I think ultimately, you know, you'll have your
4 code of ethics and you'll disclose whether or not you have a
5 financial expert, and you tick off those things. But the 404
6 regulation is the one that's costing the money and is
7 punitive for the smaller issuers that can't afford it. And I
8 think -- and I'm not sure -- the crisis I'm feeling was
9 really brought out in the last panel in terms of just how
10 many public companies' auditors are resigning.

11 You know, the ones that don't look like they're
12 going to make the 404 threshold are saying "see you later."
13 So I think if you were going to go in the direction of
14 providing some relief with respect to 404, which I think is --
15 we're seeing the burden of that -- does appear to be an
16 impediment to small business in the capital formation process.

17 And, if you want to provide real relief, I think it
18 would have to be well north of the levels that we've
19 traditionally thought about in terms of small business
20 issuers, because today, in part because of the regulatory
21 burden, it's hard to get public with market caps much south
22 of 200, 250 million, at least where I come from.

23 MR. WANDER: I think that's absolutely --

24 MR. BELLER: Herb Wander, any thoughts?

25 MR. WANDER: Yes, I think that's absolutely

1 correct. I mean, we generally advise companies who are, you
2 know, less than 50 million not to go public in terms of the
3 offering, because you're not going to get coverage. Your
4 stock price is not going to receive the kind of reception you
5 think, unless you're just a dramatically growing company.

6 And you're going to become an orphan very fast.
7 And so it seems to me that the tier concept maybe has to do
8 some rethinking about having an intermediate stage before
9 you're a fully public corporation until you receive a size
10 that you'll get the market following.

11 Because if you really are counseling your clients,
12 you're going to say to them, well, okay, no analyst is going
13 to cover you. Who's going to buy your stock? Who's going to
14 be selling it? And what you thought was a valuable company,
15 you're going to be subject to a market that's probably not
16 going to appreciate it.

17 MR. BELLER: What, do you have a sense of, if
18 market cap is the right measure or whatever measure is a right
19 measure, what size you're talking about?

20 MR. WANDER: Well, as Steve said, it's got to be --
21 his was 200 million. I certainly think that's a good
22 starting point.

23 MR. BELLER: Stan Keller?

24 MR. KELLER: I find this a difficult question to
25 deal with, which is why I put my card up, so I'll deal with

1 it because, in the abstract, of course there should be
2 tiers. But that doesn't mean anything until you start
3 drilling down to what are we talking about, in what
4 particular area, and what are the consequences, how should it
5 work?

6 I and some others on this panel were involved, I
7 think, with the development of S-B, and I can tell you, one,
8 my heart was never in it, because I don't think it was viewed
9 as particularly significant. And I've never used it.

10 So that tiering -- you know, that's make
11 weight, and, in fact, it was done during a Presidential
12 campaign some years back, as I recall, so it really was make
13 weight.

14 But real tiering where it counts, means something.
15 Now, we have the concept of accelerated filer and various
16 things turn upon whether you're an accelerated filer or not.
17 And so that can be a meaningful tier.

18 When I think of tiering, I think of one, we are
19 choosing, because of the cost benefit analysis, to separate
20 out a particular group, and they can either be looked at as
21 wearing the scarlet S or the scarlet S-B of small business.
22 We're not as good as others, and therefore we suffer a
23 detriment.

24 Or it can be viewed as recognition of what risks
25 are appropriate to let the market bear. I did a program like

1 this 20 years ago in the early days, when I was involved in
2 the formation of the small business conference -- so this is
3 the 23rd annual, so maybe that was the third annual -- in
4 which I was waving the flag for making accommodations for
5 small business. And I had Steve Friedman, who happened
6 to be a law school classmate, and then just recently
7 former Commissioner. And he said, you know, there's
8 an anomaly. Some of the bigger problems that we've had in
9 violations in enforcement have involved small business. And
10 here, we're talking about making it easier for small
11 business.

12 Well, I think what we've seen in recent years is
13 that the impact of those violations, if you're prepared to
14 accept them, of those risks on a cost/benefit analysis are
15 tolerable, unlike what we saw with large cap companies where
16 there's greater potential for serious market disruption.

17 So you can, in fact, choose to allow some risk into
18 the system. And that leads me to say if there's tiering, it
19 should be by disclosure of what the consequences are by
20 companies who choose to tier. In a funny way, we'll get into
21 this auditor financial expert.

22 Okay, you don't have an audit committee financial
23 expert? Fine. Disclose it so the market knows that. They
24 can assess what the risk is associated with it. And then I'd
25 have more flexibility to allow opt-in. I wouldn't just say,

1 you're not an accelerated filer.

2 But I would allow a seasoned company to opt into --
3 I'll call it the more heavily regulated regime if they want
4 the stature and whatever the perceived benefits are by
5 playing with the big boys.

6 MR. BELLER: Denise Crawford?

7 MS. CRAWFORD: One of the things that could be done
8 is to put the problem off as long as possible. And by doing
9 that, you'd need to raise the limits under Rule 505 and
10 Regulation A. Right now, there are \$5 million. Five million
11 dollars is an extremely low amount of capitalization.

12 It seems to me that the SEC could take a look at
13 those very low levels and raise them. What amount? I don't
14 know. But it would give these smaller companies more time to
15 grow, more time to get it together, to then become public
16 companies where they have to comply with more federal
17 requirements like Sarbanes-Oxley and those other requirements
18 that kick in once you become a publicly traded company.

19 MR. BELLER: It's sort of interesting that we have
20 a bid in our regulations in the five to ten million range and
21 have an asked of the 200 and 250 million range (Laughter) --
22 and that's at least --

23 MS. CRAWFORD: Where are all those finders today?

24 MR. WANDER: Well Alan, don't you also have to, I
25 think, attack the issue of what is the public market for these

1 smaller companies? Because the fear is that unscrupulous
2 brokers or unscrupulous traders, you know, drive up the price.
3 All of the sudden, some stock that went out for \$1 is
4 \$10.

5 And it might last at the \$10 level for a month, two
6 months, three months, but it's going to go back down to two
7 cents. And I think you also have to look at what happens
8 once it's public, in terms of who should be buying the stock,
9 what sort of information is required. And to really -- if
10 you're looking for investor protection -- and that's for the
11 investors who put their money in who need a slow growth
12 pattern, as Denny said.

13 So I think you'd have to look not just at the
14 disclosure and the governance, but also the trading markets.

15 MR. BELLER: I think that's right, and I'm --
16 anybody have a thought or a solution to Stan's problem, which
17 I can tell you makes regulators very uncomfortable, which is
18 when you start reducing requirements, if the requirements are
19 the right requirements, and let's assume that's the case for
20 the moment.

21 When you start reducing them, you start increasing
22 risk. And I think it's very hard to -- for us to just say,
23 well, we'll take -- we're willing to allow more risk in the
24 system for smaller companies than we are for larger
25 companies. It's not so hard to say the converse of that.

1 We want less risk in the system for larger
2 companies than smaller companies. But the first phrase, it
3 does catch in the throat. And I guess the question is, is
4 that just an element of life we have to deal with, or is
5 there some way to deal with that or address it? Rich? Rich
6 Leisner?

7 MR. LEISNER: Alan, nobody is suggesting that we
8 reduce that -- the cost -- and eliminate certified financials
9 for a minute, for an IPO. But I think it is fair maybe to
10 pursue a different framework for companies under 404.

11 We don't need a COSO, we need a COSTCO approach to
12 that, where somebody can come forward and say, "Here are some
13 of the significant differences with smaller companies, and
14 this procedure, procedure number two, without a scarlet
15 letter on it, is one that would satisfy the requirements."

16 And perhaps that would not even require a statutory
17 amendment. Because I think in a lot of these -- in this
18 panel, we are sort of suspending our disbelief about what the
19 statute compels the staff and the Commission to do, and what
20 it would be nice to be able to do in a perfect world.

21 But I think that if we don't focus on trying to
22 develop a meaningful second tier of regulation that is
23 without a taint and without a second class citizenship
24 badge, I think what you're risking is the loss of a whole
25 segment of the capital formation process in this country.

1 Everyone knows that, whatever the numbers
2 were for being public, they've gone up. Maybe they're not as
3 high as the Foley study, but I don't suspect it would be
4 useful for us to go back and look at the Commission's
5 proposing releases and look at the back part of the release
6 that no one ever reads that says, this compliance will cost
7 \$5,000 per company.

8 We know -- as you said just a minute ago, we now
9 have the range, somewhere between three million and \$5,000 to
10 comply. We know it's a lot and it's more than it used to be.
11 And I think it's the responsibility of people in the industry
12 to try to come up with a solution.

13 Think about the logical consequences of the
14 alternative. If in 1995 you could get a legitimate broker-
15 dealer to take a company public, two million shares, \$15 a
16 share, it qualified for NASDAQ NMS, with a \$30 million gross
17 proceeds offering.

18 And now, that same offering is now going to have to
19 be the better part of a hundred million dollars and have a
20 post-IPO market cap of more than \$200 million. Everybody that
21 fits in between that, they're either never going
22 to get to market -- you know, maybe the next Intel doesn't
23 get done, the next Microsoft doesn't get done -- or they're
24 going to get sold to some giant corporation and scenes of the
25 last reel of "Indiana Jones" with that new micro-chip going

1 off into the storage room some place is going to be done.

2 Or it's simply never going to happen. They'll be
3 sold to a bigger company or they won't do it, or they'll go
4 do something else, which is a dire set of predictions. But
5 it certainly isn't illogical to think that there would be
6 adverse impacts like that if we cut out this part of the
7 capital formation process.

8 MR. BELLER: Stan Keller?

9 MR. KELLER: First, let me say, I don't think it's
10 binomial. I mean, do you reduce regulation or not. I mean,
11 I think it's much more surgically analyzed as to where you can
12 do it and where you can kind of bear those risks.

13 And, as I put it, coupled with disclosure of what's
14 happening and the ability, if you will, to opt into
15 the higher tier. I think what Denise said and Richard was
16 picking up on -- was very important. Clearly, we've increased
17 the price to companies going public.

18 When I say the price, the level at which -- the
19 amount of money. The access to the public capital market.
20 And that may be a right decision. I'm not so much quarreling
21 with that decision. But a corollary of that is we then have
22 to focus on the alternative means of financing.

23 And I know we don't want to talk about elimination
24 of general advertising and general solicitation, and we don't
25 have to. But you still have to come to grips with that, with

1 access to financial intermediaries in a system that works, so
2 that the flow of capital on an unregistered basis is there,
3 that allows companies to grow until they mature to the level
4 where they go public.

5 I don't think I mind deferring, because we get the
6 same advice that Herb mentioned. You don't want to go public
7 unless you've got the credibility and the background of
8 support, because then you're just going to become an orphan
9 company -- you're going to have a moment of satisfaction and
10 then you're going to lose.

11 So I'm looking at, what do we do in the private
12 capital market. And then once a company is public, okay
13 where -- is there a way of relieving some of the burdens and
14 tiering it at that level, both on a corporate governance
15 basis.

16 Right now, it's somewhat self selective, but not
17 really. You're a listed company. You opt into the corporate
18 governance regime that's now imposed on listed companies.
19 Well, is there a way of tiering that. For example, NASDAQ
20 Smallcap.

21 Maybe there's more flexibility in the system -- the
22 corporate governance system than there is in the NMS and New
23 York Stock Exchange market, for example. So it's that kind
24 of differentiation that I would see taking place.

25 MR. WANDER: You also -- this is not a new problem.

1 I mean, years ago, you had two a week Charlie Plohm.
2 Right? And you had these schlock brokers who were doing them,
3 Whale Securities and all those people.

4 MR. KELLER: I did one of those here.

5 MR. WANDER: Well, so did -- everybody did one.
6 Because you had a client -- I had a client -- kids of one of
7 my best friends who started a great company, but no one was
8 going to give 20-year-old kids financing. And the father
9 said, "I'm tapped out."

10 And so we went -- I forget -- Whale Securities or
11 somebody else, and they charge a left lung and warrants
12 (Laughter). You know, I mean, it's -- reading the
13 underwriting agreement, you almost vomited, but that was
14 the only source of financing for those companies. So we
15 haven't really changed a lot, because now it's just as
16 difficult and you don't have those brokers doing it. And so
17 I think --

18 MR. BELLER: Well, that's a start.

19 MR. WANDER: Yeah. But I think you do have, as
20 Richie and -- has mentioned, that you need somebody to fill
21 that void in a responsible manner.

22 MR. BELLER: Let me note, for those of you who
23 can't see us, that Commissioner Goldschmid has joined us and
24 Steve Bochner wants to be recognized, so let's do that.

25 MR. BOCHNER: Yes, I agree with what Stan said. I

1 think what we're saying is that it appears -- and I don't
2 think this will just be transitory -- it appears that it's
3 going to be much tougher to go public now for a whole variety
4 of reasons, from analyst coverage to independent directors to
5 404 requirements.

6 So you're going to need to be bigger. And I think
7 that merits a stance at taking a look at the -- both the set
8 of regulations that apply to private companies, and are those
9 thresholds really adequate now for private companies that
10 have to get bigger and incur higher revenues and therefore
11 achieve higher revenues to offset the additional operating
12 expenses and infrastructure to be a public company.

13 So, are the 701 thresholds really rational in that
14 kind of an environment, or the exemptive schemes under the '33
15 Act really rational? So I think it's good to look at that,
16 to just watch what's happening to the IPO process.

17 And, at the same time, I think some -- it's hard to
18 -- and you know, Alan, going back to your point about, you
19 know, you don't want to open the -- start scaling back on
20 regulation for companies that, in particular, really need it,
21 I think. But, as regulators, you've got to watch and see what
22 happens.

23 You know, you put in place regulations and you see
24 what happens to the market and try to adjust, and try to do
25 what's right for business and investors and strike that

1 balance. I think what -- and this is just an early -- I
2 think we're seeing some early warning indicators that 404 is
3 having consequences far beyond what anybody thought in terms
4 of cost, in terms of auditors resigning.

5 And I think that would be something to focus on
6 quickly to see if that's the tip of the -- if it's going to
7 go away and people are just -- it's going to be sort of a one-
8 time event.

9 Or rather, is this something that really is going
10 to start creating a hardship for smaller companies because
11 the auditors are saying, look, it's just not worth it for us
12 to audit this client or come up with a negative 404
13 attestation, you know, that the internal controls aren't
14 adequate. And therefore, we're going to resign because we
15 just can't bear the liability and don't want to be associated
16 with the account.

17 MR. BELLER: Guess I want to ask one more question
18 in this area, and then maybe we could move on. We certainly
19 -- and I think we understand the message regarding internal
20 controls, and I think we intend to be vigilant in seeing what
21 happens out in the market over the next few months, and
22 frankly, after that.

23 Stan Keller mentioned some of the exchange listing
24 standards in the corporate governance area as places where
25 you could think about tiering. And I guess I'll just throw

1 open for this group briefly -- put 404 to the side.

2 We've got that message. But what other areas -- if
3 you were to think about tiered regulation, what other areas
4 would you want to, want us to, focus on, or the states or
5 the exchanges or whoever? Rich Leisner?

6 MR. LEISNER: Well, I'll jump in and say I think
7 that the independent director problem for smaller businesses
8 is one that has been underappreciated. Because what's --
9 the unarticulated word is good independent directors.

10 And qualified personnel are not rushing off to
11 become directors for smaller public companies, because it's
12 not an attractive thing for them. Of course, it's not the
13 Commission's job to make it attractive, but I think you do
14 need to take that into account.

15 And I think that's a -- you know, the cost of
16 insurance is more important for a smaller company than for a
17 big one, because the big one may be cash rich, and they can
18 indemnify their officers and say it's never a chance that
19 you'll ever suffer any personal liability for serving on this
20 board.

21 At a smaller company level, they want to see what
22 the insurance is like. And those costs are higher, if the
23 insurance is available, than they've ever been.

24 MR. BELLER: I just want to make sure you're
25 talking about companies that are on the small scale

1 of listed companies, when we're talking about
2 this.

3 MR. LEISNER: Well, when I -- when they're -- yes,
4 they might qualify for being on NASDAQ Smallcap or maybe
5 even at the small end of NMS where they would be --

6 MR. BELLER: Right.

7 MR. LEISNER: -- where getting the good directors
8 for -- a company that's a candidate for winding up as an
9 orphan if it isn't careful.

10 MR. BELLER: Right. Are institutional investors
11 forcing the unlisted segment of the market into the -- affect
12 the same requirements as the NASDAQ and New York impose on
13 listed companies?

14 MS. CRAWFORD: Uh uh (negative).

15 MR. BELLER: Hugh Makens?

16 MR. MAKENS: I think (inaudible) -- (Off-mike) the
17 institutional trend -- there's two other factors that appear
18 to be affecting that transition. Number one is,
19 if you're going to position yourself for acquisition,
20 you're going to be putting these kinds of systems in place.

21 And secondly, if you have public directors on
22 private companies' boards they tend to want many of the
23 same protections and systems. And both of those are migrating
24 into the private environment as well.

25 (Simultaneous discussion)

1 MR. BELLER: Let me take Stan first, and then --

2 MALE VOICE: Oh, go ahead.

3 MR. BELLER: Stan Keller.

4 MR. KELLER: I was going to say what you said.

5 There are in fact -- I mean, the trend is moving down, yes,
6 because of institutional investors, because of professional
7 directors, because you may indeed want to go public and your
8 investors want you to go public.

9 And we're saying in the acquisition area, if you
10 want to be acquired by public companies, you need to have
11 disclosure controls and procedures, internal controls ready
12 for the offing, because as you know, as you created, the
13 acquiring company's CEO and CFO have to end up certifying to
14 that.

15 But let me say -- in my mind, what I was referring
16 to isn't a carte blanche, okay, we leave you out of the sys-
17 tem. Because I don't think that's right. I mean, I think in-
18 deed, the benefits of Sarbanes-Oxley are there, are important,
19 and should apply to all public companies if you want access to
20 the public company market.

21 It's how do you calibrate it. And so take
22 corporate governance. Richie mentioned independent
23 directors. Well, I wouldn't eliminate the smaller listed
24 companies from the requirement of having independent
25 directors, but there's no magic in the concept of a majority

1 being independent directors.

2 And so there could be a lower level for a lower
3 tier that you then disclose what you're doing. And you can
4 have more if you want to. Have a minimum, you know, number,
5 percentage of independent directors. Similarly on the
6 committees.

7 You know, you can have a by, if you will, on
8 independence for a member as long as you've got maybe a
9 majority on the committee. The definition of independence
10 can be adjusted somewhat to recognize that you're likely to
11 have somewhat more relationships if you're a smaller company
12 with your directors, because that's how you get people
13 involved, and in fact you use them that way.

14 And you could look at where that cut is. So
15 there's -- you know, what hasn't happened is the
16 recalibration process that I think is so vitally necessary, to
17 now put back into proper balance, what was important and
18 needed legislation at the time and rulemaking at the time.

19 (Simultaneous discussion)

20 MR. BELLER: Herb Wander?

21 MR. MAKENS: Well, Alan, you asked whether
22 investors are forcing all these things on people irrespective
23 of whether Sarbanes-Oxley or the SEC does. But lawyers are
24 forcing it.

25 I mean, someone comes to me and says, "I've been

1 asked to become a director of Richie Leisner's new
2 corporation." And so I look at the *Corporate Director's*
3 *Guidebook*, the Fourth Edition, which was just published, and
4 has a new chapter on if you want to become a director of a
5 public corporation. Here are the questions you should ask.

6 And those questions are exactly these issues that
7 we're talking about, and so the lawyers are going to tell
8 their clients, "Why go on that board under these circum-
9 stances?" So I think it's broader than just investors.

10 I think it's a whole sort of reaction to the
11 excesses that we went through in the past five years, and now
12 what's the balance, as sort of Stan said. And I think
13 everybody is gun shy.

14 MR. BELLER: I think that came out also quite
15 clearly in the first panel. And I think that is an element
16 that, you know, we have to deal with on both sides of the
17 table, if you will. I'd like to move on to a different
18 question.

19 One of the things that we have heard, and I think
20 the numbers bear it out, is that the number of companies with
21 analyst coverage is decreasing, and that that's probably
22 impacting smaller companies to a greater degree than larger
23 companies.

24 In a sense, I suppose we could say we're not quite
25 sure what our role is, but I'd like to flip that around and

1 ask it as a question. And that is, "What's the view of the
2 panel with respect to whether the SEC does have a role to
3 play with respect to analyst coverage, and I guess especially
4 with respect to smaller companies?" Jamie, did I see your
5 hand up, or --

6 MR. BRIGAGLIANO: Well, I can talk about where we
7 are on that and what's happened. The Commission has approved
8 two comprehensive sets of SRO rules that really changed the
9 landscape and posed significant disclosure and structural
10 requirements on research analysts at sell side firms, you
11 know, broker-dealers.

12 I think it's important to remember that many of
13 those requirements were imposed by Sarbanes-Oxley itself, in
14 which Congress, among other things, directed loud and clear
15 that the Commission and the SROs should adopt rules to insure
16 the objectivity and independence of research analysts and to
17 make sure that material conflicts of interest are disclosed.
18 So you know, we've done that.

19 Nonetheless, the SROs and the Commission have been
20 aware and cognizant of any disproportionate impact on either
21 small broker-dealers or issuers in terms of coverage. To
22 that end, there is a small firm exception to some of the
23 structural -- what we call gatekeeping -- requirements of the
24 analysts' rules.

25 And one of the theories behind that is some of

1 these smaller firms cover smaller issuers, and often
2 companies that are important in regions, but that may not be
3 covered by large investment banks.

4 In addition, what we anticipate is that next May,
5 May 2005, will be the one year anniversary of the
6 effectiveness of all of the new requirements. After that
7 point, the SROs are going to survey the landscape on those
8 rules and see what's working, what's not, what their impact
9 has been.

10 And the impact on small issuers and coverage is
11 going to be part of that report. And, at that point, we
12 certainly are going to look at whether there's anything in
13 the rules that has, you know, diminished coverage in a way
14 that's not either warranted, healthy or appropriate, and
15 consider whether to recommend any changes, you know, after
16 that.

17 It's certainly -- we certainly sense, as Alan noted,
18 that the number of issuers covered has declined, perhaps by
19 as much as a third. I don't know at this point how many of
20 those issuers would be classified as small businesses, but
21 it's a safe bet that many of them are.

22 We also don't know entirely whether the cause,
23 how much of the cause, of the diminution in coverage is linked
24 to the rules as opposed to other factors. For example, maybe
25 fewer companies -- small companies around to cover.

1 But in any event, we expect the report to look at
2 those issues and we'll move from there.

3 MR. BELLER: Herb Wander, you have your tent up.

4 MR. WANDER: Well, I -- oh actually, I should put
5 it down. It's hard for me to see how you -- how the SEC,
6 other than changing the regulations, could induce people to
7 start coverage. And I haven't figured out a way. I thought
8 about the question before we came down here.

9 Most of the -- what I've been told, sell side
10 analysts are now running hedge funds, so they're out of
11 business. The firms' structure is totally different. So I
12 think they'll have to be a growth, again, into some sort of
13 analyst.

14 But it may be different. It may be funds or
15 investment managers will start focusing on these smaller
16 companies, taking larger positions in them, and that's where
17 you're going to get the buy side or the pool to get them.
18 But I find it difficult to think of how you're going to
19 induce people to come in and provide more analyst coverage.

20 MR. KELLER: I do think, however, it's fair to ask
21 whether regulations that have been adopted discourage analyst
22 coverage of smaller businesses. And then, if so, is there
23 anything you can do about it, about those regulations in
24 particular?

25 So for example, I mean, the overall limitations

1 upon analysts to deal with the abuses that we saw in the
2 system -- I don't think anybody is going to say, hey, let's
3 back track, we don't need those anymore, because analysts
4 will do the right thing just because we call them
5 professionals. That some of those are needed.

6 But are there ways of changing it? So, for example,
7 take a second look. The prohibition on analyst coverage
8 during, you know, in the IPO process I think has affected
9 small business coverage because the analyst is no longer at
10 the table and part of the dynamic of the going public
11 process, which frankly, was one of the selection criteria --
12 often a controlling criteria -- in what banker you ended up
13 using.

14 Not that they committed what kind of -- you know,
15 opinion they would render on you. And still, getting that
16 objectivity is important. But do we really need to, with
17 other controls in place, exclude them from the process?

18 There was a recent study, and I'm happy that
19 Commissioner Goldschmid is here so we can talk about this or
20 I can raise this. There's a recent study by three professors
21 at the Wharton School, which vindicates what we were saying.
22 It doesn't change the result, by the way.

23 And that is that Regulation FD indeed, would limit
24 analyst coverage and it would be the smaller companies that
25 would be the ones to lose that coverage first. I'm not

1 saying that's a reason for not applauding, in hindsight, in
2 retrospect, the adoption of Regulation FD.

3 But, on the other hand, it's at least worth asking
4 the question, well, is there something that can be done. So
5 for example, can you carve analysts out of the community to
6 whom you can't speak, if that analyst undertakes certain
7 duties of dealing in a more public way with the information
8 that they receive?

9 I don't think if that would make a difference, but
10 it's that kind of thinking, of revisiting the regulations,
11 and the impact that I think is important.

12 COMMISSIONER GOLDSCHMID: Yes, Stan, just to answer
13 that, I do agree that looking at this whole research analyst
14 area is very important. Indeed, I've been saying that for a
15 long time.

16 And I am worried about the amount of money that's
17 been withdrawn. I think we did the right thing in cutting
18 off the investment banking money. It had a perverse effect.
19 But there's no doubt, as I see it, research budgets are down
20 by a third and more at many firms.

21 And that, much more than FD, I suspect is what cut
22 out coverage of some smaller firms. But looking at this
23 whole picture, I am very concerned about the limits on
24 coverage today and the amount of research money that's been
25 lost.

1 What we can do is unclear to me, but not doing
2 something is a terrible mistake.

3 MR. KELLER: Because that hurts investors as much
4 as it hurts the companies themselves.

5 COMMISSIONER GOLDSCHMID: Oh, I agree. I agree. I
6 think too much money -- now the market will adjust over time.
7 But right now, looking at what's happening and trying to
8 understand -- and we do have -- as suggested at the
9 beginning, a mixed set of rules from the SROs, Sarbanes-Oxley
10 rules, our rules. There's a mish mash, and they don't
11 always work together. There's more to do in this area, is my
12 view.

13 MR. BELLER: Steve Bochner?

14 MR. BOCHNER: You know, I think when you talk about
15 analysts, you're really talking about a lapse in research,
16 maybe a lapse in prognostications, forward-looking statements,
17 coming from that community.

18 And so perhaps, while you're looking at the, you
19 know, the impact of all of these things that have impacted
20 analyst coverage, you can also look at things from the issuer
21 side, because you can also encourage issuers to provide
22 forward-looking statements, particularly if you look at the
23 IPO process, which is one where there is no existing analyst
24 coverage, companies are constrained in providing their own
25 guidance because in 1995 when the Private Securities

1 Litigation Reform Act was adopted, IPOs were specifically
2 excluded, I think for valid reasons then about hype.

3 But I wonder whether in light of this lapse of
4 analyst coverage where we can't take a look at some of the
5 perhaps, quiet period rules. And I know you're doing that,
6 I think you're taking a look at some of the communication
7 issues.

8 I think that's a good idea. Should there be more
9 openness? Should we take advantage of some of the means of
10 communications that have arisen since 1933 and make that
11 available to the IPO process?

12 But in particular, taking a look at whether denying
13 safe harbor protection for IPO candidates is really, in this
14 environment, the right thing. Or would it be better to
15 encourage those companies to provide that information?

16 I think there's ample liability, potential
17 liability, through other provisions of the securities laws.
18 So that may be another way of trying to get that information
19 to the market.

20 MR. BELLER: Thanks very much. As we did the last
21 time, I want to leave ten minutes or so to go around the
22 panel and get some closing thoughts. But I do want to cover
23 one other subject, at least briefly before we do that. And
24 that's the prohibition on insider loans of Sarbanes-Oxley,
25 Section 402.

1 That provision produced as much of a flurry of
2 attention as I think any other provision, when the Act was --
3 immediately in the aftermath of the adoption of the Act -- in
4 July, August of 2002. A lot of that seems to have died down,
5 I think in part because the bar, the private bar, organized
6 itself and attempted to provide some constructive advice.

7 I think we continue to hear from time to time, at
8 least, the suggestion that whatever you think of 402 as a
9 general matter, it does have some unintended and
10 disproportionate consequences for smaller companies. And I
11 would like to spend a couple of minutes on that before we
12 close. We'll start with Stan Keller.

13 MR. KELLER: Let me pick up, having been involved
14 in the bar's organized effort, which one academic said was a
15 violation of the anti-trust laws.

16 In the main -- this is not a small -- limited to a
17 problem for small business. I mean, it runs across the
18 board. One area where I think it can be identified as a
19 small business issue in which something could be done, and I
20 would submit after now more than two years, the Commission
21 with its rulemaking authority under Sarbanes-Oxley can
22 judiciously dip its toe in the water, is grandfathering of
23 pre IPO arrangements that were not entered into in
24 contemplation of the IPO.

25 In other words, private companies have arranged

1 things. Okay, it's disclosed up front and it's not subject
2 to the same abuses that new arrangements of public companies,
3 which were the target of 402, are subject to.

4 Beyond that, I think again, judicious
5 interpretative assistance from the Commission in areas where
6 it's easy to bring clarity in this area would help all
7 companies, and therefore, would help smaller companies. You
8 know, for example the status of advance of expenses and
9 indemnification.

10 And that's low hanging fruit in my judgment --
11 cashless exercise arrangements of -- low hanging fruit,
12 relocation loans for legitimate, you know, business
13 arrangements, maybe with a cap, so it doesn't pick up mansions
14 on Nantucket, is easy to deal with.

15 So that would -- I think the -- enough time has
16 passed. It isn't the 60 years, I guess, from the 1930s. But
17 the Commission can act in this area.

18 MR. BELLER: I'm sorry. Herb Wander?

19 MR. WANDER: I suspect most independent directors
20 actually like the rule. Because one of the hardest decisions
21 that they have to make is -- President comes in and says, "I'm
22 margined up to the hilt and I'm going to -- stock is going to
23 go out and we're going to have a market disruption. You've
24 got to loan me money because I can't get money anyplace
25 else."

1 And the directors had to grant those loans, but
2 they're under the wire on those situations. So I don't -- I
3 think I agree entirely with Stan, that there are many areas
4 that this was just sort of a meat ax that we could surgically
5 fix that are legitimate.

6 But all in all, I suspect most independent
7 directors like the rule. They just don't want to -- go to a
8 bank. We're not a bank.

9 MR. BELLER: Steve Bochner?

10 MR. BOCHNER: Yes, I would agree with that. I
11 think a couple of narrowly construed exceptions - I'd try to
12 settle the option exercise issue -- you know, get that off
13 the plate. I would you know -- maybe relocation, new hires,
14 you know, where independent directors approve loans for
15 legitimate business purposes.

16 I think it can be a very useful tool and to the
17 benefit of shareholders. And I think I would -- but I agree
18 with Herb -- I think having those kinds of restrictions are
19 probably -- or having very specific limitations and -- I
20 mean, obviously, maintaining the general prohibition is
21 probably the right approach.

22 MR. BELLER: Okay. If no one has anything to add
23 on that subject, I'm going to close this off again by going
24 around the panel. I'll start at the other end this time with
25 Herb Wander.

1 Any take-aways, closing thoughts in 60 to 90
2 seconds?

3 MR. WANDER: Well, real quickly, I think the finder
4 business, broker question is not a difficult one to address.
5 And I think it should be addressed, whether it be a
6 combination state and SEC regulation.

7 But again, as putting myself -- and a lawyer, when
8 somebody comes to me and they can't find money, and they
9 bring somebody in and the guy promises him all sorts of
10 money, I look at him and I say, "There's no tooth fairy."
11 And --

12 But he says, "Well, I'm going to go out of business
13 or I can't make payroll and what do I do?" And so having
14 some sort of registration that doesn't mean you're a broker-
15 dealer and that capital rules and all these other sorts of
16 things probably makes sense and is easy to do.

17 On the questions of tiering, I agree with Stan,
18 that I think you have to sort of -- before you decide on what
19 size to tier, you have to decide on what it is that you're
20 not going to require and then look at the size. I would look
21 at the size secondly.

22 But at the end of the day, I think it's going to be
23 a hard chore to do, to say you're not quite a full citizen
24 here. And because of the other pressures that are out there
25 because of investors and lawyers, frankly.

1 MR. BELLER: Right. Good. Denise Crawford?

2 MS. CRAWFORD: In an effort to create a more
3 perfect world, I have two suggestions, two take-aways. One
4 would be that -- and this will be a bit repetitive -- that we
5 give these smaller companies more time. That the SEC really
6 consider raising the limits for Rule 505 and Reg. A deals so
7 that there is a maximum amount that is more realistic in
8 today's times.

9 Five million dollars is just too low a dollar
10 amount. It's a 20-year-old amount, at least with regard to
11 one of them, and a few lesser years I think with regard to
12 the other.

13 The other take-away is one that we didn't discuss,
14 but I would be remiss if I didn't bring it up. And that is,
15 just as we need to look at the numbers for giving the
16 companies more time, we also need to revisit the standard for
17 being an accredited investor.

18 That has not been looked at in over 20 years. The
19 standard is extremely low. And I know that it's very hard
20 for small business people to sort of swallow the idea that
21 you would want to narrow the universe of acceptable investors
22 in small businesses.

23 But if you really get a long term, if you really
24 think about it, you want to have people who can afford to
25 invest this money, because long term, the investor confidence

1 that you gain from doing that inures to your benefit.
2 So to sort of synthesize those two suggestions, we just need
3 to revisit all these old numbers in every context that
4 affects the small business capital formation.

5 MR. BELLER: Actually, let me ask you two -- one,
6 let me point out, we look at the accredited investor
7 definition almost certainly every six months or year. You
8 were right that we haven't proposed anything in a very long
9 time.

10 But I think that's a reflection of the tensions
11 around that rule. I understand the point you're making.
12 With respect to your first point, would you restrict the --
13 those increased amounts in terms of the types of investors
14 who could invest as a trade off? And how do you feel about
15 sort of public markets developing around those exempt
16 offerings?

17 MS. CRAWFORD: Well, we used to say in the
18 regulatory area when I first started out, that the ideal
19 situation would be to license investors. Because then you
20 didn't have to worry about all this other stuff.

21 But yes, there are a number of ways to get at the
22 problem. And I think just starting that dialogue with a very
23 serious focus on making improvements would be a good way to
24 go. I don't think that anybody is necessarily locked into
25 one formula.

1 MR. BELLER: Jamie? Brian? I don't know if you
2 want to participate in the closing remarks or not. We didn't
3 rehearse that, so --

4 MR. BUSSEY: The devil is in the details on
5 finders. And as we've asked for before, I think a clear
6 articulation of the problems -- and I think it's occasional
7 finders, professional finders, business brokers and then
8 proposed solutions.

9 Because what I think I'm hearing is that it's not a
10 one size fits all situation. And to the extent it's through
11 the ABA Small Business Committee or otherwise, we really
12 appreciate the input. Our doors are open.

13 MR. BELLER: Steve Bochner?

14 MR. BOCHNER: Just two parting comments. One, to
15 echo Denny's comments about taking a look at the private
16 company exemptions. I think that's a worthwhile thing. And
17 in addition to the exemptions for capital raising, I'd also
18 take a look at 701.

19 I think the other thing to keep an eye on --

20 MR. BELLER: 701 is the exemption for --

21 MR. BOCHNER: Compensatory.

22 MR. BELLER: -- security offerings to employees.

23 MR. BOCHNER: Compensatory --

24 (Simultaneous discussion)

25 MR. BOCHNER: Because I think companies are going

1 to be bigger when they're private and have to issue more
2 stock to employees. Because we've got -- you know -- I think
3 the other thing to take a look at is perhaps work with the
4 SROs in figuring out what is going to be the impact of all of
5 these companies that aren't able to get their financial
6 statements filed due to auditor resignations and 404 problems
7 and so on. I think we're going to see a lot of that going
8 on.

9 MR. BELLER: Stan Keller?

10 MR. KELLER: To try to summarize, I guess the theme
11 I was hearkening on -- you know, like all reactions to
12 dramatic events, they tend to be overreactions. And
13 clearly, Congress did not take the time, or have the time
14 perhaps, to differentiate in the meat cleaver legislation.
15 And it's up to the regulatory agencies, particularly when
16 given the statutory authority to do so, to start that
17 differentiation process with the benefit of some experience.

18 So I think that needs to take place. And in saying
19 that, it's recognizing that the changes that were made, the
20 regulations that were imposed, the requirements that were
21 placed on business in the whole were sound and important for
22 the integrity of the markets, which is what capital formation
23 is all about.

24 So it ends up being dealing more surgically with
25 where relief can be provided and where it's not inconsistent.

1 And we talked about corporate governance.

2 I think the other key -- and it all comes down to
3 capital formation -- is as we're doing, revisiting the capital
4 formation process, the regulation of the capital formation
5 process. And I would urge that that not be limited
6 to the top tier of companies, and certainly not the super top
7 tier of companies, but that it be brought down.

8 Now if it be done in steps, so be it. But it
9 should be an acknowledged first step. The focus is going to
10 be on top tier companies. But with the mission of bringing
11 the process down to where it's really needed. It's not needed
12 by the top tier companies because they already have free
13 access to the marketplace and to the hard thinking at the
14 lower levels.

15 MR. BELLER: Rich Leisner?

16 MR. LEISNER: As empirical proof of Stan's
17 erudition, the Sarbanes-Oxley Act according to Bill Gates is
18 29,144 words long not including spaces. The word small
19 business, according again to Bill Gates, doesn't appear in
20 the statute.

21 The word "small" does appear once in good old
22 Section 209. I'm sure you're all familiar with that. A
23 provision dealing with small and regional accounting firms.
24 So it falls to the regulators, as Stan has suggested. And I
25 applaud his statement to begin this recalibration process

1 with the focus on the consequences all the way through, going
2 backwards from the public company down into the capital
3 formation process, and see how it all fits together.

4 And so you've got some ideas here about the people
5 who raise the money, the broker-dealers, 701, looking at the
6 private placement numbers. Those are all great suggestions.
7 I only have one to add, which is that you look again at the
8 idea of what is advertising and general solicitation as a
9 part of that -- looking through that spectrum of the process.
10 And we have confidence that you'll do the right thing.

11 MR. BELLER: Hugh Makens.

12 MR. MAKENS: I get the last shot?

13 MR. BELLER: No, I think Commissioner Atkins and
14 Commissioner Goldschmid get the last shot (Laughter) --

15 MALE VOICE: As it should be.

16 (Simultaneous discussion)

17 MR. MAKENS: (Off-mike) Let me hit several areas.
18 The important part of the capital formation process is the
19 aftermarket, for people who buy stocks in small businesses.
20 One of the things I would do, suggest doing, is re-looking
21 at the 15c2-11 requirements and imposing a requirement that
22 the 15c2-11 information be published on the website of the
23 company, rather than just in the hands of the broker-dealer.

24 One of the real problems is getting that
25 information out into the hands of the public, rather than

1 just in the hands of the broker-dealer.

2 I would also do away with the requirement that
3 another broker-dealer can piggyback on someone else's. I
4 would also ease the ability or look at the process of easing
5 the ability to allow small businesses to use smaller broker
6 dealers to participate in transactions in inactive markets.

7 I see it continually in the areas of insurance
8 companies, banks. It's very difficult to go into those
9 markets and provide any kind of -- even a very inactive
10 market -- and I think it would be a major service to develop
11 the system to be able to do so.

12 And I would love to see you crack down on the
13 computer touts because I -- about once a week, I forward off
14 to the Division of Enforcement another tout sheet on
15 something that's going to triple in price, and we're about to
16 hit -- go on the New York Stock Exchange.

17 On the loans areas, I'd recognize -- first, I'd
18 think setting some caps and permitting activity below those
19 caps makes a lot of sense. I would also recognize that there
20 are companies that are filing with the states and going
21 through the registration process with the states.

22 And there you've got -- NASAA has their loan policy.
23 And that policy provides a very tight stricture for
24 circumstances under which loans can be made. And I would
25 suggest, for those that have passed through that policy,

1 probably the Commission doesn't have much of a concern.

2 I also would liberalize the area of loans in the
3 recruiting process, again with the caps. In the finders area,
4 I urge the creation of private placement broker-dealer regs.
5 with a simplified, targeted registration process, opening up
6 the process of intra-state and possibly regional finders.

7 The creation of relief in the M&A area for greater
8 transactions, stock based transactions, recognizing as
9 long as they're done company to company, the chances of
10 public risk in that area are very small.

11 And I would recognize that the states have
12 developed a process for the last almost hundred years of
13 registration of agents of issuers, and that the agent of
14 issuer registration process may work well and serve small
15 business.

16 And if you have that registration process, you may
17 not need to trigger broker-dealer for more limited activities
18 than are circumscribed presently by 3(a)(4). In the --

19 MR. BELLER: I'm going to --

20 MR. MAKENS: -- I focus --

21 MR. BELLER: Hugh, I think I'm going to stop us
22 there.

23 MR. MAKENS: All right.

24 MR. BELLER: I guess I'd ask Commissioner Atkins or
25 Commissioner Goldschmid whether you have any closing

1 thoughts for us.

2 COMMISSIONER ATKINS: Well, just to thank you for
3 your participation. You've given us a lot to think about.
4 Now that the two-year mark after Sarbanes-Oxley was
5 enacted is, I think, obviously a perfect time to
6 look back and see what the effects, both intended and
7 unintended, are and see how we can address them. Thanks.

8 COMMISSIONER GOLDSCHMID: Yes. I very much share
9 that view. And we really appreciate your coming. To me, this
10 has been a very helpful session. As the opening statements
11 indicated, small business is at the heart of much of what's
12 dynamic and important in the economy.

13 And we appreciate your coming and telling us what
14 to do. Sometimes we'll do it (Laughter).

15 MR. BELLER: I'd like to add my thanks on behalf of
16 the Commission and the staff and other participants in the
17 forum. This was also a wonderful panel, extremely
18 informative, and we appreciate your time and effort in
19 spending some time with us this morning and afternoon. Thank
20 you very much.

21 (Announcements follow.)

22 (Whereupon, a luncheon recess was taken.)

23 MR. DUNN: Okay. Then we're going to do this:
24 We've collected questions. I've handed them out to the folks
25 up here who I think have the best answer for them. I'm going

1 to let them read them and give the answer, and then I
2 have a few at the end.

3 And in the interim, I think some folks from Gerry's
4 office are going to be walking around in case you have any
5 more. So with that, I think we'll start on my right with
6 Carol Stacey.

7 MS. STACEY: Thanks, Marty. For those of you who
8 don't know me, I'm the Chief Accountant in the Division of
9 Corporation Finance. We have, it looks like, one accounting
10 question or semi-accounting related question.

11 The question is: "Sarbanes-Oxley clearly allows Over
12 the Counter Bulletin Board companies not to have an audit
13 committee. If, under 404, an accounting firm cannot give a
14 clean opinion because there is not an audit committee, isn't
15 that contrary to Congressional intent?"

16 I think you're probably all familiar with the rules
17 that the Commission has done, and anywhere they cite what an
18 audit committee's responsibility is, they always say, or we
19 always say, if there's no audit committee, you would look to
20 the board of directors who are presumably fulfilling that
21 role in place of, or in the absence of, an audit committee.

22 I think even if -- and I can't remember
23 if the PCAOB's Rule on 404 specifically says this, but if it
24 doesn't, I think it's still reasonable to assume that if
25 there is no audit committee for 404 purposes, you would look

1 to the effectiveness of the board of directors in performing
2 the audit committee function.

3 So I don't understand why an audit firm would not
4 give a clean opinion, just because there's no audit
5 committee, because that would be now the board of directors
6 functions.

7 So I think it should not be an issue. You would
8 then be evaluating the effectiveness of the board of directors
9 in that role.

10 MR. DUNN: Gerry, you're up next.

11 MR. LAPORTE: Okay. First question: "What is the
12 status of the S-8/8-K release regarding public shell mergers?
13 Will it be adopted as proposed?"

14 The status of the release is that the comment
15 period has ended. We're looking at the comments that we got,
16 and we hope to be able to recommend something to the
17 Commission before the end of the year. Will it be adopted as
18 proposed? I can't answer that one (Laughter).

19 MR. DUNN: We gotten along the lines of what, 30, 35
20 comments, a lot of them very good on the definition of shell
21 and along those lines. So we'll factor them in. But who
22 knows?

23 MR. LAPORTE: Right. We can't predict what the
24 Commission will decide to adopt. Second question: "Is the
25 "test the waters" provision operative? If so, how effective

1 is the experience?"

2 The "test the waters" provision is only operative
3 in Regulation A, and it hasn't been used by very many people.
4 To some extent, there's a problem at the state level
5 that people can't overcome, so I'm not sure that it's been
6 very effective in its current iteration.

7 We've talked from time to time about redoing
8 Regulation A, and those of you who were here this morning
9 heard some people saying that it's time to take
10 another look at Regulation A. So maybe, as a result of this
11 morning's discussions, we'll speed up our review of
12 Regulation A.

13 And if we do, that will be an appropriate time to
14 consider "test the waters." It's also possible that in
15 connection with looking over small -- what this morning we
16 called the "intermediate area" of small business financing
17 -- "test the waters" might be something that we can do in
18 addition to looking at general solicitation or
19 something to see what we're going to do between the \$25
20 million and the \$200 million offering.

21 Third question: "Are the proceedings from prior
22 forums programs available? If so, how does one obtain
23 copies?"

24 The proceedings from prior forums like this, which
25 is the SEC Government-Business Forum on Small Business

1 Capital Formation, back to 1993, they're available on our
2 website. If you go to the SEC website and you click on "Small
3 Business," there's a page for the small business forum. Be-
4 fore 1993, if you want them, you can get copies from our
5 office.

6 MR. DUNN: Okay. We'll turn to Brian Bussey.

7 MR. BUSSEY: First question is: "If finders do get
8 registered with the broker-dealer, what is the broker dealer's
9 liability for that finder, now a registered person with the
10 firm, for his outside activities away from the broker-dealer?"

11 I point the person to NASD Rules 3030 and 3040.
12 3030 contains a notice requirement for outside activities for
13 compensation; and then 3040 is a rule that deals with outside
14 activities involving private securities transactions.

15 And the rule splits the world into private
16 securities transactions for compensation and those not for
17 compensation. Private securities activities for compensation
18 -- they -- first, the person needs to put the broker-dealer
19 on notice. The broker-dealer needs to approve that outside
20 private securities transaction activity; and then, third, has
21 to supervise that outside activity as if it were the broker-
22 dealer's own activity.

23 And then the second question is: "What discussion,
24 if any, has there been on creating a tiered marketplace for
25 inactive stocks? Specifically, this marketplace would be

1 absent of broker-dealer middlemen, a Dutch auction system or
2 marketplace simply matching orders."

3 I can't speak to discussions outside of the SEC,
4 but I can point you to the fact that such a marketplace would
5 either have to register as a broker-dealer or as an exchange,
6 depending on the specific circumstances of how the market
7 would operate.

8 MR. DUNN: The next set -- we're going to turn to
9 John Reynolds, who is the Assistant Director for our Office of
10 Emerging Growth Companies.

11 MR. REYNOLDS: Thank you, Marty. For those of you
12 who don't know what my office does, my office reviews most of
13 the IPOs filed by small businesses with the Division. The
14 question I have -- I have one -- is: "Why does the SEC not
15 consider Pink Sheets equivalent to the OTC Bulletin Board for
16 the purpose of enabling issuers to use market price as sales
17 price on a Form SB-2, since the NASD rules for "firmness and
18 trader reporting" are the same?"

19 I believe this arises in the context of a selling
20 security holder offering where it's an initial public
21 offering. There's not a primary offering. It's just
22 a registered selling security holder offering.

23 And the securities are not quoted on a market or
24 they're quoted on the Pink Sheets. We have, for the last
25 several years now, taken the position that resales of those

1 securities need to be made at a disclosed price until such
2 time as the securities get quoted on the Bulletin Board.

3 And after that time, these securities can be sold
4 either at the prevailing market price or in privately
5 negotiated transactions. We have not extended that position
6 to quotes from the Pink Sheets. You know, I'm sure we'll be
7 ready to consider your arguments to equate the two and treat
8 them similarly.

9 But at this point, we look at the Bulletin Board as
10 being a marketplace that provides a good indicia of value for
11 the securities that are traded on that market. And I would
12 like to point out that the Bulletin Board issuers are
13 reporting companies. And that's it for my question.

14 MR. DUNN: Liz Osterman's next. She's an
15 Assistant Chief Counsel in the Division of Investment
16 Management.

17 MS. OSTERMAN: Good afternoon. My question relates
18 to business development companies. And it reads: "With all
19 of the negative implications of the current regulatory
20 structure on small, often orphaned, small businesses,
21 wouldn't the SEC be doing the market good by adopting a more
22 friendly stance towards business development companies as
23 opposed to a more onerous one as currently seems the case?"

24 And I guess the answer to that sort of falls into
25 two categories. If you've looked at business development

1 companies very carefully, you would understand that they were
2 created in 1980 and they were intended to fund small
3 businesses.

4 And that is something that we are interested in
5 having them do, and I think that is clearly their purpose.
6 At the same time as they were created under the Investment
7 Company Act, Congress specifically imposed what they called
8 "important investor protections," which essentially means the
9 Investment Company Act generally applies to BDCs as if they
10 were closed-end investment companies.

11 There are a number of exceptions to that rule where
12 there is some more flexibility to BDCs than there are to
13 registered funds. But nevertheless, we consider those
14 important investor protections very near and dear to our
15 hearts and we stay true to them.

16 At the same time, we've become aware of an issue
17 that has had an effect on limiting the investment
18 opportunities of BDCs, and that was because of a change in
19 the definition of "margin security" that the Fed made.

20 That change was completely unrelated to business
21 development companies, but it affected what they could freely
22 invest in. So we're looking at that provision. We're
23 considering options of things that we can do as a staff, and
24 we are certainly interested in insuring that BDCs continue
25 with their stated purpose of funding small, developing and

1 financially troubled businesses. That's it.

2 MR. DUNN: I will jump in. I have a bunch here,
3 and to the extent I know about half the answer, the rest of
4 these folks hopefully will join in. I have one particular
5 I'm going to have to ask John to help a little bit about.

6 But the first two I have here relate to independent
7 equity research. And one goes to defining "independent" and
8 adopting some rules around it, and another goes to looking to
9 perhaps what Singapore has done or what other similar
10 countries have done as to fostering independent research.

11 And I think the best answer for that is what
12 Commissioner Goldschmid had said earlier -- it may well
13 be time for us to start looking at these rules and figuring
14 out what we need to do about research. The world of it has
15 certainly changed in the last couple of years, and that's
16 exactly what -- one of the reasons we're here is to figure
17 out what we should be doing next.

18 So those, I will take as suggestions. I don't
19 speak for the Commission. I can't say "Done, it's a rule."
20 But there are things that we definitely need to be thinking
21 about that the world has changed, and we may be behind on it.

22 So we're going to work on those. So thank you for
23 those. One other question is: "Is there anything we can do
24 to speed up processing of our 1933 Act filings?" I think
25 usually, that

1 should be the question we should be asking you, because we do
2 everything we can to speed up the processing of 1933 Act
3 filings.

4 And we've done a lot of hiring and a lot of trying
5 to do some tweaking of our review process for just this
6 purpose. We still have our goal of getting under 30 days,
7 and I think we average that pretty regularly. If there
8 are any suggestions on smaller businesses, I'd ask John if
9 there's anything specific you see that holds things up.

10 MR. REYNOLDS: You know, I get that question a lot.

11 MR. DUNN: Nobody ever says, "How can we slow down a
12 review of a 1933 Act filing?" (Laughter)

13 MR. REYNOLDS: No, no. Well, I think a lot of
14 factors go into the length of time that it takes for a filing
15 to go effective.

16 You know, obviously, it's an issue with the staff
17 on this end, with the amount of work that is in my office.
18 That's an issue. Also, you know, the small business filings
19 frequently come in different forms.

20 There may be significant changes during the
21 course of a registration statement. The nature of the
22 offering could change. Sometimes we don't get amendments for
23 long periods of time and financials need to be updated at that
24 point, or perhaps I've lost staff because they're no longer
25 in my office, and I have to assign a new examiner and new
26 accountant to it.

1 So there are numerous reasons why it -- which go
2 into the timing of filing effectiveness. I would suggest for
3 small businesses to double check the documents that you file
4 with us to be sure that they are significant in every
5 material way.

6 I mean, be sure you have your audit report in
7 there. Be sure you have current financial statements. Be
8 sure you're not missing part of your document. Also -- so
9 those are things that you can do to help us help you. And I
10 would encourage you to do those sorts of things.

11 In other words, just be sure that your filing is in
12 good shape when you send it in on EDGAR. And that would help
13 us a great deal.

14 MR. DUNN: Thanks. "What are the repercussions of
15 not complying with SOX in regard to small businesses?" The
16 repercussions are the same, small or large businesses. SOX's
17 main term is "reporting issuer."

18 So the -- most of the provisions in there apply to
19 you once you're a reporting company under the 1934 Act, or
have
20 a registration statement in here under the 1933 Act. It
21 doesn't matter whether you're small, big, anything, there.
22 The repercussions mostly are civil. The 906
23 certifications are criminal. And they are -- some of them are
24 directly in the 1934 Act -- so they would be 1934 Act
25 violations. Others would be violations of the particular
26 provision of

1 Sarbanes-Oxley. But it's mainly civil and it applies across
2 the board.

3 "Given the high cost of public compliance for
4 companies that are or have been small orphans as well as high
5 Rule 13e-3 and related costs, has any thought been given to
6 ways to help such companies off the playing field with a
7 more streamlined, going private process?"

8 It's an interesting question, and we've gotten the
9 same question for foreign issuers. Is there some notion that
10 this isn't what folks bought into? And so there should be
11 some way of getting out.

12 Of course, the goal, as always, is to keep
13 everybody in and keep that as streamlined as possible. But
14 we recognize that the world has changed. Some of the
15 discussion in the last six months that you've read in the
16 press is certainly that the Commission has been, or the
17 staff, at least, is bouncing around ideas about whether that
18 would be appropriate, because some folks are just not able to
19 do it any longer.

20 And we have said in the press that we are thinking
21 of such things. Who knows what will ultimately happen, but
22 it's in the hopper of things as to realize that not only do
23 we need to streamline whatever we can for whoever is in the
24 system, but sometimes the ease of getting out isn't there,
25 and it should be there.

1 It's always a balance. You know, do you want to
2 let people out and then look at the investors who aren't
3 getting the information, versus is it really in their
4 interest for all the money to be spent keeping them in?

5 So I don't know that there's a win or a lose side
6 of that. I think that either side is a little bit of a loss,
7 and it's a question of which loss you take. But I recognize
8 there are losses on both sides, and the staff has been saying
9 it's something we need to think about and try to come up with
10 a way or, if there's not a way, then to explain why not.

11 So I take that as a suggestion. It is something
12 that we've been trying to figure out. I apologize -- I
13 have a Reg. SHO question which I got late in the process. And
14 Jamie wasn't around to answer it, because he asked me about
15 five minutes before we came up here if there were any SHO
16 questions, and I said "no."

17 So whoever gave me this, I apologize. Please come
18 up and I'll make sure Jamie gives you a call tomorrow as soon
19 as we can. The only thing I know about SHO, being a Corp.
20 Fin. guy, is it's a kind of Taurus. I don't really know.
21 I don't know short sales from the Market Regulation side and I
22 do apologize for that.

23 Question: "Women and minority owned businesses are
24 critical to the success of the economic security according to
25 President Bush. Therefore, why is the SEC yet to establish

1 an office of minority- and women-owned business? It is worth
2 noting that only four percent of small and medium sized
3 businesses that go public are majority owned by minorities
4 or women."

5 I think that's a fair question. It's something to
6 think about. And occasionally, we get it. I tend to view
7 Corp. Fin.'s role as explaining the law to all companies as
8 best we can and trying to ease the process of getting through
9 it and providing investors with the information that's
10 required.

11 Our responsibility under Section 2(b) of the 1933
12 Act is to balance investor protection and capital formation.
13 And I don't know if the purpose of such an office would be to
14 support a particular type of company, which usually is not in
15 our role.

16 However, if somehow in our role we are not
17 providing our guidance to a particular type of company, we
18 need to think about that. I would think that most of those
19 companies would be asking Gerry's office for information,
20 and that need would seem to be met there.

21 We don't usually go about promoting one type of
22 company or another. We see our goal as helping all of them,
23 and, in the small business area, because we know there are
24 particular questions, we have an office for that.

25 Perhaps the purpose of the question is to say there

1 are particular questions in that area that we haven't thought
2 of. And if that's the case, we'll definitely think of it.
3 But I would tend to think the Small Business Office works in
4 that area.

5 Another question goes to, "What is the SEC doing "
6 -- or I'll read the end of it -- "What specific action is the
7 SEC taking to remain competitive in the global economy in
8 respect to insuring that U.S. financial markets can compete
9 with ethical foreign public equity markets?"

10 I don't know that I could give a list of specific
11 things, because I think that if at any point the Commission
12 got up here and voted on something, and we said, "We're doing
13 this because we think we can keep -- it keeps us from being
14 able to compete with other markets," they'd probably shake
15 their heads.

16 I understand the viewpoint that is asking that
17 question, and I respect it. However, I think that everything
18 the Commission does is with the goal of making the U.S.
19 markets as liquid and transparent as they can. And in that
20 way, you compete with foreign markets.

21 So I will take that as the best answer I can give
22 for that. We definitely factor that in to everything we do,
23 and we recognize the world is changing. To have a xenophobic
24 approach to markets is stupid. And I don't believe that the
25 Commission does that. And we try very, very hard to relate

1 to what is going on around the world and contemplate it.

2 The last two questions I have go to the structure
3 and attendance at today's forum. They are what they are.
4 The Planning Committee believed that this was the best way to
5 have this and get the most information around. I personally
6 think it's the best way, because this way, having it here and
7 doing it this way, allows it to be webcast, and you don't have
8 to actually be here to get all the information you can learn.

9 I think it's a wonderful idea. We'll, of course,
10 try to get better and tweak things as we go, as always. But
11 I just think the opportunity to get on the web and not have
12 to go to the hotel in Virginia or whatever particular part of
13 the country we're in, is the way to go.

14 Being here helps with participation in the break-
15 outs. I think those are the key to the whole thing. But the
16 gathering of information up to this point, I think this is a
17 wonderful idea as to how to do it and I congratulate the
18 forum folks on thinking about it.

19 With that, we've gone through these. Again, I
20 apologize for the SHO question. If I had gotten it two
21 minutes before, I would have had an answer. I'm very sorry.
22 That's my mistake. So please come up and talk to me about
23 that.