

RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE
on
SMALLER PUBLIC COMPANIES

First Day of Meeting

August 9, 2005

1:00 p.m.

The John Marshall School of Law
Room 300
315 South Plymouth Court
Chicago, Illinois

The following individuals were present in person:

Committee Members:

Patrick C. Barry

Richard D. Brounstein

Pastora S.J. Cafferty

C.R. "Rusty" Cloutier

James A. "Drew" Connolly III

E. David Coolidge, III

Alex Davern

Joseph "Leroy" Dennis

Janet Dolan

Richard M. Jaffee

Mark Jensen

Deborah Lambert

Richard Leisner

Robert E. Robotti

Kurt Schacht

James C. Thyen

Herbert S. Wander

Committee Observers:

George J. Batavick

Daniel L. Goelzer

Jack E. Herstein

SEC Staff:

Cindy Alexander

Anthony G. Barone

Mark W. Green

Kathleen Hanley

Will Hines

Gerald J. Laporte

Kevin M. O'Neill

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Officer, Peoples Bank, Munster, Indiana Page 61

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experienced public company director, Chicago, Illinois Page 78

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St. Louis, Missouri Page 157

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**Exhibit A -- List of Members of the Public Who
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PROCEEDINGS

2 MR. WANDER: Why don't we all take our seats and
3 begin. I'm going to make a few introductory remarks and then
4 let everyone in the room introduce themselves and identify
5 themselves who are either on Advisory Committee or our
6 guests. And let me start by welcoming everyone to -- this is
7 our third formal meeting session, our second where we are
8 taking testimony. And the Advisory Committee is quite
9 interested in hearing the views of all interested parties,
10 issuers, investment bankers, investors, accountants, lawyers,
11 everyone else, and we are continually looking for ideas on
12 how to improve the regulatory system for smaller businesses.

13 Our hearings are essentially very formal. They are
14 being webcast, so we will go down for posterity, and probably
15 your voice will go in some sort of a time capsule that
16 somebody will open up a hundred years from now. But we
17 welcome all of your input.

18 And let me also note that we have published a
19 questionnaire that is on our web page, which is on the
20 Securities and Exchange Commission web page, and we are
21 looking again for additional input in written form. I notice
22 I got a stack about that much last night, so people are
23 already responding. And we look forward to all of those.

24 So with that very, very brief introduction I'd like
25 to introduce Jim Thyen, my Co-Chair, and then everyone in the
1 room around the round table can introduce themselves.

2 Housekeeping item. Please will all persons state
3 their names prior to speaking because the webcast can't pick
4 out who we are without that.

5 MR. THYEN: Good afternoon. I'm Jim Thyen,
6 President and CEO of Kimball International.

7 MS. DOLAN: Good afternoon. I'm Janet Dolan,
8 President and CEO of Tennant Company.

9 MR. DENNIS: Hello, my name is Leroy Dennis. I'm
10 executive partner of McGladrey & Pullen, CPA firm.

11 MS. CAFFERTY: Hello, I'm Pastora San Juan
12 Cafferty, I'm a professor at the University of Chicago.

13 MR. CLOUTIER: Hi, I'm Rusty Cloutier, president of
14 Midsouth Bank Corp. in Lafayette, Louisiana.

15 MR. JANKOWSKI: Hello, I'm Jess Jankowski, I'm the
16 CFO of Nanophase Technologies in Romeoville, Illinois.

17 MR. PERKINS: I'm Don Perkins, Chairman of that
18 Board and I brought Jess with me because he's my brains.

19 MR. ROBOTTI: Hi, I'm Bob Robotti, President of
20 Robotti and Company in New York.

21 MR. JENSEN: I'm Mark Jensen, a partner at Deloitte &

22 Touche.

23 MR. BOCHNOWSKI: I'm David Bochnowski, Chairman and
24 CEO of NorthWest Indiana Bancorp.

25 MR. SPEARS: I'm Mark Spears, CFO at LKQ
1 Corporation.

2 MR. SCHROEDER: Good afternoon. I'm Mark
3 Schroeder, President and CEO of German American Bancorp.

4 MR. DAVERN: Alex Davern, Chief Financial Officer
5 at National Instruments.

6 MR. GOELZER: My name is Dan Goelzer, I'm a member
7 of the Public Accounting Oversight Board.

8 MR. HERSTEIN: Jack Herstein, with the Nebraska
9 Department of Banking and Finance.

10 MR. SCHACHT: I'm Kurt Schacht, with the CFA Center
11 for Financial Marketing Integrity in New York.

12 MR. LEISNER: Richie Leisner, I'm a lawyer in
13 Tampa, Florida with the Trenam-Kemker firm.

14 MR. BROUNSTEIN: I'm Rick Brounstein, I'm the
15 Executive Vice President and Chief Financial Officer of
16 Calypte Biomedical.

17 MS. LAMBERT: I'm Debbie Lambert, I'm a partner
18 with Johnson Lambert and Company, a CPA firm.

19 MR. CONNOLLY: I'm Drew Connolly, principal of IBA

20 Capital Funding and Executive Director of the CEO Council.

21 MR. COOLIDGE: Dave Coolidge, Vice Chairman of
22 William Blair and Company, investment bankers.

23 MR. JAFFEE: Dick Jaffee, Chairman of the Board of
24 the Oil-Dry Corporation of America.

25 MR. WANDER: Thank you all for introducing
1 yourselves and for attending today. We have scheduled the
2 first panel of witnesses for two hours, and what we have been
3 doing in the past we'd like to continue to do and that is
4 give each an opportunity to make opening remarks and
5 presentations, and then the members of the Advisory Committee
6 will ask you appropriate questions. So why don't you make
7 your introductory statement. Give us a little of your
8 background, I think would also help for those here in
9 attendance and for those listening on the webcast.

10 And I guess, Mark, we could start with you since
11 you're on the left.

12 MR. SCHROEDER: Thank you. Again, I'm Mark
13 Schroeder, President and CEO of German American Bankcorp
14 located in Jasper, Indiana. And I do thank the Committee for
15 the privilege of being allowed to speak here today. I
16 suspect my invitation was somewhat because I was -- Mr. Thyen
17 and I are two public companies in the same small town, and I

18 was pleased when Jim was named Co-Chair and called him to
19 vent a little bit on Sarbanes-Oxley, hence have this
20 opportunity today so I'm glad to be here.

21 German American Bankcorp was formed in 1983. We
22 are a bit unique in the community banking corp. We are a
23 multi-bank holding company. We have five small community
24 banks as part of our group. We were formed for the express
25 purpose of giving the small bank shareholders an opportunity
1 and a vehicle to band together to operate in a more efficient
2 manner. And part of that was listing our stock on NASDAQ in
3 1993. Today we have about 3200 registered shareholder and a
4 150 million dollar market cap. Clearly our company is in
5 that microcap area and understands the pains of compliance
6 with Sarbanes-Oxley. Let me talk about three or four things.
7 I have filed a written statement, and so for those of you
8 that want to see a little bit more background in detail,
9 certainly it is there and available for you. But I
10 understand that I was looking forward today from people like
11 me who are testifying is what issues, what are the most
12 pressing issues that smaller public companies, in our case
13 very small public companies are dealing with. And does the
14 cost of compliance with Sarbanes-Oxley, is there a cost
15 benefit in the relationship.

16 At German American Bankcorp clearly we believe
17 given our shareholder base and given the cost which was about
18 \$850,000 for us in 2004. And given the fact that we are in a
19 regulated industry that has historically had a very good
20 track record in terms of internal controls. Our company I'm
21 proud to say likewise has had a very good record of internal
22 controls.

23 The extra layering of the regulatory burden and the
24 cost of that regulatory burden has not had a significant
25 benefit for our shareholders. And to that extent at the most
1 recent shareholder meeting I discussed that with the
2 shareholders. And I can tell you that our shareholders,
3 every one that I have spoken to, part of the reason they
4 bought our stock initially was because they know us, they can
5 touch us, they can feel us, and they can assess management. Part
6 of it we are in a regulated industry and they know that we
7 have those internal controls. They likewise don't see a lot
8 of increased benefit in Sarbanes-Oxley.

9 But what I would like to focus on really four areas
10 in answering which of, as a CEO of a small public company,
11 what are the four areas that probably have created the
12 most difficulty for us and what is our recommendation as to
13 what the SEC and the PCAOB could do in terms of helping us

14 work through those issues. Those four issues are: the lack
15 of external auditor guidance because of the new regulations;
16 the scope 404 compliance, both in documentation and
17 assessment; the frequency of the internal control
18 certification and attestation process; and last being the
19 banking industry, and something I'm sure you've heard from
20 others in the banking industry, duplication of federal agency
21 regulatory oversight by multiple government agencies.

22 Let me start with the external auditor guidance and
23 also kind of splash over into this scope with the 404
24 compliance. With due respect to all of the audit firms
25 represented here, I think the fundamental issue in both of
1 these cases is that our audit firms have become paranoid,
2 rightfully so, I might add, but they've become paranoid in
3 terms of -- as a small company we have historically
4 outsourced to our attorneys and our accountants those
5 technical parts of whether it's regulatory, accounting, legal
6 issues. Our external auditor has always been an important
7 part of that group, an important part to make certain our SEC
8 filings are complete and they were accurate.

9 In today's world where every auditor I think
10 believes in every conversation with every audit client
11 they're putting their firm at risk, they're no longer willing

12 to provide that guidance. And I do understand that the PCAOB
13 has issued a statement basically saying to the audit firms
14 you perhaps have gone bit too far here, you can provide some
15 guidance and some direction in this more than you have in the
16 past. But yet I have acquaintances in the accounting
17 industry that have told me that that's a bit of a mixed
18 signal, because that may be what they're hearing but when
19 they have field examiners come in to do their firm audit
20 they're hearing something else.

21 Along those same lines, the scope of 404. Going
22 through the first year of 404 in terms of documentation and
23 in terms of testing the internal control systems, again being
24 in the banking industry we have never had a major issue. We
25 have never had any type of restatement issues. The federal
1 banking examiners have scrutinized our internal control
2 system time after time, both in financial reporting and
3 operating controls, no major issues. But yet when we go
4 through this process, the level of depth that we had to go
5 to, the level of documentation that we had to do was very,
6 very burdensome, and quite honestly to some extent almost
7 unbelievable.

8 Made a comment to some of the other people when we
9 were talking earlier, that as part of this process our

10 management team, myself, CFO, the internal auditor, and with
11 our external auditor there as an observer, early in the
12 process looking through our internal control system. In one
13 day we added additional layers of checks and balances that as
14 I was leaving the meeting I told the group my fear is that we
15 have put things in place that will continue to give us an
16 excess overhead burden much beyond what we need, well beyond
17 the time I'm no longer with this company.

18 And again I think that and the guidance situation
19 is driven because our audit firms, not just our audit firm,
20 but all audit firms are somewhat paranoid and rightfully so.
21 The SEC and the PCAOB needs to go further in providing very
22 clear guidelines for audit firms as to what they can do and
23 what they can't do. I would also suggest that in order to
24 have those firms again become an asset to help the companies
25 comply with their SEC reporting there needs to be some type
1 of limitation on what their penalty is, if they would make an
2 inadvertent error. Right now, in our small firm, our auditor
3 firm I firmly believe feels very strongly that a mistake that
4 they would make in our case has the same level of severity as
5 if they were auditing Enron.

6 There has to be some type of proportionality in the
7 issue. And one of the ways to do that would be to take some

8 multiple of the fees that they receive from us and at least
9 set a ceiling on, okay, if you make an inadvertent error as
10 auditor on German American Bankcorp, yes, it's going to hurt
11 you, yes you are going to be fined, but the fine is not going
12 to be the, your entire firm at risk. It's going to be some
13 proportionality of the fees that you earned from that client.
14 That would be my recommendation.

15 The other two items that I want to talk to, and
16 this one in particular, I think affects not only those of us
17 in banking but it affects every small company. As a small
18 company our internal control systems and risks don't change
19 dramatically from year to year. If we have a good internal
20 control system in place and we go through 404 compliance, we
21 go through the documentation, we go through the testing, we
22 go through the attestation process and get a clean opinion,
23 one of things that the SEC can do that would greatly help
24 smaller firms in covering the overhead cost or the regulatory
25 burden, is don't ask us to do that process from scratch every
1 year. Being in the banking industry, coming from the bias of
2 the risk-based approach that federal banking regulators and
3 examiners routinely take. Under that risk-based approach for
4 smaller banks, they come in and do an audit, an exam, and
5 it's clean, they won't be back for an extended period of

6 time. On the other hand, if they come in and they find
7 things that aren't the way that they should be, they
8 accelerate that process.

9 The frequency of the certification process 404 and
10 the attestation process and the documentation process, my
11 recommendation would be for those smaller public companies
12 that have a clean opinion from auditors on their internal
13 control system, go to a three year cycle. Instead of a
14 quarterly certification by the CEO and CFO, for those low
15 risk smaller public companies go to an annual certification.
16 Should as part of the three year cycle on the attestation, a
17 smaller public company does not receive a clean opinion, then
18 go back to annual attestation and quarterly certifications
19 until they again have a low risk profile and clean opinions.

20 For our company, because we do out-source so much
21 the process that we go through, we're faced with one of two
22 challenges. If we stay on an annual cycle, one, we can gear
23 up our staff certainly, to do this on an annual basis. But
24 our costs, that \$850,000 that I mentioned that we spend both
25 external about \$600,000 external costs and about \$250,000
1 internal cost that we spent in 2004, we expect will drop but
2 only moderately to about \$600,000 this year.

3 As a small company \$600,000 dollars is not an

4 annual expense that we can readily absorb year in and year
5 out. If, however, it was a once every three year cycle, we
6 could marshal our resources, and on that every third year
7 process we could effectively manage the process that way.
8 But if in fact we have to retain it on an annual basis,
9 there's no way that we can reallocate resources and manage
10 that cost on a cost effective basis. So I would ask that the
11 SEC consider a risk-based approach to the frequency and also
12 the level of scope that we have to go through and our
13 external auditors have to go through.

14 The fourth and final item that I would like to
15 mention is the duplication of federal agency oversight.
16 Again, I think this is perhaps I think somewhat unique in the
17 banking industry, but talking with Mr. Jaffee before the
18 session I understand that sometimes you have banking
19 regulators and sometimes you have environmental issues that
20 you're dealing with.

21 But let me give you a good example. German
22 American Bancorp, as I mentioned, is a bank holding company.
23 We have five small community banks as part of our group.
24 Every quarter we issue to the FDIC, who is our primary
25 federal banking regulator, five call reports. At the federal
1 reserve level we issue a parent company only financials, we

2 issue consolidated financials, and we have a second to your
3 holding company so we issue financials on those. That's on
4 top of our 10-Q and our certification process that we go
5 through there. We certify to the FDIC, we certify to the
6 Federal Reserve, and we certify to the SEC. And all of that
7 information is publicly available. It's all available on the
8 Internet. There has to be some method by which, for smaller
9 banking companies there can be some method of which rather
10 than duplicate filings we could file with one federal agency
11 instead of three federal agencies.

12 Again, I thank you for the opportunity to speak
13 today. As a small public company this is critically
14 important to our company and to our shareholders. With 3200
15 registered shareholders and with the commitment we made to
16 our shareholders to give them the liquidity of traded
17 securities we have, don't have the option of going dark and
18 bringing our number back under that level to go dark. We're
19 in this for the long haul, and in some manner or fashion our
20 only choice is find a way to comply cost effectively or
21 partner with someone through a merger transaction to who has
22 that economies of scale.

23 And I guess my comment there would be I think
24 clearly that Representative Oxley and Senator Sarbanes surely

25 did not have the intent when this law was passed to take
1 small microcap companies, community folks such as German
2 American, and put them in a position where eventually that's
3 the decision. Not that the cost of Sarbanes-Oxley in and of
4 itself would be the issue that would have to drive our
5 company to have to consider that type of sale or merger
6 transaction, but it's one more layer of regulatory burden on
7 top of an another layer on top another layer that eventually
8 comes to that situation. Thank you.

9 MR. WANDER: Thank you. I'll just start off with
10 hopefully a simple question. What was your net income last
11 year?

12 MR. SCHROEDER: Net income last year, bit of a down
13 year, right at 6 million dollars.

14 MR. WANDER: Are there any other -- yes, Janet.

15 MS. DOLAN: Thank you very much for your testimony,
16 Mr. Schroeder.

17 MR. SCHROEDER: Thank you.

18 MS. DOLAN: One of the schools of thought with
19 regard to the cost of Sarbanes-Oxley is that it was a big
20 cost the first year because most companies didn't have
21 processes and they didn't document it so they had a lot of
22 work to do. You come from a different environment because

23 you already had at least two levels of scrutiny of your
24 processes, so I'm just curious if you could give us a little
25 more detail on why it ended up costing you so much. And I
1 have a couple -- is it that the 404 went into controls that
2 the other two agencies didn't and therefore you had to do
3 some new documentation, or is it that they went into a lot of
4 the same controls but they went to the nth degree much
5 deeper? I'm just curious first of all what caused the
6 additional effort and the additional external costs.

7 MR. SCHROEDER: The additional costs was really
8 related to two primary areas. First of all we've had a very
9 effective internal control system. That internal control
10 system has been tested by the federal banking regulators, but
11 it has not -- we did not have the level of documentation of
12 that control. We've got policies, we've got procedures, but
13 not necessarily to the nth degree on the documentation side.
14 And secondly, the cost of testing that system.

15 The level at which we needed to test the scope of
16 that testing, and I've heard this from banking acquaintances
17 throughout the Midwest, from various auditors, so it's not
18 just our audit firm that's an issue, but very much detailed
19 documentation followed by detailed testing. Additionally,
20 because we have outsourced so much of our audit work in the

21 past, we've managed the process with our own personnel but
22 tended to out-source the testing, we didn't have the
23 resources internally to gear up for this. So we did have to
24 contract with our -- another audit firm, other than our
25 external audit firm obviously, to do a good deal of that testing.

1 MS. DOLAN: Follow-up question. One of the
2 concerns that we're hearing a lot in testimony from a lot of
3 issuers, is that the outside auditors could not or would not
4 rely on any of the internal testing and work that was done.
5 That would be particularly interesting for me when you are a
6 regulated issuer. Was there any opportunity for the external
7 auditors who were doing the 404 audit to rely on some of the
8 work of the FDIC or the state banking work that was done, or
9 did you feel that there was real duplication of effort?

10 MR. SCHROEDER: There was no reliance on that work
11 that was done from the banking agencies. Clearly they did
12 look at what our own internal management testing was done,
13 but no, which was not even considered.

14 MS. DOLAN: Then my last part of this question is:
15 You know none of us wants to reinvent the wheel, so we've had
16 some suggestion that we should look at other industries and
17 maybe get some better practices from them. Is there anything
18 you can tell us about the way the FDIC regulates you that you

19 would say look, they have a better risk approach than at
20 least the current 404 audit implementation as it's currently
21 implemented, or anything else that they do that you say why
22 don't you look at this, it might be helpful in terms of
23 trying to bring a -- more of a risk-based approach to 404?

24 MR. SCHROEDER: Clearly the whole approach from a
25 federal banking regulatory perspective is risk-based, they do
1 monitor the risk profile from the quarterly reports that we
2 file and also come on-site. But the risk-based approach in
3 terms of scope, for example, they will come in when, they
4 looked at our loan portfolio from an asset quality
5 perspective and our credits. They know that's where the risk
6 is. And the whole approach of the banking regulators take,
7 nothing I guess is going that I could state specifically, but
8 the whole approach is a risk-based approach. The other piece
9 of this they also recognize that there is a difference from
10 small banks and large banks. Very large banking
11 organizations, they have federal regulators on-site every day
12 of the year as part of the process.

13 For us as a small banking operation we may have
14 regulators in-house once every eighteen months, once every
15 three years under certain circumstances. So they recognize
16 the complexity, which is another item that the federal

17 reserve looks at and what the other banking regulators, and
18 they look at our organization and say is this a complex
19 organization? Do they have a lot of activities that are
20 unusual for organizations of this size and adjust then their
21 review based on complex non-complex, large versus small, and
22 what's the quality of their systems and the quality of their
23 management.

24 MS. DOLAN: Okay. Thank you.

25 MR. WANDER: Leroy?

1 MR. DENNIS: Leroy Dennis. Thank you. Mark, Leroy
2 Dennis. I chair the subcommittee for the accounting, so I'm
3 interested in your comment about the relationship with the
4 auditors. And I really have two questions for you. One, is
5 have you seen any difference in the relationship with your
6 auditors since the guidance issued by the PCAOB? And
7 secondly, you mentioned that there should be some
8 recommendations or some guidance -- some further guidance
9 issued by the SEC. Have you had any thoughts about what that
10 relationship should be, what kind of recommendations you
11 would make?

12 MR. SCHROEDER: I think we have seen some
13 willingness -- to some level of willingness to engage in a
14 discussion with management on certain accounting issues not

15 from just a guidance and advice perspective. Still I think a
16 fearful participation, but somewhat of a participation.

17 Prior to that literally on our tax side of the house is the
18 one example I can think of, not only did our external
19 auditors tell us we can't help you with that, but don't ask
20 you us because if you do, that in and of itself is admission
21 that you may have an internal control weakness in that area.
22 So I think in terms of what level of guidance and assistance
23 can they give us, and I then I think tax is a good example.

24 Being a small company we don't have resident tax
25 experts. We have people that do a good job for us. Our CFO
1 has some people that work for him that do an exceptionally
2 good job. But we have to rely on outside advice and counsel
3 for our tax filings, for tax footnote of our financials flows
4 off of that. And we're not asking -- we understand the
5 external auditors can't do the work, but they can certainly
6 point us in the right direction so that we can do the work.
7 And I think that the clarity which the SEC needs to provide
8 to these audit firms is where is that line? Because now it's
9 a gray and murky area. So when in doubt as an audit firm
10 they take the safe route and do nothing.

11 MR. WANDER: Did you have any further questions,
12 Leroy?

13 MR. DENNIS: No, not at this time.

14 MR. JAFFEE: Thank you, Mark. I thought your
15 testimony was very interesting. I've got two questions --
16 I'm sorry. Dick Jaffee. I thought your testimony was very
17 interesting and right to the point. I've got two questions,
18 and I'll probably ask this to everybody who talks about 404.
19 We're able to identify, and there have been a lot of survey
20 data, we've read a lot of it, about increased audit fees and
21 costs of compliance with 404. Have you been able to, and I'm
22 sure this would be anecdotal or episodic, identify in your
23 own organization other costs, let's say lost opportunity
24 costs that you think are excessive for people focused on
25 this as opposed to focused on your business?

1 MR. SCHROEDER: We have not tried to quantify that
2 component of it. We will tell you some of this again was
3 because of the late start because of lack of clarity of
4 direction as to where we go on 404, but I can tell you during
5 the month of this year, during November and most of December,
6 our entire staff was focused on 404 compliance. We were not
7 calling any customers, our lending people weren't focusing on
8 that because my instructions to them were we can't afford to
9 fail on this, all hands on deck. And that will get better,
10 obviously, in future years. But no we've not -- we've done a

11 rough quantification, but when I talked to \$850,000, \$250,000
12 in total costs, that's our accounting people, our auditing
13 people, some of our management people, but it's not
14 necessarily throughout the organization where it was during
15 November and December it was our entire focus, and thankfully
16 we did come out with a clean opinion.

17 MR. JAFFEE: The other question I have is, do you
18 see any benefit from 404? Can you identify anything when you
19 say, "I'm glad we did"?

20 MR. SCHROEDER: Corporate governance. There are
21 some governance issues in terms of independence of directors,
22 but as a banking company we've always focused on independence
23 of directors. Code of business conduct. There's nothing in
24 our code of business conduct that wasn't our standard
25 approach, but we have put it in written form, our employees
1 understand it, the whistleblower features that we've now put
2 in place that was relative to the corporate -- so the
3 corporate governance piece of it I think certainly had some
4 very good attributes in it.

5 In banking it was a matter of perhaps documents,
6 what was already in place. But that has been very good.
7 404, as much as I hate to say it before this group, I can
8 see -- for our shareholders I can see absolutely no

9 quantifiable value that came from the 404 process.

10 MR. JAFFEE: Thank you.

11 MR. WANDER: Kurt?

12 MR. SCHACHT: I'm Kurt Schacht. Thank you for your
13 testimony. I want to ask you about auditor's paranoia,
14 because I'm from New York and everybody is paranoid in New
15 York. So when you say auditors are paranoid and rightfully
16 so, and then I think you said that inadvertent mistakes have
17 Enron consequences. I'm not sure what you mean by that,
18 whether you have any basis for that?

19 MR. SCHROEDER: Kurt, probably more of a feel. The
20 feel that I have in working with our auditors is that, as I
21 said during my initial comments, that it seems that in every
22 conversation with us there is an underlying concern that if
23 they cross some line, will they cross over and they are
24 advising and counseling and helping management rather than
25 auditing the process that they are at risk in an upcoming
1 review that, by the PCAOB, that their firm would be
2 criticized for that process. I think it has something to do
3 with if I'm the partner in charge of that audit, particularly
4 because we're the "second tier" firm, I don't want to be the
5 partner whose audit client resulted in that happening. And
6 from the firm's prospective, I think that there's a fear in

7 every conversation if they cross that line, they're putting
8 their whole firm at risk. That's just my perception of the
9 process.

10 MR. SCHACHT: Do you expect your costs to go down
11 this second cycle?

12 MR. SCHROEDER: They will go down some. We had, as
13 I said, about \$600,000 in hard dollar costs the first cycle,
14 but hard dollar costs will only drop to \$400,000 in the
15 second cycle. If there is a third cycle, which unfortunately
16 there probably will be, we expect further reduction, but
17 probably not a significant reduction at this point. We have
18 factored in and said this is going to be a half a million
19 dollar a year cost for us between internal and external or
20 dollar costs as the law is now interpreted and applied. And
21 we will do -- as a small company I will tell you that we
22 scrounge very hard for \$50,000 or \$100,000 dollars, and a
23 half a million dollars is real money from our shareholders'
24 perspective.

25 MR. WANDER: Yes, sure.

1 MR. CONNOLLY: Actually I was born in New York too
2 and I'm always paranoid. Drew Connolly. Coming at from that
3 half million dollar cost and really quantifying that in terms
4 of what it means to your stock and therefore to your

5 investors is what I'm interested in. What kind of
6 price/earnings multiple is your stock trading for?

7 MR. SCHROEDER: We're trading currently for, on a
8 run rate, about 14, on a trailing twelve months about 20.

9 MR. CONNOLLY: So splitting the difference, and say
10 at 16, on a half a million dollars.

11 MR. SCHROEDER: About a half a million dollars, or
12 about five cents a share.

13 MR. CONNOLLY: So you're taking eighty cents of
14 share worth of market value away from your equity at 16 P/E
15 at a nickel cost that would otherwise go the other way -- what's your stock
going for,
16 sir?

17 MR. SCHROEDER: Stocks selling at about 14 dollars
18 per share.

19 MR. CONNOLLY: So somewhere near a dollar hit to
20 earnings is what that true cost of that audit looks like, if
21 it's a half million dollars, and a 16 P/E.

22 MR. SCHROEDER: Multiplied by on a price
23 perspective.

24 MR. CONNOLLY: So, in effect a dollar a share --
25 and how many shares outstanding, just as an example?

1 MR. SCHROEDER: Just under eleven million.

2 MR. CONNOLLY: So eleven million dollars has
3 disappeared out of your investors' wealth, whether it's a
4 real number or non-real number because of that half million
5 dollar annualized cost.

6 MR. SCHROEDER: Yes, I think that's fair.

7 MR. CONNOLLY: Thank you.

8 MR. WANDER: Rusty?

9 MR. CLOUTIER: Mark, great testimony. I will admit
10 that Mark and I are very dear friends. Jim knows that I knew
11 his predecessor George very well and Helen.

12 I wanted to ask you a couple of questions just to
13 kind of clarify a little bit. We had a very unique period.
14 On June 30th you closed your quarter end, and I would assume
15 that as every bank in America on July the 30th you filed your
16 call reports, because there is not any leeway in filing that
17 call report. I think you would agree and I know Dave would
18 agree -- we have two bankers on the panel -- that it's not up
19 to you to actually extension on a call report, you file it.
20 You have not filed your 10-Q yet because I would imagine it's
21 not filed yet. It is --

22 MR. SCHROEDER: We actually did file our 10-Q a
23 couple days ago.

24 MR. CLOUTIER: Okay. So you have filed it. But

25 you didn't have to file it. You could still be in a period
1 of waiting. My question to you is: Do you understand, and
2 do you think all your fellow bankers understand, that when
3 you file your call report, that if you've made any mistakes
4 you have a very serious problem and that the OCC or the FDIC
5 or the Fed has all the powers it needs to take you out of
6 office as quickly as they care to at German American as
7 President of the bank?

8 MR. SCHROEDER: It's been that way for many, many
9 years, certainly my whole banking career. And yes, I think
10 certainly CEO's -- bank CEO's clearly understand when that
11 when they sign a certification on call report, they are
12 putting their -- certainly their reputation and their career,
13 and in some cases, it would be blatant, their very freedom at
14 risk. We've always had it that way on the banking side.

15 MR. CLOUTIER: So once you sign the call report,
16 you have attested that all your financial information is
17 correct. And the fact of the matter is, and I don't mean to
18 make light of this, but when you sign your 10-Q, it's kind
19 of an after event -- you've already been over your books and
20 already asked all the important questions and make sure those
21 call reports were right when you signed them. Would that be
22 a correct statement?

23 MR. SCHROEDER: That's correct.

24 MR. CLOUTIER: Let me switch to another area which
25 I think is very interesting. You stated that you were very
1 concerned about the cost of the people you were having to
2 hire to continue to meet all these requirements, and that it
3 was taking away quite a bit from your company. Is it a fair
4 statement that you maybe as a president and CEO have spent
5 more time worrying about Sarbanes-Oxley and putting new
6 people in to check the checkers, as we like to say sometimes,
7 than you have maybe on hiring loan officers and try to grow
8 your business and grow the economy in the areas you serve?

9 MR. SCHROEDER: Certainly that was the case in
10 2004, which was the first year of implementation, admittedly,
11 but yes.

12 MR. CLOUTIER: Mark, last question. You and Jim
13 know each other, both from the same hometown, both from
14 somewhat of the Midwest. As you know, there's a lot of
15 concerns about the Midwest economically, and I was very
16 concerned in your comment that if there's not some relief
17 coming, German American Bankcorp may have to consider selling
18 itself as one of the opportunity to a larger company.

19 Would it not be that if that came about, other bank
20 holding companies in the Midwest in Iowa, Nebraska, in other

21 parts of the country, in Illinois, where there's more
22 community banks than anywhere except in the state of Texas,
23 all reach the same conclusion that it is not good for rural
24 America that there is much loan considerations from you being
25 there than there is from one of the major, and forgive me to
1 my good friends in New York, one of the major New York city
2 banks, running a branch in your hometown?

3 MR. SCHROEDER: Rusty, you're -- obviously those in
4 community banking, as you are, understand well that one of
5 the attributes of community banking is that we recycle funds
6 in our own community. That deposits are made from our
7 community and the loans are made back into our community.
8 One of the strengths of this small town that Jim and I are
9 from is that with a strong German heritage our ancestors
10 invested in local companies. And there is a lot of wealth in
11 our community because the dollar stayed there and the profits
12 that were made stayed there. That's what makes community
13 banking work. And if small community banks, public company
14 community banks, wither up and go away, there will be a
15 detrimental impact on rural America and the communities that
16 they serve.

17 MR. CLOUTIER: Thank you very much.

18 MR. WANDER: I think we ought to move on unless

19 there's some other questions.

20 Mark, why don't -- since you're sitting next to the

21 person, proceed.

22 MR. SPEARS: My name is Mark Spears. I'm the CFO

23 of LKQ Corporation, and I will take a second to tell you what

24 that is. We are in the recycled after market parts business.

25 We sell to mechanical repair shops, and deliver parts that

1 are to be recycled, automobile parts or after market parts,

2 which is basically engineering type parts. The company was

3 founded in 1998. We went public in the fourth quarter of

4 2003. At the time we had a little over three hundred million

5 dollars in revenue, about three hundred million in market cap

6 after we went public. Today we're a little over six hundred

7 million market cap and just a little bit over five hundred

8 million dollars in revenue. So we've had a pretty good

9 growth trajectory there, really from day one.

10 We're considered within the small business range

11 that I believe this Committee is looking at. We may be close

12 to getting over that in the near future. But I thought it

13 would be worth kind of hearing about some of the pains we

14 went through in 2004. As I said, we went public in the

15 fourth quarter of 2003. This 404 compliance testing that we

16 jumped into right away. You know, as probably everybody, we

17 feel like we were lucky. We spent 1.2 million dollars
18 despite having fee estimates of only six hundred thousand
19 dollars, we felt lucky it almost doubled, from what everybody
20 thought it was going to be including the people we hired to
21 help us do that.

22 While we sound like a concise company, we don't --
23 our big thing is being a low cost provider of parts to help
24 insurance companies save money. So we are a low cost
25 provider and structured ourselves that way to stay that way
1 to stay competitive. So we don't have a big corporate
2 office, probably 25 people at the time in our corporate
3 office and has all the disciplines from marketing to
4 accounting to computer systems.

5 So as we went forward in the 2004 process of 404,
6 we weren't really ready to -- we weren't expecting what
7 would -- what really hit us there. We were not planning to
8 use inside resources, we did not have an internal audit group
9 at the time. Our plan was to get one at some point. We
10 didn't have extra financial force sitting around. We were
11 all working 40 hours a week. So we did use an outside firm
12 to come in to do our management consultants, do a lot of our
13 legwork, a lot of interviewing of people to do the
14 documentation that the outside auditors wanted. And like I

15 said all that was about 1.2 million dollars. Just for 404,
16 not the fees to do the basic auditing.

17 I guess the biggest thing I wanted to leave with
18 the Committee was what surprised me a lot was how much time
19 is spent -- there's two levels testing, entity level
20 controls, the higher level, general and financial reporting
21 controls and the transaction controls. And I wasn't really
22 surprised at the level of what's being done on those general
23 financial reporting controls, the whole thing about policies,
24 communications down in the organization, someone has a
25 problem how do they report that up the chain of command,
1 something they shouldn't be doing, accounting, who do they
2 talk to about the ethics, those types of policies. You know,
3 I think the governance -- I know you mentioned governance
4 earlier, but that to me made a lot of sense since as we went
5 through that.

6 We felt we were pretty well prepared for that.
7 What was very surprising the amounts of time and money spent
8 on what I would call the transaction controls especially for
9 a company like us which we still consider a small business,
10 and certainly would be considered a small cap for a long time
11 on the transaction controls. You know, I think all
12 businesses, including small businesses, feel like just to

13 stay in business you have to have some good controls. You
14 have to obviously collect your receivables. You obviously
15 have to manage your billings to your customers, otherwise you
16 really are not going to be in business very long. And we
17 felt like we had really good controls.

18 The amount of time spent going through and
19 documenting and testing and reviewing different locations
20 throughout our company. We have over 50 locations. Our
21 people really, you know, after an account's thirty days past
22 due are they calling that customer, and are they then sending
23 a letter out, even though it was in our procedures. And I've
24 worked with larger companies and smaller companies before in
25 my past history. And it kind of hit home, but especially a
1 smaller business senior management is a lot closer to what's
2 going on out there than perhaps a larger business; there's
3 less layers between senior management and the field offices.
4 Because of that I believe senior management spends more time
5 with people out on the line making the sales, using the
6 revenue, incurring the expenses, and it just came across as a
7 lot of waste of resources, testing things that just didn't
8 seem to matter because they're already in place, they have to
9 be in place for a business to operate.

10 Maybe there's some things I'm over exaggerating on,

11 that have to be looked at, but I know the Committee's looking
12 at -- I don't believe you're looking at exempting completely
13 from 404 small companies, but maybe every few years coming
14 back and looking at things. You know, I feel like the
15 governance, the ethics, the general financial controls are
16 important for a public company. I think it helped us,
17 actually, making the point of how serious this is being a
18 public company, and how all the employees have a
19 responsibility if they see something that's not right, to
20 report that up. But I just felt like, and I would say out of
21 the 1.2 million dollars, probably less than a third of the
22 effort was doing those higher level controls.

23 I'm not saying we should have done more, it was
24 more than adequate to cover those. Where maybe the other two
25 thirds was running around looking for receivable collection
1 after its billing and things like that, that really a small
2 business probably has a pretty good handle on just because
3 the management team is out there. It doesn't have a lot of
4 room to make mistakes when you're a small business. You have
5 to manage your cash and your earnings as well to make sure
6 you're making money from your products.

7 I think I guess maybe on that section I'm just not
8 aware of a lot of big company failures that happened because

9 of errors in the transaction controls. You know, most of
10 them seem to take place at the higher levels in the corporate
11 offices and some of the ethics and the controls in place.

12 A lot of attention has been made about gee, the
13 auditor just did too much. I'm sure we all probably did too
14 much that first year trying to understand, you know, how much
15 work is needed, et cetera, but I know the auditors are asked
16 to do an internal control opinion on the whole company and
17 just -- you know, way back in my prior career I was an
18 auditor too in public accounting, I was a CPA. And when
19 you're signing your line there, there's a sense of being
20 overly cautious. So I don't know if just telling the
21 auditors to stop doing as much stuff is going to get
22 anywhere. I think we have to really look at what kind of
23 reports we want from them is a way to break that report up
24 and maybe have different types of reports between size and
25 company, small business versus large businesses. That's all
1 I've got for this Committee. Thank you.

2 MR. WANDER: This is Herb Wander. Mark, could
3 you -- you started to do that, give us a little of your
4 background.

5 MR. SPEARS: Started with LKQ in 1999 as the chief
6 financial officer. That's the first position I had as a

7 financial officer. Prior to that at several companies I had
8 been a chief accounting officer, with three different legal
9 entities, three different public companies, and prior to that
10 I spent about nine years in public accounting.

11 MR. WANDER: Have you estimated what you think your
12 404 cost will be this year?

13 MR. SPEARS: We think our external cost, which was
14 about 1.2 million for '04, will probably be somewhere between
15 eight or nine hundred thousand. And it's a little misleading
16 because we have gone out and hired a director of internal
17 audit, to kind of bring down some of that cost as well, so
18 offsetting his salary and his benefits. And over time we'll
19 bring in one or two auditors to work beneath him to try to
20 reduce the fees that we're paying to an outside consultant.

21 MR. WANDER: Questions from the Advisory Committee?

22 MR. THYEN: Mark, this is Jim Thyen. Could you
23 talk a little bit about how Sarbanes has changed your
24 decision making process in the company, if it has, and maybe
25 in terms of disclosure, governance, and oversight on how you
1 make your decisions. Maybe to preface that to get a little
2 context, tell us a little bit about who your customers are
3 and how you serve your customers to provide value and then
4 relate that back to decision making process changes. Thank

5 you.

6 MR. SPEARS: Our direct customers who we sell to
7 and collect receivables from would be repair shops, collision
8 repair shops. If you have an accident and your car needs to
9 be fixed that's who we sell our parts to. However, the
10 person that pays that job is an insurance company, Allstate,
11 State Farm, companies like that. So we really feel as our
12 customer both those people, because insurance companies have
13 very heavy influence on how the car is going to be repaired.
14 I know -- I can't say that Sarbanes 404 has come in and made
15 us do a lot of different things differently with our
16 customers. We are -- we have put in more systems, we're
17 looking for more systems to audit, to get better controls
18 over that, but from a customer standpoint I can't -- I really
19 don't see an impact of 404 on that.

20 MR. THYEN: Talk a little bit about your
21 competitors and who they are. And if you had the decision to
22 make again, would you go public?

23 MR. SPEARS: Our competitors -- is really anybody
24 else that sells auto parts, and that includes the OEM
25 Manufacturers, General Motors, Ford, those types, along with
1 a lot of smaller competitors that sell recycled parts.
2 There's six thousand automobile dismantlers out there in the

3 United States, fairly small companies that buy cars, wrecked
4 cars, take them apart and then recycle certain of the auto
5 parts from that. We also compete with bigger after market
6 companies than us, that would be engineering from generic
7 type parts, like if you need a fender, the insurance
8 company -- if your car was old enough, it wouldn't get a
9 General Motors fender, it would get a new fender made by
10 another company, we call it a generic type part.

11 As far as going public, I think we still would have
12 gone public even with 404. Would we have done it just a few
13 months before 404 was effective? Maybe not. It was a lot of
14 cost and planning that out a little better I think I would
15 have at least tried to convince the board to maybe delay that
16 another year. It was a lot to have your IPO and then
17 immediately get thrown into that, and at the same time you're
18 in a whole new area where you're dealing with the
19 institutional investors, mutual funds, auditors that -- I
20 think they audited with the same on the financial statements
21 but charged a whole lot more. There's a whole different risk
22 environment when you're public.

23 So that's probably -- I think we would have gone
24 public, we wanted to for a lot of reasons. We felt like it
25 was not just to raise capital, but it was needed to really be

1 taken more seriously by the Allstates and State Farm
2 companies where our financial is much more transparent than
3 if we were privately held.

4 MR. THYEN: Thank you.

5 MR. WANDER: Janet?

6 MS. DOLAN: Mark, thank you for your testimony.

7 You're in a very unique position having been an auditor and
8 now being on the inside as a CFO and gone through a 404
9 audit. I would like to ask you there seems to be a lot of
10 wide-based consensus that we either have already a risk-based
11 approach but it just isn't yet working its way down to the
12 front lines as the framework that is being used, or we should
13 at least get to one. And you mentioned entity controls but
14 you also mentioned high level financial controls.

15 When you look at the way the auditor approached
16 your audit, could you have designed a risk-based approach?
17 Could you and the auditors have actually sat down and
18 developed what you would consider a risk-based approach? It
19 seems that everybody wants to do that but nobody wants to
20 take the first step and figure out how to go about doing
21 that. So you've been on both sides of the aisle -- well
22 first of all, do you think that the auditors used a very good
23 risk-based approach? And if not, could they have and how

24 would you and the auditors have been able to get there?

25 MR. SPEARS: In our approach through '04 by the
1 auditors, and by the consultant we hired as well, was more of
2 a shotgun approach. It was kind of like let's hit
3 everything. And even as the designing approach and going
4 through the process, one of the things -- both the firm we
5 hired and the auditors, I just don't want to dump on the
6 auditors there, is another auditor firm we hired to be our
7 consultant. But as the rules keep changing, we're trying to
8 come up with where we're going to end up here.

9 It was like -- I mean it was almost comical except
10 we were spending money so it wasn't, and it felt like -- in
11 all fairness a lot was because it involved the first year.
12 Everybody was doing it everywhere. Resources were short.
13 Even the firm we hired had a hard time getting all the
14 resources they needed. Everybody was doing it all at once
15 with the calendar year ends. It was not -- it did not look
16 very risk-based, you know, approach to me. I felt it could
17 have been more risk side. But again, it was something new to
18 us because it was an audit of internal controls, it was not
19 an audit of financial statements. I think when they audit
20 financial statements it is very risk oriented. The
21 inventory, that's our largest asset, that's where they spend

22 their time where the higher risk is on the financial
23 statements.

24 MS. DOLAN: Just one follow up. Have you had
25 any -- sat down with your auditors and done any kind of
1 scoping out of year two audit? Can you tell yet whether
2 post-May release from the PCAOB you're going to have any more
3 risk-based approach?

4 MR. SPEARS: We talked about it more. I haven't
5 seen any new programs so to speak. Probably more of our
6 discussions have been on the side of the consultant we
7 continue using and scaling it down and focus, as you said, on
8 some of the bigger issues, using him there trying to cut back
9 on the fees.

10 We had a discussion with our auditors shortly after
11 I believe the SEC and the Oversight Board issued earlier in
12 the year where they felt like the auditors have done too much
13 and they were pretty open to sit down and talk. So I have --
14 I know -- I don't want to give the impression that I feel
15 like our auditors ran out and tried to turn up the fees to
16 maximize their profit. I don't think that was the case at
17 all. Actually we sat down and had discussions. But in all
18 honesty I think they were missing some things and have to
19 cover everything. It was just a fear there of this new -- of

20 this opinion they're about to give on internal controls that
21 they really just had to cover all the bases.

22 MR. WANDER: Leroy?

23 MR. DENNIS: Mark, thank you. I have a couple of
24 questions for you. You mentioned that we need to define what
25 kind of report that we want the auditors to give on internal
1 control. Are you proposing that that be different from say
2 large companies?

3 MR. SPEARS: I think for about probably about a
4 third of the cost, maybe 80 percent of the benefit if there
5 was a way to -- and I haven't been out of auditing for a long
6 time so I'm the not sure of the opinions firms can give
7 anymore. But if you can give an opinion, what I would call
8 the general entity control and the financial reporting
9 controls, that would go a long way in really covering the
10 major risk.

11 Personally I feel that way with larger companies
12 too, but on a small based and the added value, it's given in
13 control on the entire transaction flows of a company and
14 transaction controls, there's some -- I don't want to say
15 there's no value in that. There's some value there. There's
16 probably a little less value for a smaller company than a
17 bigger company, because how close management is to what's

18 going on in small business. Management travels all the time
19 out there in the face of the small business, they just don't
20 have the layers between them.

21 MR. DENNIS: Could you also address Mr. Schroeder's
22 comments about his relationship with the auditors and the --
23 whether you experienced the same thing as far as being able
24 to go to your auditors for help and if that changed in May
25 when the guidance got issued?

1 MR. SPEARS: I haven't really seen a change there.
2 I know over the last two years the auditors have been so
3 much -- management hasn't decided these things in the audit.
4 We still do use our auditors for our tax work. That's about
5 it. Our audit committee chairman really doesn't want to use
6 them for certain due diligence items and acquisitions, so we
7 pretty much split that. But when it comes to certain
8 accounting issues, I kind of feel like they know a lot about
9 us and they're probably the best ones that can provide
10 certain accounting guidance. We're a little lucky because we
11 have a chief accounting officer that's very knowledgeable and
12 my prior experience as an accounting controller rather than a
13 CFO, so it's kind of nice to have the two of us talk back and
14 forth internally. A lot of small businesses they don't have
15 that. They have one chief financial officer that's fairly

16 skilled and his insight is talking to his auditors. To try
17 to get another accounting firm to get opinions from
18 accountants for certain complex transactions and then run
19 that by the auditors, that's going to be pretty costly for a
20 small business.

21 MR. WANDER: Alex?

22 MR. DAVERN: Yes, Alex Davern. I just wanted to
23 confirm I understood you correctly to say that the cost in
24 year one of 1.2 million and in year 2 it adds up to about a
25 million dollars, is that correct?

1 MR. SPEARS: It's going to be about eight
2 hundred -- well, probably about nine hundred thousand dollars
3 plus I'll be adding other things on -- basically all that's
4 dropping is, as of now anyway, is the large consulting firm
5 that I hired. They're dropping their --

6 MR. DAVERN: So about 1.2 million to 1 million
7 roughly, is that fair?

8 MR. SPEARS: We expect to get to around 900,000.

9 MR. DAVERN: That's fine. Secondly, I wanted to
10 probe a little bit related to where in your transactional
11 process a lot of the work got done that had the least amount
12 of value. I specifically want to raise in my experience, the
13 issue of IT-type controls and if you had any rough estimate

14 of how much of the dollars spent were spent related to
15 IT-type controls and your view on the effectiveness of that
16 expenditure in terms of the material accuracy of your
17 financial statements.

18 MR. SPEARS: I think it was fairly effective. It
19 probably helps that primarily, because we've done about 30
20 acquisitions since we founded way back in '98, but we are all
21 on the same basic sales, billing system, that type of thing.
22 On the same general ledger system and same financial
23 accounting package, so that helped a lot. People that I know
24 who are the CFO's of companies having mixed systems said it
25 was awful, different systems, platforms. I don't have a real
1 handle on how much of the cost was that, just kind of seemed
2 that people involved and hearing they're doing it. It may --
3 or maybe 20 percent, and that's a rough estimate on my part.

4 MR. COOLIDGE: Dave Coolidge. Could you describe
5 to what extent the Sarbanes-Oxley issues, 404 or whatever,
6 have come into play in your dialogue with your investors --
7 institutional investors when you were doing your initial
8 public offering? How much concern did they evidence, how
9 much since you have completed the 404 review, et cetera, how
10 much of a focus has that been in your dialogue, and do you
11 think it's made any impact on your stock or your stock

12 performance?

13 MR. SPEARS: Well, the biggest thing with our
14 investors was how much cost are you spending to do this. And
15 then of course they always want to know how much it's going
16 to be the next year, how much lower it will be the next year
17 to try to look at your earnings. I think very few of them,
18 if any of them, even asked how we thought the opinion was
19 going to come out. They were all focused on the cost, how
20 much is it going to cost.

21 We very much talked about that in our 10-Q filings,
22 our MD&A discussion, how much it cost. Basically in our MD:A
23 discussed it was going to cost and we very much talked about
24 that in the 10-Q filing, how much the cost. And basically,
25 you know, I mean as discussed in our MD&A we're not looking
1 at a big drop going into the following year. A lot of this
2 will be continual, there will be some drop. But very little
3 really.

4 Any discussions there were here about it were well,
5 how much does this cost. And a couple of comments would come
6 back and say gee, that's not too bad compared to some
7 companies. They were quite attuned to this large cost.

8 MR. WANDER: Mark -- Pastora.

9 MS. CAFFERTY: Mark can go and I will follow.

10 MR. JENSEN: I have a short question. If you
11 assume for a moment that the auditors had, because most of
12 your comments were about audit firms, if auditors had less
13 involvement or possibly no involvement with the internal
14 control structuring of the company or the auditing and
15 internal controls but you were still required to file 404
16 certifications and make management's assertion, would you be
17 comfortable selecting that without auditor involvement, and
18 secondly, would your board be comfortable with that, and
19 thirdly, would your CEO be comfortable with that?

20 MR. SPEARS: Yes, I think all three would be
21 comfortable with that.

22 MR. WANDER: What about your investors?

23 MR. SPEARS: That's a tough question. I don't
24 know.

25 MR. WANDER: Fair answer. Pastora?

1 MS. CAFFERTY: We've heard a great deal about
2 concern about companies not going public or companies going
3 dark because of the burden of SOX, in particular 404. I was
4 particularly curious and would like to hear you talk more
5 about -- when you said we would have gone public anyway
6 because of the transparency. I guess what I would like you
7 to focus on is the benefits of the, if any, that you have

8 seen of the increased transparency offered by 404 to public
9 companies and reassurance to your investors.

10 MR. SPEARS: Yeah, I think if we had not gone
11 public we felt to get the size we wanted to get at to grow,
12 we were going to have to attract talent to the company, we
13 wanted to have a good relationship with insurance companies
14 and make them understand we were a professional company. And
15 quite frankly, we don't use this word at LKQ, but a lot of
16 these that we buy, you know, consider themselves junkyards,
17 so this is not -- it's not a bank. It's not a highly
18 professional looking animal.

19 So we really wanted to show that. We also wanted
20 to attract people into management, we really felt like --
21 that was kind of the goal from day one when LKQ was put
22 together. We bought 30 businesses around the country in a
23 two year period and then we didn't buy anybody for three
24 years we didn't go public, that was planned not to do that
25 until we adjust to all this. But in buying those companies
1 to make sure they bought in as part of the group and it
2 wasn't just an acquisition it was more of a merger. About
3 two-thirds of our proceeds was cash, one-third was stock, on
4 average, and we were privately held.

5 And so at some point in time putting this group

6 together in centralizing it you had to have an exit plan at
7 some point for their stocks. There's a lot of reasons we
8 felt like to be a public company wasn't just to raise
9 capital. In the whole financial reporting side as well you
10 get a lot of information. I guess we could have published a
11 booklet on that if it were privately held, but it was just a
12 whole different level when you're a public company. I think
13 people look at you more -- we actually -- last point on that.

14 We actually felt like that helped to go a long way.
15 We have actually procurement contracts with some of the OEM
16 manufacturers -- Daimler Chrysler, BMW, Honda. They give us
17 those cars and we dismantle them for them and sell the parts
18 off of them. We felt like in the past, you know, they'd
19 never do that with automobile dismantlers in a big way. It
20 was too much trouble. It was part of the background of used
21 cars still under warranty and you get warranty claims on
22 them. So that was a reason we felt like as well be able to
23 grow the way we wanted to and have relations with them and
24 customers we need to go public.

25 MS. CAFFERTY: I was particularly curious because
1 you refer to the benefit of transparency in going public with
2 the investors but also with customers. So I guess as
3 follow-up, I'm sure you've given some thought to this since

4 you've given so much thought to SOX as evidenced by your
5 testimony today. Do you see additional advantages from the
6 increased transparency provided by SOX and the increased
7 governance to a small and particularly recent and public
8 company.

9 MR. SPEARS: I do. I'm not sure how much the 404
10 section does kind of carving that out at this point. You
11 know, I think people read the 404 report and say well that's
12 nice and maybe it makes them feel good, but if you didn't
13 have that in there I'm just not sure that's getting us any
14 new brownie points with insurance companies in the -- you
15 know, the full 404. I'm not saying throw it all out. I
16 think the governance piece does give it some benefit. I'm
17 just not sure on all the transactional flows how much benefit
18 we get from that.

19 MR. WANDER: Rusty?

20 MR. CLOUTIER: Mark, Rusty Cloutier. Great
21 testimony. I really wanted to follow-up with you on having
22 gone public fairly recently. What percentage of your shares
23 would you say are institutionally owned?

24 MR. SPEARS: I would say almost all the public
25 shares are institutionally owned.

1 MR. CLOUTIER: So you have very little what they

2 call would individual shareholders. Like in the state of
3 Louisiana, you may not have any shareholder in my state.

4 MR. SPEARS: I would say we have 21 million shares
5 outstanding. You know, we probably -- we have probably about
6 eight million or so people that sold businesses to us, larger
7 share investors. We really don't have any retail market
8 right now.

9 MR. CLOUTIER: And following up on that, did you
10 have any research at all done on your company, anybody that
11 is calling to the retail market to sell stock in your company
12 currently?

13 MR. SPEARS: We don't.

14 MR. CLOUTIER: Would you assume most of the
15 institutional investors you have in your company are pretty
16 sophisticated investors? I mean most of these people are
17 representing trust funds or brokerage firms or mutual funds.
18 Would you consider most of them pretty sophisticated
19 investors?

20 MR. SPEARS: Yes.

21 MR. CLOUTIER: Would you make the assumption that
22 the -- Mark, sitting next to you, made the statement he asked
23 his shareholders, and they said they would prefer to have the
24 money and kind of not do 404, and I believe you have not had

25 an opportunity to ask your investors that. But to follow-up
1 on an earlier question: Do you think most of your
2 institutional investors would say give me the return as Drew
3 pointed out, the price to earnings ratio maybe adding a buck
4 a share to your stock, do you think there would be any
5 preference to that?

6 MR. SPEARS: If there was an exclusion where a
7 smaller company didn't have to do anything, no governance, et
8 cetera, at this point I think they would have some issues
9 with that. I think some -- the ISS and some of the
10 orientations that follow governance, you know, you'd end up
11 with a bad report, even if you were small. That's why I feel
12 like get some benefit of the 404 on the governance side at
13 least. It would be awful hard to throw the whole thing out
14 for a small business.

15 MR. CLOUTIER: No, I understand that. I'm not
16 talking about the governance part. I'm talking about the
17 other part.

18 MR. SPEARS: I don't think -- I think to drop the
19 fee two thirds, if that's the right number, I think they
20 would be pleased with that on the earnings side. It's like
21 three percent of our net income.

22 MR. CLOUTIER: So of all of these institutional

23 investors who are very sophisticated, none of them really
24 have called you up or sat down with you and really went over
25 your 404 report or what wanted to ask you material weaknesses
1 or really got into any great discussion with you on any of
2 those discussions.

3 MR. SPEARS: That's correct.

4 MR. CLOUTIER: Thank you.

5 MR. WANDER: Dan.

6 MR. GOELZER: Mark, you have kind of a unique
7 perspective, as you comment, a new public company that was
8 thrown into 404 quite rapidly after having become public. Do
9 you think your perspective on the benefits and the costs
10 would be any different if there had been a much longer phase-
11 in period or assessment for the year or two years or three
12 years, would any of the work that was done would have been
13 done anyway for business reasons?

14 MR. SPEARS: No, we would not have gone out and
15 rushed into the first year after being public the type of
16 things we did. I think over time, as I say, phase in. When
17 you're phasing something in, obviously you're more efficient
18 in the way to do it. In some respects I think it was a waste
19 of money in some of the things that we did. So a phase in
20 would be much more beneficial than just jump right into it.

21 I still struggle with the -- we always intend to put in, but
22 I struggle, you know, spending the money we did to go out and
23 send a lot of people all over the place. Quite frankly a lot
24 of people who do that for you, in '04 there wasn't real
25 experienced people. We had people supervising them, they
1 were high rate people, hiring people, but they weren't real
2 experienced. So phasing in certainly would benefit small
3 business in a big way.

4 MR. WANDER: Yes, Drew?

5 MR. CONNOLLY: Drew Connolly. Thank you once
6 again. Very clearheaded statement. It's interesting though
7 that the number, and I apologize to Mr. Schroeder because the
8 one calculus we didn't do was a pre-tax and a post-tax
9 analysis. But your million two in true cost divided over the
10 same 21 million shares is approximately a nickel a share as
11 well. So since this whole process is about building market
12 share, increasing wealth, and ramping sales, you're to be
13 congratulated on those numbers in your short life as well. I
14 guess I'd like to know what -- in a perfect world what would
15 you do with that million two? Would you hire more people,
16 would you build more plant and equipment, would you make more
17 acquisitions? And finally, with the exception of estate
18 planning, I think you listed every possible reason to go

19 public as motivators for you, so congratulations on that as
20 well.

21 MR. SPEARS: Yeah. I mean what would we do with
22 the capital of 1.2 million we spent? We are continuing to
23 grow. Not only are we doing acquisitions, we are adding
24 facilities and plants, warehouses and that type of thing. I
25 can't sit here and honestly say we wouldn't do any of that --
1 we'd do it faster because we saved the 1.2 million. I
2 realize after taxes about seven hundred and so thousand
3 dollars. But we are supposed to be earning money for the
4 shareholders. And in the end here these types of things
5 should be something that benefits the shareholders, and it's
6 taking something like a nickel away from the shareholders at
7 some point -- at some point we'll be in a dividend mode here.
8 We're not now, we're still in the growth mode, but we should
9 be returning that to the shareholders and --

10 MR. CONNOLLY: I'm also concerned about the stake
11 holders, the employees, the potential acquired companies, the
12 folks who were the prior earners, and the community that
13 your, quote, "junkyards" are in -- and by the way, the U.S.'s
14 largest export last year was in fact scrap. Thank you for
15 taking your portion and keeping it home. Because the
16 reworking in the metal bending industries which we've almost

17 in the press, you know, given that up. That's something we
18 don't do any more. We're right here in the heartland and I'm
19 absolutely certain that there are folks who are working for
20 you or working for some of the companies that you're doing
21 business with, and those are jobs that are not going to come
22 back. So that is a concern, and certainly that is one of the
23 implications of regulatory costs on companies such as yours.

24 MR. SPEARS: Correct.

25 MR. WANDER: Any other questions?

1 MR. DENNIS: Could I ask one question?

2 MR. WANDER: Sure.

3 MR. DENNIS: Leroy Dennis. Mark, thank you again.
4 Just curious if this Committee were to make a recommendation
5 and the SEC were to adopt it, that substantially changed the
6 rules for 404 so that there were -- was a big difference
7 between smaller companies and larger companies, would you see
8 that in your growth mode that you're in of hindrance for your
9 ability to attract the institutional investors to your
10 company? Or -- I'd like your comment on that.

11 MR. SPEARS: I really don't think -- let's say
12 there was an exemption and we did not do 404 compliance in
13 2004 -- I don't think we would have had any less reception
14 from the institutions, you know. It would have probably come

15 up when we did the IPO roadshow and we were overbooked
16 several times over. I think we still would have had that
17 demand in the institutions whether the 404 would hit us in
18 '04 or down the road.

19 I think what we're going to do 404 there is there
20 will be concern by institutions that you don't, like, to fail
21 the test and have a lot of significant material weaknesses.
22 So I think it is important when you come to that point that
23 the management has come through controls regardless because
24 the -- the last thing you want to do is go out a with a
25 material weakness that could affect your stock.

1 MR. DENNIS: We've some things in prior testimony
2 about S-B regulated companies and how underwriters and
3 investors really aren't interested in those S-B rules, that
4 they suggest that people just go ahead and go public with --
5 under the regular S-X rules. And I'm curious whether the
6 same thing would happen in 404.

7 MR. SPEARS: When we did the IPO we were probably
8 too large to get a lot of the smaller exemptions I believe.
9 325 million in revenue. So, we really didn't get into that or
10 look at that. Our chairman thinks we're going to grow to be
11 huge, so he wasn't looking at the S-B rules too much.

12 MR. WANDER: If there are no other questions, why

13 don't we move on to our next guest. David?

14 MR. BOCHNOWSKI: Thank you. I'm David Bochnowski

15 and I'm Chairman and Chief Executive Officer --

16 MR. WANDER: Could you wait a minute? The court

17 reporter is changing paper. Not a disk, I note, just paper.

18 Okay. Thank you.

19 MR. BOCHNOWSKI: I'm chairman and CEO of North West

20 Indiana Bancorp, a federal reserve chartered bank holding

21 company for the --

22 MR. WANDER: Could you move the microphone closer.

23 MR. BOCHNOWSKI: Is that better? I'm the chairman

24 and chief executive officer of the North West Indiana

25 Bancorp, holding company for Peoples Bank. North West

1 Indiana Bancorp is chartered by the Federal Reserve, and our

2 operating unit Peoples Bank, a state-chartered bank located

3 in Munster, Indiana. I am also a former chairman of

4 America's Community Bankers, the trade association for over

5 1200 community banks and savings associations across the

6 country.

7 Before I was a graying banker, 35 years ago, if I

8 could tell a little bit of a personal story, I was a

9 lieutenant in the United States Army serving in Vietnam,

10 having gone through the shake and bake version of the special

11 warfare school at Fort Bragg, and I found myself working in
12 an advisory capacity at a Vietnamese fire base. I got a call
13 on the radio one day that an "06" was coming in and wanted
14 briefing on the intelligence situation in our area of
15 operation. "06" is military talk for bird colonel. He
16 jumped out of the bird and over the whirl of the aircraft, I
17 said "Colonel, my name is Lieutenant Bochnowski and I'm here
18 to give you your briefing on the intelligence situation in
19 our area of operation." He looked at me and he said, "a
20 Lieutenant with a last name like yours I'm not sure that's
21 possible."

22 So here I find myself trying to follow-up on some
23 incredible testimony that has been given about the issues of
24 Sarbanes-Oxley, particularly those in the testimony of Mark
25 Schroeder, which I'm not sure I can add to that. I do have a
1 prepared statement which I submit for the record. But let me
2 just give a brief overview and go from there.

3 People's Bank did a public offering back in 1984.
4 We raised 3.1 million dollars, and at that time we had 157
5 million dollars in assets. Today we're nearly a 580 million
6 dollar company, and we have 46 million dollars in equity
7 capital. Back then we had 50 employees, right now we have
8 175. The compounded annual return for our investors since

9 1984 has been 23.2 percent as measured by the price
10 appreciation and dividends paid on our stock. We currently
11 have 440 shareholders and our stock is traded on OTC Bulletin
12 Board. Average volume in the last three months has been
13 about 325 shares.

14 We're very happy with our decision to have gone
15 public. We have also announced in May of this last year that
16 we were considering terminating our registration with the
17 SEC, and that was not a step that we took lightly. In fact,
18 as I think I will tell the story and hope explain it to you,
19 our board of directors felt their fiduciary duty required
20 them to look at that step under the circumstances that we
21 think we face. We do have a special Committee that's
22 currently reviewing the issues. If in fact that special
23 Committee were to make a recommendation to the board to
24 terminate and in fact the board were to adopt that
25 recommendation, we have made the decision that our
1 shareholders will have the final say and publicly announced
2 that, this will go to a shareholder vote even though we're
3 not required under Indiana law to do that. But I want to
4 make it clear that those are all ifs and there's been no
5 decisions made at this point.

6 Why did we take the step to review our options as

7 far as an SEC de-registration was concerned? Plainly and
8 simple, simply 404 and the impact upon us. We would like to
9 remain a public company. We think it's been a fine
10 existence. We like the fact that we publicly report. We
11 like the fact that we can tell our story to our shareholders
12 on a quarterly basis and on an annual basis. It's not our
13 intention to go dark, that's not where we're coming from,
14 when we looked at this issue.

15 We're not trying to push shareholders out; that's
16 not a goal of ours. We came to this point because at the end
17 of our meeting with our auditors when we got to the 2004
18 annual report, the question was asked by a member of the
19 auditing Committee of the auditors, gee, next year under 404
20 we're facing additional costs, could you tell us what those
21 were. Without blinking an eye the auditor said your costs
22 will double. You'll go roughly up a hundred thousand
23 dollars. That caused some internal discussion as to what the
24 additional cost might be.

25 And we estimate that the soft cost would go from 75
1 thousand -- up roughly 75 thousand or a hundred thousand
2 dollars, and that would include the need to hire additional
3 personnel to track our compliance with 404. So when you're
4 dealing with accompany that has had a consistent return of 20

5 percent plus to its shareholders, you're almost compelled to
6 look at these issues, and that's why we are where we are.

7 I think the specifics that Mark raised, and I would
8 second all that he said, but to give you some insight
9 perhaps, to those things that we continue to look at and why
10 we are where we are. Number one, is that we believe that
11 this is an open ended commitment that we are making in terms
12 of cost as a company of our size. And why do I say that?
13 First there are very few audit companies that will audit our
14 firm. The Big Four firms don't want us. Whenever we bid our
15 job, they're always 50 to a hundred percent higher than the
16 two who are capable of doing our audit. So there's really,
17 at our size, only two firms that we think we're comfortable
18 with. That doesn't mean there might not be others out there.

19 I can tell you I can think of at least one case of
20 a billion dollar company that a Big Four firm has indicated
21 they don't want to bid on. So part of what's happening with
22 Sarbanes-Oxley is an oligopoly is being created or has been
23 created with pricing power running one way and that's not
24 towards those of us who would be doing the contracting. 404
25 creates a pass/fail system on internal controls at the end of
1 the year. You either pass or you fail. It's at the end of
2 the year.

3 What company in its right mind is going to go
4 forward publicly and wait until the end of the year to find
5 out whether you passed or failed. We concluded that we would
6 have to hire another person to bring us to the point both as
7 a board and as a management group where we would be
8 comfortable with our progress on that particular issue so we
9 wouldn't get to the end of the year and find out that gee, we
10 didn't make it this year. Because there would be a lot of
11 explaining to our shareholders and we didn't want to be put
12 in that position.

13 There is an unknown factor in all of this and I
14 will go back to something Mark said because it really plays
15 strongly into our thinking on this issue. And it's simply
16 this: If the current -- and we're not an accelerated filer,
17 so we haven't faced 404 yet. But if we get into a situation
18 where under 404 we're required to ask for advice as to how we
19 handle a particular issue, and I'm not going to suggest we're
20 a very complex company, because we're not, but just assuming
21 that we would get there, and unlike in the past our auditor
22 says gee, we can't give you that advice because it will taint
23 our ultimate decision on your controls, you'll have to go
24 somewhere else.

25 That means we have to have another audit firm that

1 advises us on how we comply so that the audit firm that we
2 have tells us whether or not we're complying. That's a
3 hidden cost that we really don't know if it's out there, but
4 I think that's one point that Mark was making, and I think
5 it's important to us.

6 This leads me to, we talk a lot about
7 Sarbanes-Oxley and what was the legislative intent. The
8 legislative intent I believe was all of us as companies would
9 publicly report so that our information would be transparent
10 and would be known to the public, and we're fine with that.
11 We don't want to change that. Our concern is that what's
12 happening with Sarbanes-Oxley as it's being applied as we've
13 come up with SHEWTA, the Shareholder Equity Wealth Transfer
14 Act. Because that is exactly what will happen to us. If we
15 use Jim's analysis, this is going to roughly cost us seven
16 cents a share.

17 If we use his analysis and we apply that to our
18 earnings multiple and take it forward this year but multiply
19 it over the next 10 or 20 years based on the last 20 years
20 we've just gone through, although past results are no
21 predictions of future results, the numbers get a little
22 mind-boggling. We think we're about building shareholder
23 value and there will be, with 404 compliance issues that are

24 going to take away from, a little bit Mr. Jaffee's comment,
25 what are we about. We've been trying to figure out how get
1 into this scheme.

2 And it's not a regulatory scheme and it's not even
3 an SEC scheme, it's what the accounting industry in our
4 opinion, through PCAOB, is telling us what we have to do. So
5 we're not quite sure who is responsible for this. We only
6 know that we have to figure out how to comply. And in a
7 highly regulated industry, that's a real challenge.

8 Miss Dolan's comment about exams, and I would like
9 to amplify a little bit of again what Mark talked about, the
10 examiners when they come in, they come in roughly year to
11 year and they're very interesting people. First of all, the
12 examiners I know almost in my -- I've been doing this since
13 1981. I can say that there's very few of them I don't like
14 personally. They're all wonderful people, great gals and
15 great guys who have families and spend time away from their
16 homes traveling to see our company.

17 But make no mistake about it. An examiner on a
18 mission makes an internal revenue agent look like a friendly
19 guy or gal. They come in knowing what the last exam said,
20 because they've got their notes. And after you get through
21 the niceties of life, they ask you about the things that went

22 on last time just to see if you can remember what they
23 remember and what you've done to correct those issues. And
24 so when it comes to controls, there is no question that we
25 all know what the game is, and that you better get it right
1 the first time. And that gets back to Rusty's point of
2 earlier, that when you sign your name onto something it has
3 real meaning. And if there are issues that come up that need
4 to be changed, you need to change them.

5 I would parenthetically say on this issue of
6 building value, I know of at least one and perhaps other
7 companies, smaller companies, certainly smaller than
8 ourselves, that are going to merge because of the
9 Sarbanes-Oxley cost, they can't absorb it. That leads to
10 interesting questions, go back a little bit to what Rusty
11 said about the direction of where we're going in America.
12 Because we have had since the days of Hamilton-Burr, we've
13 rejected the idea of a National Bank of America. We've had a
14 system of debt distribution or at least consumer access to
15 debt that's been widely dispersed across this great country
16 of ours. We will diminish that and there will be unintended
17 consequences if the results of Sarbanes-Oxley is that
18 companies have to go out of business just because they can't
19 absorb the costs. And I think there are examples of that

20 that are real.

21 So having said all that, what do we do? One thing
22 that I think I would suggest is that at least as to smaller
23 companies, please consider extending for one more year the
24 right not to have to comply. And I say that for this reason:
25 We know that you issued -- not you, but the SEC issued
1 guidance in May. And we don't know how long it's going to
2 take for that guidance to get through the system and whether
3 or not there will be any changes as a result that guidance.
4 But for all of us to have to incur this cost only to find out
5 that some time from now we shouldn't have incurred the cost
6 in the first place because there's going to be changes made,
7 would suggest that we're all better off waiting.

8 I come from an industry that when, and only the
9 bankers here perhaps can relate to this, but when you receive
10 guidance from your friends at the federal government, it
11 basically says you need to comply because otherwise they'll
12 send some people to come to see you. The challenge here is
13 that the SEC has issued guidance, but there's a whole
14 industry that's ignored it as near as we can tell. I know
15 that our audit firm has said it's caused no change in their
16 approach. I think anecdotally I can report that from a wide
17 cross section of bankers that I've had conversations with,

18 they say the same thing. If that's true in our industry, if
19 it's true across all the other industries. We have to wonder
20 where these challenges will lead us.

21 Second, and this has been talked about, and it's in
22 my testimony, the banking side both the FDIC and the banking
23 regulators have said for companies at a billion and below,
24 they're changing our reporting requirements so that we are
25 not to face the strict side of the banking regs because
1 they're recognizing where the risk is. They're saying that
2 risk doesn't fall on smaller companies.

3 And then the last thing is that either terminate or
4 at least review the attestation that we're asking auditors to
5 make to internal controls. There's a part of me that I was
6 trained as a lawyer and I clerked for a federal judge many,
7 many years ago, and I always tell my friends that back in
8 1981 I stopped practicing law and went to make an honest
9 living as a banker. But there's a part of me that says that
10 when we ask auditors to attest to the efficacy of the
11 internal controls and they say yes, they're okay, what risk
12 position are they in when we find out that they weren't okay?
13 And so I think that Mark's suggestion that there ought to be
14 some guidance and some rules as to where the line is with
15 respect to what auditors should be attesting to, that just

16 makes a whole lot of sense for everybody. So I would be
17 happy to take any questions you might have.

18 MR. WANDER: David, thank you very much. And you
19 will be happy to learn that one of the items on our agenda
20 for our public meeting tomorrow afternoon is to adopt a
21 resolution recommending to the SEC that they continue the
22 delay in implementing 404 for companies of your size. Rusty?
23 You have quite a fraternity, Rusty.

24 MR. CLOUTIER: I know a lot of these people pretty
25 well. Dave and I shared at the same time with two different
1 trade associations as chairman and David has always made
2 great testimony and he's always done a good job testifying on
3 the Hill, and he's represented the American community bankers
4 very well.

5 To kind of to set the tone for who he represents,
6 of the 13 hundred banks, David, I would take that none of
7 them has paid a two billion dollar fine recently that you
8 know of.

9 MR. BOCHNOWSKI: Not to my knowledge.

10 MR. CLOUTIER: Yeah. Nor could they afford that.
11 That's what I want to get. We talk about transparency every
12 once in a while. If I was to hand you Mark's financial
13 statement, either Marks' financial statement, small

14 companies, being the banker you are, I would assume that you
15 could read those statements and most probably within a
16 reasonable period of time make some opinions of their credit
17 worthiness because of the size of their firm and the
18 complications of the business they're in. Would that be --

19 MR. BOCHNOWSKI: I think that's absolutely true.
20 In fact it's easy because we can all go on the FDIC website
21 and see that right after it's filed.

22 MR. CLOUTIER: Now if I was to hand you the
23 statement of Citicorp or Chase with their options trading
24 business and all the businesses they're in, and of course
25 according to my record Chase is back in U.S.A. Today pleading
1 guilty to some SEC charges this morning and of course paid
2 the two billion dollar fine. They did it, Chase did it,
3 Canadian Bank just did. It's up to seven billion now in the
4 Enron scandals. Would you say their statements are very
5 transparent, that any banker in America could look at them
6 and determine exactly where they stand today?

7 MR. BOCHNOWSKI: Apparently not, the bankers could
8 not do so but others couldn't either. But it goes, I think,
9 to the complexity argument, that it's very clear that I am
10 arguing and I believe Mark is and I believe everyone else is,
11 is that because we're small business a different set of rules

12 should apply, and that more complex rules should apply as you
13 move up the chain.

14 MR. CLOUTIER: Right. In your statement on page
15 six and I thought it was very well done, and I will read it
16 because I thought it was so well stated. "In the end what
17 our board was looking at was basically a wealth transfer from
18 our shareholders to the public auditor with no compensating
19 benefit to the company. This particularly is frustrating in
20 that the catalyst for Sarbanes-Oxley was a rash of corporate
21 scandals caused in large part by auditors and other
22 gatekeepers not doing their jobs." Now I would only point
23 out that with the complexity of Enron and WorldCom, which is
24 very complex, and the trading which was led by the large
25 companies in America which was very, very complex, that
1 really at the end of the day in a Federal court the auditors
2 were found not guilty. And so we are paying a very large
3 penalty. And I loved your term transfer of wealth. From
4 your shareholders, my shareholders and everyone else's
5 shareholders to some third party when our statement's already
6 very transparent. They're very, very transparent. I agree
7 with you. I can go on the FDIC website and figure out your
8 bank in ten minutes, Dave, and vice versa, and we're paying a
9 large cost for this. Am I correct on this?

10 MR. BOCHNOWSKI: I think that's absolutely true.

11 MR. CLOUTIER: Last question. You come from pretty
12 much just the suburbs just outside of Chicago, am I correct
13 on that?

14 MR. BOCHNOWSKI: In fact from my office on a clear
15 day you can see the Sears Tower.

16 MR. CLOUTIER: Would you say there's a great value
17 to your company being out there and that if it was merged
18 with a major bank, once again the same question I asked Mark,
19 would there be some real loss to your community?

20 MR. BOCHNOWSKI: I think that's absolutely true.
21 It seems to me that the community banks are thriving in some
22 communities, that simply because a customer, and in our case
23 it's the customer that's on the commercial side, it's one to
24 six million dollars, it is small business, if they want to
25 come in and see their banker, if they want to call, they see
1 us. With the larger organizations that customer at that
2 level is dealing remotely and really can't get to his or her
3 decision maker. And I think there's a certain part of the
4 American consuming public, especially at the small business
5 level, that wants to have face to face meetings and
6 conversations with their banker -- with their decision maker,
7 not with their banker.

8 MR. WANDER: Yes, Richard.

9 MR. BROUNSTEIN: Hi, Rick Brounstein,. We've had a
10 lot of testimony from the small community banks and it's
11 compelling. I guess I'm going to probably pick on you for
12 information because of your role in America's community
13 bankers. You mentioned your current bank is maybe five
14 hundred million to six hundred million in assets and you're a
15 small business, you're non-accelerated, so your market cap is
16 somewhere below 75 million.

17 MR. BOCHNOWSKI: Under all those rules, yes. Well
18 actually the market cap is 97 million today, but because of
19 the way that's held, we don't get past the 70 mark.

20 MR. BROUNSTEIN: At the prior meeting there was a
21 lot of talk in terms of, you know, banks that had assets of a
22 billion or less were really pretty small banks. Is there any
23 way to sort of make a relationship on average between, you
24 know, what's a six hundred million dollar bank or a billion
25 dollar bank, market cap typically, are we talking about a
1 hundred million or two hundred million or talking about some
2 of these being much larger?

3 MR. BOCHNOWSKI: It would be hard to generalize on
4 that simply because you have trading multiples and you have
5 various levels of capital. I would think that if we're going

6 to what's the appropriate size for a small business, I think
7 I fall back -- I would myself, would fall back on the SEC's
8 own study that says that markets to track and pay attention
9 to companies that have seven hundred million dollars of
10 capital. And that's I think where I would draw the line.
11 And if that were true, you're probably talking about banks
12 that are in the two or three million dollar, four million
13 dollar --

14 MR. BROUNSTEIN: Billion.

15 MR. BOCHNOWSKI: Billion. I'm sorry.

16 MR. WANDER: Any other question? Yes, Al.

17 MR. DAVERN: One question. I think I heard you say
18 that the banking regulators are looking at some different
19 type of regulation based on size, around a billion dollars,
20 correct?

21 MR. BOCHNOWSKI: Yes.

22 MR. DAVERN: Would you tell the Committee a little
23 bit about what the difference will be in the regulatory
24 process or burden between those below and above.

25 MR. BOCHNOWSKI: FIDICIA, which is the Financial
1 Institutions Deposit Insurance Company Improvement Act,
2 basically has been in place since '91 - '92, and it says that
3 at five hundred million or above, you have to -- as an

4 example, you must have on your board a CPA. You must attest
5 separately, which is then reviewed by both your outside
6 auditor and the examiners -- your control systems. And so
7 that's going to move from the five hundred million to the
8 billion dollar level. Again, because I think the banking
9 regulators are looking at their own companies that they
10 regulate and they're maybe falling back on some of the points
11 that Rusty was making and suggesting that they're trying to
12 be risk-based and they see that the risk is in some of the
13 more complex organizations.

14 MR. WANDER: Thank you for being so patient, Don
15 Perkins, but we would love to hear from you now.

16 MR. PERKINS: My name is Don Perkins, and Herb and
17 I have done some other things together so he's taught me
18 patience.

19 To anticipate his question, my background includes
20 being the CEO of a fairly sizable retail business called then
21 called Jewel, now called Jewel/Osco, in Chicago. I've served
22 on 25 corporate boards in my lifetime, half of which at least
23 of Fortune 500 companies. I'm now too old to do that so I
24 work with some smaller companies, one of which is the reason
25 I'm here today.

1 I'm the non-executive Chair of a company called

2 Nanophase Technologies. And with me is Jess Jankowski who is
3 the chief financial officer. When I tell you about the size
4 and nature of Nanophase, I think you will agree that it was
5 absurd to apply Sarbanes-Oxley to a company like ours.

6 Nanophase produces nano-size materials measured in
7 billionths of a meter for use in sun screen and other
8 personal care applications, semiconductor wafer polishing, or
9 to add to the wear-resistance of both paint and transparent
10 coatings to name a few. If you want to know how big these
11 are, if you stacked nano-crystals on top of each other and
12 had one for every human being in the United States or three
13 hundred million people, it would come to something like
14 eleven inches high. So we're in the business of creating new
15 chemicals.

16 Nanophase financed its early development by going
17 public in 1997. Sales growth is slower than we expected, but
18 we have great confidence from our investors.

19 Our stock multiple is what qualifies us for
20 Sarbanes-Oxley. It has no reflection on the size or
21 resources of the company. It is a high tech company in a
22 high profile, in this case, nano technology business. Our
23 market capitalization is 120 million dollars which represents
24 twenty times sales. We have only 50 employees. Three of

25 these are finance and accounting professionals who are
1 responsible for everything from entering vouchers, billing,
2 paying bills, cost accounting, SEC reporting, sales and
3 franchise tax reporting, budgeting, forecasting, contract
4 review, and investor relations, among other things.

5 In an environment as small as ours, redundant
6 controls are inherently inefficient if not impossible. The
7 CFO signs every check and approves every purchase order in
8 excess of fifteen hundred dollars. The CEO signs every check
9 over ten thousand dollars and approves every purchase order
10 over five thousand. I or another board member signs off on
11 any purchase of equipment which would be in this case 250
12 thousand dollars or more. We have a total of seven people
13 responsible for the administration of the small company, but
14 we may need to add somebody if we are to follow the pressures
15 brought on to us by Sarbanes-Oxley.

16 Because of the one size fits all approach of
17 SOX-404 requirements, an unwarranted and we believe
18 unnecessary burden has been put on our small company. In
19 2004 we spent \$259,000 on 404 specifically, and that's about
20 five percent of our sales. Our projected -- Jess' projection
21 for this year is that it will be two-thirds of that cost,
22 although I need to look at Leroy Dennis up there and ask him

23 because he's our auditor. In these numbers we have not
24 included the tens of thousands dollars in additional annual
25 and quarterly fees incurred with our auditors relating to the
1 change in the general climate since 2001 and the specific
2 enhancements previously required by other sections of
3 Sarbanes-Oxley. We believe very strongly that our
4 shareholders would be better served if those dollars and
5 those hours were spent on revenue enhancement and new product
6 development.

7 Since we disclosed, and this will answer the
8 question you've been asking others. Since we've disclosed
9 the results of our SOX-404 audit in March, not a single one
10 of our investors, many of whom are in weekly contact with the
11 company, has made even a passing comment regarding the
12 completion of our 2004 SOX-404 audit, and we had no findings
13 of material weaknesses, thank goodness.

14 It seems us that small companies have investors who
15 understand many of the risks involved and do not expect
16 Fortune 500 level internal control systems to be in place.

17 Since we operate at a loss, you can't -- I don't
18 know what multiple losses we would get, Drew, at your
19 question -- we operate at a loss. We could have spent 259
20 thousand dollars on product development and enhanced our

21 revenue line which is really important to us. But the past
22 is the past. We spent the money, I'm unhappy about that,
23 frustrated about that. But in terms of the future, we have
24 four suggestions, and some of them are the same, but maybe my
25 words will be just a shade different.

1 The first suggestion for the future is to use a
2 revenue test as well as a market capitalization test for
3 requiring SOX-404 compliance. Even a 50 million dollar
4 revenue requirement would help companies like Nanophase avoid
5 spending such a high percentage of sales on accounting. As
6 an alternative, others have suggested a more limited set of
7 requirements for a small company. I don't know how many of
8 you have seen the books that are prepared to have all the
9 boxes to be checked for 404. I'm on two publicly traded
10 companies, it doesn't make any difference what the size was,
11 in each case I'd say it's about six inches high, the
12 paperwork that is created to do this.

13 Second suggestion, permit, or better yet, Leroy,
14 require audit firms to do all of the work for small
15 companies, to complete whatever is required of them under
16 SOX-404. One-fourth of our expense last year was required
17 because our audit firm, McGladrey & Pullen, told us that
18 their interpretation of their role under PCAOB prohibited

19 them from doing this work so we had to go hire somebody else.

20 We believe the total auditing bill would have been
21 less expensive if they had done -- if McGladrey & Pullen had
22 done all of the SOX-404 work. We had to contract with an
23 outside firm to complete it. The complications and expense
24 within the company and two outside firms to do this was
25 inefficient to say the least.

1 The third suggestion, and this one will help us
2 now, all the things I'm going to suggest, but this is the one
3 I wish you would put at the top of your list. Do not require
4 an annual reaffirmation of the internal controls of a small
5 company like Nanophase. Let us revisit the effort every
6 three years or so. That's the same suggestion that was made
7 by my banking associate down the table. We as directors of
8 Nanophase will make sure that we keep track of whatever might
9 be changing the business, but to go back and do this work and
10 spend another few hundred thousand dollars this year and have
11 to do this on an annual basis seems to us to be both
12 unnecessary and unwise.

13 And our fourth suggestion is to redefine the IT
14 expectations for small companies. The IT portion of SOX-404
15 project is probably designed by technicians who have spent
16 much of their careers working with banks and other

17 institutions that have long been subject to strict control
18 standards. We operate on an off the shelf software package.
19 And because of that the value clashes with our auditors were
20 apparent immediately. After many meetings they did revise
21 what they thought ought to be done, but we still have
22 unresolved issues because we're a very small company
23 operating with very few people.

24 Thank you members of the commission for listening
25 to our expression of frustration. We would be very pleased
1 if you would find some way to have a more reasonable
2 challenge for us as a very small, hi-tech, hopefully growing,
3 hopefully surviving company in an unusual world. All of the
4 money that was raised in 1997 to take Nanophase public has
5 been reinvested in the business. This was not somebody
6 selling out and making a lot of money off it. This has been
7 a project which incidentally was started at the University of
8 Chicago, with inventions there about how you could produce
9 nano-size crystals. It's been a long, tough road. It hasn't
10 been helped at all by Sarbanes-Oxley, and our shareholders
11 have not expressed one concern, or -- we don't even get a
12 compliment for having no material weaknesses.

13 MR. WANDER: Thank you, Don, very much. Members of
14 the Advisory Committee, any questions? Mark?

15 MR. JENSEN: Mark Jensen. Thank you for your
16 testimony. I just have some questions about the companies
17 just so we can frame, maybe a little bit of fill in some of
18 the blanks -- when you went public in '97 how much did it
19 raise?

20 MR. PERKINS: 32 million.

21 MR. JENSEN: Has it raised any capital since then?

22 MR. JANKOWSKI: I --

23 MR. WANDER: Could you speak into the microphone?

24 MR. JANKOWSKI: About twenty million since then but
25 it probably totaled probably 30 million prior to that through
1 VC funding.

2 MR. JENSEN: What you got was --

3 MR. JANKOWSKI: I really don't know. I'm sure a
4 couple of thousand for the most part. Certain shareholders
5 own about 18 million shares outstanding, several shareholders
6 own or control five hundred to a million shares of stock.

7 MR. JENSEN: What's the trading activity?

8 MR. JANKOWSKI: About a hundred thousand shares a
9 day.

10 MR. JENSEN: It trades fairly. I just was curious
11 with the number of shares trading every day you have new
12 shareholders coming in, what their expectations are for the

13 company in terms of --

14 MR. JANKOWSKI: We think that those shares get worn
15 out -- because we have a series of shareholders that have
16 been sitting on the stock and we have day trading and other
17 things -- that's a whole separate SEC discussion. But with
18 respect to this, nobody really seems to care, and that's been
19 frustrating because it's been a large commitment of
20 resources. Three of us probably put a thousand hours in
21 the last four months of the year on top of this ongoing load,
22 and that takes away from costing and lots of other things
23 including traveling and talking to the investors coast to
24 coast.

25 MR. JENSEN: So shareholders, would they obviously
1 ask for an audit and --

2 MR. JANKOWSKI: Our board we have several members
3 that are not as experienced as Don, but Fortune 500 level
4 executives retired, and we adopted the blue ribbon panel
5 requirements for audit committees back in '99. And we run
6 our company -- essentially we took what was an informal
7 process, I signed every check that the company issues and we
8 codified it and just put layers and layers of people around
9 so if we wanted to do something, run around, have many people
10 chasing me saying things all the time now, that had I not

11 signed it today I would have signed it in 40 days when I
12 write the check and in either event I would see it. But now
13 everybody's concerned about a control total efficiency
14 percolating upwards.

15 MR. JENSEN: Just one last comment. Is there a
16 difference in your -- perspective on shareholder interest in
17 auditing financial statements versus your internal reports,
18 or are you able to distinguish between the to where their
19 interest really lies -- or do they just assume it's all one
20 package and therefore available to them?

21 MR. JANKOWSKI: We've received notes --

22 MR. JENSEN: I'm not trying to be --

23 MR. JANKOWSKI: Generally the bulk of our investors
24 are concerned with revenue growth. So we get beat up every
25 quarter if the revenue doesn't grow. And when we talk about
1 the bottom line and the continual loss, it's shrinking but
2 it's a loss, everybody says that's important, cash flow is
3 important, and that's our -- our quarterly conference call is
4 five minutes of me going through the math and 25 minutes of
5 going through what's happening on the revenue growth side of
6 the company.

7 MR. JENSEN: Okay.

8 MR. WANDER: Yes, Rusty?

9 MR. CLOUTIER: Don, I kind of wanted to ask you a
10 little bit more of a personal question. Most of us that have
11 testified or sat on these panels are CEOs, and it's good to
12 have a person who has sat on several boards. As you heard me
13 say a minute ago, I think in a very small company like the
14 one you are here representing today, it's very transparent as
15 you said, you know, when the CEO signing the checks of ten
16 thousand or under and CEO 15 hundred and under. But of
17 course you've also served on some very large boards. I would
18 ask you the question: Do you see a difference in
19 transparency as a board member when you serve on a small
20 company that you feel you can get your hands around it much
21 easier and know what's going on versus a very large public
22 company? Is it much more difficult to get transparency even
23 from a board member sitting in there making decisions that is
24 affecting the shareholders. Do you find a difference or
25 there is none?

1 MR. PERKINS: Of course we're much closer to what's
2 going on in this business than I was in the Fortune 500
3 companies which I served. But I think it's important to add
4 that my philosophy of serving on boards and I've, done as
5 much of that as most people you will meet, has been that --
6 when I join a board, I put my reputation in the hands of the

7 CEO. And if I'm ever uncomfortable about that, one of us is
8 going to go. So I've had my board life determined more by my
9 judgment of people in their quality and their integrity than
10 by verifying every number in the business. And I have the
11 same concern with a small company as I do with a large
12 company. I have great confidence in Jess.

13 MR. CLOUTIER: So I guess what I could reason this
14 and I agree with you, is it really comes down to the honor
15 and integrity of the people running the company. Forget
16 about all the checks and balances. If you've got a dishonest
17 person, they most probably are going to do dishonest acts.

18 MR. PERKINS: I've also been a strong advocate of
19 governance reform, as Herb knows. In fact, Don Jacobs,
20 recent dean of Kellogg, and I have put on governance
21 conferences for 15 years and Pastora has been at some of
22 them. And I can say as much as I'm happy to see the
23 corporate governance recommendations of Sarbanes-Oxley,
24 there's not a recommendation there that wasn't part of what
25 we've been proposing for many years before Sarbanes-Oxley.
1 Because it makes good sense, and there are many things today
2 in corporate governance I would change beyond what
3 Sarbanes-Oxley requires or recommends.

4 MR. CLOUTIER: What would be some of those things?

5 MR. PERKINS: To me the weakest part of corporate
6 governance today is the fact that directors are re-slated
7 without being really truly evaluated by their boards. My
8 statement is that I think it's intellectually dishonest to
9 re-slate a director who has not been put through some kind of
10 evaluation process by his or her peers on the board. That's
11 not required by Sarbanes-Oxley, and yet I think it's highly
12 important. There's an expectation of board members that they
13 will be re-slated until they reach a retirement age or until
14 something very unfortunate or unpredictable happens.

15 MR. WANDER: Pastora?

16 MS. CAFFERTY: Thank you so much for joining us
17 today. I'd like you to discuss this more, because some of
18 the -- you can't hear? Sorry. I'll speak even louder. One
19 of the issues that has been raised is the question of the
20 burden of having independent directors, a preponderance of
21 independent directors, a majority of independent directors,
22 for small public companies. Some of the governance costs
23 have been questioned, and I would like to hear you speak
24 about that.

25 MR. PERKINS: Back when I first started serving on
1 boards I didn't realize that most boards back then were
2 predominantly inside directors. In fact it wasn't until the

3 New York Stock Exchange required audit committees of the
4 three independent directors that such famous companies as
5 Exxon, Johnson and Johnson, and Time, Incorporated had to put
6 outside directors on so they could get an audit. And that
7 goes back to probably the early '70s. It wasn't that far in
8 the past. I can't imagine anybody going on a board today
9 that was not predominantly outside. That has been something
10 I've felt strongly about for a long time, but that's not
11 really much of an issue today, I don't think. And I think
12 the cost of -- if that was the nature of the question,
13 Pastora, the cost of outsiders is very small in relation to
14 the benefit that comes from it. In fact in Nanophase one of
15 the benefits of the board we put together is to open doors
16 to -- for a company that's introducing chemicals that are not
17 very well understood in the world. It's how we locate the
18 market for such unusual items as the ones that we produce.

19 MS. CAFFERTY: Let me pursue this because again I
20 think drawing on your experience and your leadership on
21 corporate governance. What I would like to hear you talk
22 about a little bit is the benefits of the corporate
23 governance in Sarbanes. And I believe that Sarbanes does not
24 go as far as we would have maybe the boards go and as we have
25 discussed in the past, so I would like you to talk about that

1 because the other issue that has come up, the benefit that
2 would be to smaller public companies, perhaps to all
3 companies, if all the regulatory agencies and the regulatory
4 bodies, the NYSE, the SEC, and so on, had similar rules, that
5 we were not responding to slightly different rules with each
6 agency.

7 MR. PERKINS: It's like several other questions
8 I've heard here today. The answer's of course. It has
9 bothered me because I've spent so much time on corporate
10 governance that Sarbanes-Oxley is looked at as having changed
11 things. I don't think -- I think it has codified good
12 corporate governance rules, and hooray for that. And
13 certainly boards are more alert today thanks to the disasters
14 of the Enron and MCI. I spent some time serving on the ATT
15 board back before -- back when it was the largest company in
16 the country, and it's amazing to see what's happened to that
17 company in recent years. But one of the things that happened
18 was they were competing with a company that was falsifying
19 its results. And the chairman, specifically Mike Armstrong,
20 will tell you that he ran that business differently because
21 he was trying to figure out how they were so inefficient in
22 relation to what MCI was reporting. And much of the damage
23 that's been done to ATT was done by a competitor in their

24 dishonest reporting. So the implications of these disasters
25 are to me terrible. But do we carry that all the way down to
1 the Nanophase and have them spend money that we ought to be
2 spending on our product development to -- how often can we --
3 can we check on poor Jess here and the two people he has
4 working for him?

5 MR. WANDER: Janet?

6 MS. DOLAN: I want to thank you for your getting us
7 off on a discussion of governance which I think for many of
8 us I believe is probably much more critical to the solving
9 the true problems that we solve. But I would like to get
10 back to your recommendations because we -- first of all, we
11 appreciate people who come in with recommendations. We hear
12 a lot of horror stories, but the real question is what do we
13 do about it.

14 Your suggestion of requiring 404 attestation maybe
15 once every three years, I think Mr. Schroeder had the same
16 one. That's a bright line, it's easy to administer, it's got
17 a lot going for it. But it still requires that you're going
18 through a complete 404 certification as it's currently
19 implemented, maybe it will get better. And I have a question
20 for you which is, even if you had to do it once every three
21 years, do you think it brings value or do you think a better

22 approach, if it could be done, would be to try to figure out
23 a risk-based approach or a more defined risk-based approach
24 where you only are certifying or testing and certifying the
25 most critical controls? Do you have an opinion -- are you
1 saying do it every three years just because you assume we're
2 going to have to do it anyway, let's make it less onerous, or
3 do you have another idea of how to do it in a way that really
4 might bring value to your shareholders.

5 MR. PERKINS: Clearly, as far as I'm concerned,
6 there is no benefit whatsoever in doing it every three years
7 or any one year. I would support doing it more simply in
8 which case I would give the microphone to Jess to tell you
9 what more simply means.

10 MR. JANKOWSKI: To put it in context, one thing to
11 remember is our auditors -- we have a good relationship with
12 our auditors. And one of the things was we had to establish,
13 well if we have an error, what does that mean? Well we
14 determined if we took 90 samples, one error, there was a
15 reasonable margin of error. If we had two, that would be
16 potentially bubbling up to material weakness, certainly
17 material deficiency. We don't have 90 samples. We don't
18 have 90 big deposits.

19 In a quarter we certainly don't have it, so we were

20 doing 60 back to 30, and you look at it, it's almost cartoon
21 relative to our business. The bright line is drawn by having
22 so much oversight. You know, I don't see the advantage to
23 much of it because the areas -- I mean a traditional way to
24 look at financial reporting, you know we have a lot of
25 capitalized IP. Some of that IP is a -- from years ago was a
1 four hundred dollar trademark application that's going to
2 last 15 years. Well, this year we had error in the way we
3 calculated IP. It wasn't spread over -- over the right
4 amount of years it was so immaterial -- it was material in
5 light of SOX-404. It was material to me.

6 I was annoyed that my people -- or my two people
7 and I didn't catch the error. But the reality was there was
8 a time when that would just be so immaterial to our six
9 million dollar loss, to our five million dollars in revenue,
10 to whatever expenses accumulated and you just would ignore
11 that. And to focus resources on that takes us away from
12 looking at the big things which are things like revenue
13 recognition, handling of deposits and cash. Inventory -- in
14 our case we have inventory that's not saleable to anybody
15 except to a company that wants Nano materials. So there's
16 really not a huge risk there. Our fixed assets are almost
17 all manufactured, hand built by us, and have no resale value.

18 So you look at all of these things of our company.
19 To me, you can look at four items and give yourself comfort
20 that the company's doing things properly, that there's no
21 either tacit or directly complicit cheating going on, there's
22 no collusion. And I would like to see something -- an
23 approach like that, a risk-based approach that ignores some
24 of the standard -- if there's ten standards, there's all
25 kinds of internal control standards we all learned in school
1 that we live by.

2 Some of them are so irrelevant to a five million
3 dollar company with one location with three products with
4 three customers making up 90 percent of their sales, that the
5 auditors have to have the flexibility to look right back and
6 see say well, hey, we have a 60 percent revenue customer, you
7 have a 20 percent revenue customer. Why are we going through
8 this whole process? They -- very few people choose to pay
9 more than they normally would for items. We went and vouched
10 it all, and confirmed all of it. We're just looking through
11 samples. It's an exercise in tedium for the most part.

12 MR. WANDER: Alex, and then Rick.

13 MR. DAVERN: One question relative to the cost and
14 effectiveness of the different versions of Sarbanes-Oxley on
15 preventing corporate fraud, obviously this was passed in the

16 environment of post-Enron, post-WorldCom. So I'm curious if
17 you take all the governance aspects, were to rate their
18 effectiveness, perhaps, at preventing fraud in public
19 companies and their relative cost and then compare that with
20 the relative cost, and in your mind of effectiveness of 404
21 for preventing fraud among senior officers in companies of
22 your size and with your complexity, is it effective in
23 preventing fraud under those circumstances?

24 MR. PERKINS: I've had trouble finding any
25 rationale that tells me that any part of 404 has been
1 effective. Period.

2 MR. DAVERN: I was --

3 MR. PERKINS: I didn't hear your question. I'm
4 sorry.

5 MR. DAVERN: I was just wondering if, Mark, you
6 would want to comment as well.

7 MR. SCHROEDER: In terms of detecting fraud, I
8 think the corporate governance issues, as this other
9 gentleman has indicated, it's codified with what good
10 companies had in place for governance, and certainly from a
11 corporate perspective, the underlying culture, the underlying
12 climate, is the best method for detecting fraud. And I think
13 the formalization of whistle blowing for a company our size

14 adds value to that process because employees know that they
15 have an anonymous way to do what they should do in those
16 situations and report it and know that it's going to be acted
17 upon.

18 So you can't measure how much that's helped, but it
19 certainly has helped set the climate that our board wants to
20 have in place as far as code of business ethics and things of
21 that sort. But I also agree that -- I see that outside of
22 404. Because the 404 side of things and the checking of
23 mundane little silly items is -- doesn't add to anything new
24 to the mix. Our CFO I was interested -- the gentleman we
25 have talked about initially, the CFO after we went through
1 the 404 process basically said "I now initial the wall when I
2 turn my light off in my office."

3 So I think you've got to separate these two.
4 Sarbanes-Oxley, corporate governance issues for our company
5 is a good thing. 404, no value.

6 MR. WANDER: Did you want to comment, the other
7 Mark?

8 MR. SPEARS: I agree with Mark. I think the
9 little -- all the work that's done on these little things
10 it's not -- if you're trying to keep corporate fraud out
11 you're not going to catch it in that small amount of internal

12 audit type work or transactions, that's not where it occurs.

13 MR. WANDER: Any -- yes, I'm sorry, Rick.

14 MR. BROUNSTEIN: Something that I want to come
15 back -- this is Rick Brounstein. I want to pick on or take
16 advantage I guess of something that Mark Spears added, and
17 now that we have more another CFO here. And that is
18 everybody's talked about corporate governance and tone at the
19 top and entity, and I think that's a pretty foregone
20 conclusion and everyone's sort of trashed 404. But within
21 there Mark said something that stuck to me and that is there
22 is a piece of -- it may be nothing to do with fraud but has
23 to do with getting it right and that's the financial
24 reporting controls. And I'm not sure -- as a smaller
25 company, how did you address that? Was there some value
1 there, anything you might talk about that specific area of
2 404?

3 MR. JANKOWSKI: I think there was some value there
4 in a procedural sense, however, the value to us was check
5 lists. But the check lists that we were given as an example,
6 and a good check list to go through had hundreds of items.
7 When you look at it you end up having to determine which of
8 these items are germane and which are not germane. And at
9 that point you're making it -- you're making a judgment

10 that's subjective which I think the standard is trying to
11 avoid, subjective judgments and have an objective cloaks over
12 the whole process. I think from the reporting side our
13 reporting was always strong. I think your company is small
14 enough that the auditors understand very well what the in's
15 and out's are in our financials.

16 So again, I guess I would say there may have been
17 some advantages to it, but it was kind of swatting flies with
18 a sledge hammer. You know what we have to do now disclosure
19 controls is the next one that's going to perk up, is another
20 big item to -- if you follow that to the letter there's
21 almost a Committee meeting every time you do anything. And
22 it's unrealistic when I see everybody in the company that's
23 going to test the disclosure control at the coffee pot every
24 day it doesn't seem to be germane to us.

25 I'm not saying one of the businesses, Mark the CFO
1 here, had discussed is a complicated -- you have many -- lots
2 of communications, and lots of locations, so you have some
3 pretty old fashioned internal control issues. Our business
4 is so simple relatively speaking that I don't know that the
5 financial reporting disclosures have been all that, the
6 processes suggested with were all that strong. I think we
7 were already there before we started.

8 MR. WANDER: Yes, Drew?

9 MR. CONNOLLY: My name is Drew Connolly. Mr.
10 Perkins, thank you very much for that testimony. As someone
11 who spends his career hoping to help finance small companies,
12 knowing that there are gentlemen and women of your stature,
13 commitment and integrity level available to small companies,
14 could we see each other after the hearing? I think I have a
15 few other posts that need to be filled. But --

16 MR. PERKINS: You might be interested that on the
17 board I have the retired chairman of Cummins Engine, the
18 retired chairman of Zenith, and one of the senior officers of
19 FMC, a major chemical company. All of them bring to this
20 little business talent that wouldn't be available except that
21 most large companies have retirement ages for directors.

22 MR. CONNOLLY: Playing golf isn't all it's cracked
23 up to be after retirement, I take it. But in candor I
24 believe I've actually seen a presentation, perhaps this
25 company presented maybe at a National Investment Bankers'
1 Conference. Is your stock symbol NAPT?

2 MR. PERKINS: NAMX.

3 MR. WANDER: Excuse me. Where is this stock
4 trading on, NASDAQ?

5 MR. PERKINS: Yes.

6 MR. WANDER: And do you have any research covering
7 it?

8 MR. PERKINS: Three institutional analysts, so we
9 have no retail analyst coverage, but we have three actually,
10 all within the last six months probably do a -- we're happy
11 to capitalize on it.

12 MR. CONNOLLY: Actually that's where I was also
13 going to go. There's been a lot said about how you did a
14 PIPE financing, VC funding, sophisticated investors. The
15 average investors are often not able to access that
16 institutional research, except indirectly or occasionally and
17 possibly through their brokers. The ability to find solidly
18 managed growth stories, good investments, need to be obviously
19 finding companies that need investors and investors that need
20 good companies is the ultimate objective, I suspect. Do you
21 have any thoughts for the Committee, not limited to
22 Sarbanes-Oxley on how companies such as your could access
23 capital markets, could benefit within the framework of
24 regulation?

25 MR. JANKOWSKI: Well I think as it stands now it's
1 going to discourage -- I mean typically private equity money
2 is not as free flowing as public capital because it's not
3 liquid. And with the -- as Mark said, Mark the CFO said --

4 I'm Jess Jankowski by the way. Talking about going public at
5 325 million dollars, that is the sort of thing we're hearing
6 from people in New York and San Francisco. These companies
7 need to be 75 to a hundred million to go public. Part of it
8 is you have this hurdle on regulation. And the reality from
9 my perspective is that lots of companies that were -- that we
10 were what you called a "story deal" in 1997, we wouldn't be
11 public in today's environment.

12 We wouldn't have been able to invest 60 million
13 dollars in getting to the point that we got to. And I think
14 that's going to limit the most entrepreneurial, probably the
15 high failure rate, high success rate companies from going
16 out, take Yahoo and take Amgens, none of those companies went
17 public with a hundred or three hundred million dollars of
18 revenue. They all went public in a garage with some bright
19 eyed people that were excited about an idea that couldn't get
20 VC funding because VCs typically are much more conservative
21 than that. It's not just the entire Sarbanes-Oxley. But we
22 probably spent a million and a half being public. So we're
23 spending thirty percent of our revenue every year being
24 public counting, you know, my salary which has -- that
25 escalated nicely thanks to SOX-404 and I do appreciate that.

1 MR. CONNOLLY: It's nice to know we did fine with

2 something.

3 MR. JANKOWSKI: We've got that. We've got lots of
4 lawyering. We've got lots of systems. And I think that in
5 terms of advice where to go, I think people are going to
6 consolidate probably around public companies, probably going
7 to start doing rollups where if you have enough money you
8 just say okay, I have the public already, I'll start buying
9 technologies and look at a lower multiple and probably be
10 more conservative.

11 MR. CONNOLLY: Finally --

12 MR. PERKINS: We're not going to get money future
13 money from the capital markets -- if I could wave a magic
14 wand and make Nanophase private, I would do it immediately,
15 because we're going to get our money in our future from our
16 customers who see what we're doing as a less expensive way to
17 do R&D and to find their growth items through what we're
18 doing. This is where our last major influx of capital has
19 come from. And they found us, a German company, that I'm
20 embarrassed to say I've never heard of.

21 MR. CONNOLLY: Sir, I appreciate that, I am
22 concerned with it, it is a specter that overhangs our capital
23 markets in a very serious fashion. Companies that are
24 managing for the future that are good governed at the top,

25 that are aware contributors to a boom tech growth, new
1 technologies, new job creation orientation, making statements
2 such as that need to be cautionary to all of us and certainly
3 the regulators in the room and the regulators who may review
4 this transcript because that is ultimately what's at stake.

5 And thank you also for making my larger point when
6 talking about having a negative price earnings multiple
7 because I assure you, sir, you are at least one of several
8 hundred, possibly a couple of thousand minor micro public
9 companies. Certainly not all of them with market caps of 120
10 million dollars, and that's to your credit as well, but there
11 are a lot of folks below that number where that Sarbanes-
12 Oxley compliance number is the difference between a positive
13 P/E and a going concern conceivable letter --

14 MR. WANDER: I think we've run over about fifteen
15 minutes, but I think the discussion was well worthwhile. And
16 before we close I'd like to offer an opportunity to any of
17 our guests to make any final remarks they might have.

18 MR. SCHROEDER: One remark really a response to
19 Miss Dolan's question to Mr. Perkins I believe. The question
20 of the frequency of the testing process. I think it requires
21 both. I think it requires a risk-based approach to make
22 certain that whenever you do it, be that annually, be that

23 every three years, be that every five years, that common
24 sense is applied to the process. But I also agree with what
25 the other gentlemen have said here today in that it
1 doesn't -- we have a 94 percent retail shareholder base.
2 It's obviously not important to the institutional
3 shareholders. I can assure you it's not important to the
4 retail shareholders. And the best solution would be to
5 exempt smaller companies in the process completely, but I'm
6 also a realist and I know that's not likely to happen.
7 Alternatively, a risk-based approach every three years is
8 much better for us marshaling our limited resources and
9 focusing on it once every three years rather than a yearly
10 basis.

11 MR. PERKINS: Hear, hear, a banker I can agree
12 with.

13 MR. WANDER: Any other final comments? If not, why
14 don't we resume at quarter to 4:00 for our next panel, and
15 thank all of you very much.

16 (A brief recess was taken.)

17 MR. WANDER: I've been directed to make sure that
18 everybody speaks into the microphone because the webcast is
19 not picking up everybody, and all of those out in etherland
20 are going to be upset.

21 I'd like to welcome our next panel, and I think
22 maybe I'll do something a little differently. I'll start
23 from my right and your left. So Bill, would you like to
24 begin and introduce yourself?

25 MR. TRAVIS: Sure. My name is Bill Travis. I'm
1 managing partner of McGladrey & Pullen, a national CPA firm
2 focused on mid-sized businesses.

3 MR. MOLITOR: My name is Michael Molitor. I'm
4 Assistant Professor at Thomas Cooley Law School in Lansing
5 and Grand Rapids, Michigan.

6 MR. STIEVEN: Hi, my name is Joe Stieven. I'm
7 Director of Financial Institutions Research at Stifel
8 Nicolaus. I'm actually also leaving in the next month going
9 to form my own company called Stieven Capital Advisors, but I
10 can't go into any great detail on that on the advice of
11 counsel. No business cards yet.

12 MR. HICKEY: I'm Jim Hickey, I'm a principal at
13 William Blair & Company in Chicago.

14 MR. WANDER: You watched, all of you, the format
15 that we followed. We would like to continue to follow the
16 same format, and call on you, Bill, to open the session with
17 your remarks please.

18 MR. TRAVIS: Thank you. Co-Chairmen Jim Thyen and

19 Herb Wander and members of the Advisory Committee, thank you
20 for the opportunity to talk to you on behalf of McGladrey &
21 Pullen, and hopefully the smaller public companies that we
22 represent.

23 As you know, small and mid-sized businesses
24 represent a significant and important part of the U.S.
25 economy in their sheer numbers, their employee base and their
1 impact on job creation and innovation. We're very pleased
2 that the SEC has taken an interest in considering the impact
3 of the Sarbanes-Oxley Act on current and future smaller
4 public companies.

5 In the last few years many smaller public companies
6 have been unable to raise needed capital through an IPO or
7 even a secondary offering process. Additionally, many
8 smaller public companies have been orphaned, strapped with
9 the costs of being a public company while receiving few of
10 the benefits that go along with it. Some of these companies
11 have been fortunate enough to go private, but I'm not sure
12 that going private is necessarily the best answer for the
13 U.S. economy. Hopefully the SEC's process will address the
14 capital formation issue facing us all in mid-sized businesses
15 along with the cost benefit analysis relating to the Act.

16 Some of the benefits. The enactment of the

17 Sarbanes-Oxley Act in our view has certainly resulted in many
18 positive changes and enhanced investor confidence, including,
19 one, there's an increased awareness within the reporting
20 companies and audit firms of the importance of a proper tone
21 at the top and of the personal responsibility to do the right
22 thing.

23 Secondly, there's an increased emphasis in
24 companies and audit firms on the importance of effective and
25 efficient internal controls and reliable and transparent
1 financial information.

2 Thirdly, there's an increased emphasis on stronger
3 corporate governance including enhancements in business
4 ethics policies and training, and stronger and more active
5 audit committees. We as external auditors are certainly much
6 more active and engaged with the audit committees today.

7 Fourth, there an increased recognition in the --
8 there's an increased recognition of the importance of
9 auditing to the capital markets. The audit profession is
10 again important to the public, to students on the university
11 campuses and within the audit firms themselves. However,
12 these benefits certainly have come at a cost perhaps at a
13 disproportionate level for smaller public companies. To
14 further enhance the benefits of the Sarbanes-Oxley Act, we

15 fully support a careful and thoughtful evaluation of the
16 benefits and costs for smaller public companies.

17 To that end, we suggest and consider the following
18 six items: One, as you know, smaller companies -- smaller
19 public companies have different resources, capabilities and
20 investor bases than large cap companies. As a result we
21 believe the SEC registration and filing process and
22 requirements should be scaled to fit the resource limitations
23 of these smaller companies, while being attentive to the
24 needs of the investors in these companies and to the public
25 at large. We believe additional research may be required to
1 better understand exactly what information investors in
2 smaller companies really want and really need.

3 Second, we support establishing a definition for a
4 smaller public company that significantly increases the
5 number of registrants that fall below the large company or
6 accelerated filer requirements. We believe the Committee
7 should consider raising the public float threshold to 700
8 million from the current level of 75 million. And the
9 Committee may also want to consider whether certain
10 qualitative criteria should be considered or established as
11 well. We further recommend that consideration be given to
12 separating smaller public companies into both micro-caps and

13 mid-caps with differing requirements for each of these
14 groups.

15 Third, while we recognize it is easy to recommend
16 and much more difficult to design, we believe the internal
17 control requirements should be modified for smaller public
18 companies to simplify the requirements and to reduce the
19 associated costs. Obviously any such changes would need to
20 be consistent with the needs and wants of investors. Areas
21 for consideration include the adoption of a more
22 risk-based approach that would allow the utilization of prior
23 knowledge gained by the auditor and the spreading of certain
24 required procedures for process controls over a multiple year
25 period.

1 Number four, we'd like to allow adequate time to
2 consider the input received by the Committee we recommend
3 extending a Section 404 compliance date for non-accelerated
4 filers which I heard earlier today that would be your
5 recommendation.

6 Number five, we suggest that the Committee consider
7 whether the accelerated filing deadlines should be further
8 extended for smaller public companies, perhaps permanently.
9 As you know, these dates are scheduled to be reduced to 60
10 days after year end for fiscal years ending on or after

11 December 15, 2005. We believe that smaller companies need
12 additional time in order to implement the processes necessary
13 to successfully meet these shortened timelines.

14 Additionally, we have some question whether a shorter time
15 frame is cost beneficial for the investors in the smallest of
16 public companies, many of which may have very limited or
17 inactive public float.

18 Lastly, we recommend that thorough guidance be
19 provided regarding the SOX 404 requirement of smaller public
20 companies and their auditors. This type of guidance will
21 minimize uncertainties and better align the deliverables
22 around the expectations of the PCAOB and their inspection
23 teams.

24 This concludes my prepared remarks. I want to
25 thank you for allowing me the opportunity to provide input to
1 the important work of the Committee. I would be happy to
2 address any questions that the Committee may have for me.
3 Please be assured that McGladrey & Pullen is very supportive
4 of your effort and would be willing to assist in any way
5 which we can. Thank you.

6 MR. WANDER: You've already demonstrated assistance
7 by giving us Leroy who has been a very valuable member of the
8 Advisory Committee. Dick?

9 MR. JAFFEE: Dick Jaffee. We're going to talk size
10 and the definition that's going to come of -- come out of our
11 size Committee tomorrow. But you raised an issue and I would
12 like to explore with you a little bit, and I think you're in
13 a good position to comment. Total capitalization is a pretty
14 simple calculation. Number of shares outstanding times stock
15 pricing on some given day. The public float calculation gets
16 a little more complex, but as we get into this definition of
17 size and thinking about the closely held owner operators and
18 so forth when they're excluded when you get to public float
19 calculation, you begin to see that there are differences
20 between the two. How do you feel about it? Is it tough as
21 an auditor to make a good judgment on the public float
22 calculation? Is that a complex calculation?

23 MR. TRAVIS: I don't see that as a complex
24 calculation.

25 MR. JAFFEE: How do you go about doing that?

1 What's the definition or the difference between the two?

2 MR. TRAVIS: In simple overly simple terms you have
3 affiliates and non-affiliates. People who are not affiliated
4 with the organization make up the public float calculation.
5 That's oversimplified.

6 MR. JAFFEE: But your recommendation, if I heard

7 you correctly was, that above seven hundred million public
8 float as opposed to total capitalization would be what you
9 would recommend.

10 MR. TRAVIS: Yes.

11 MR. WANDER: Jan.

12 MS. DOLAN: I want to thank you for the specificity
13 of your recommendations, and I'd just like to ask you for a
14 little more drill down on a couple of them.

15 MR. TRAVIS: Sure.

16 MS. DOLAN: Spreading the financial and the impact
17 and just the cost of 404 is obviously one way to reduce the
18 burden, annual burden, you know last panel we heard a
19 recommendation possibly only do the whole thing, but do it
20 every three years. Spreading it across the three year period
21 is yet another way to try to divide it. We have run into --
22 we have been exploring that concept with different
23 stakeholders but certainly some of them have been with other
24 audit firms. And there seems to be a concern about how would
25 you -- the mechanics of how would you actually do that.

1 I mean how would you determine what could be done
2 in any one year? Would you test it only a third of this
3 year, but certify them at the end? How do you decouple this
4 concept of point in time that everything has to be all done

5 and certified at a certain point in time. How do you start
6 decoupling that and spreading it out over, say, some controls
7 over year, over a three year period, or even everything gets
8 done over a year but doesn't all have to be done as part of
9 the end of the year activity. Tell me some of the mechanics
10 of how you could go about doing that.

11 MR. TRAVIS: Well it's a great question. I think
12 the answer depends on how descriptive you really want to be.
13 From my simple point of view, the users of the financial
14 information, investors, management, and others, are making an
15 assumption that the internal control system is working day in
16 and day out. And so from my point of view when you look at
17 tone at the top and culture and things like that, do we have
18 competent people in the organization, that's something that
19 you would assess annually. Are there really significant
20 changes.

21 Beyond that, for smaller public companies I would
22 look to where are the significant risks in the business and
23 what are the significant changes and use that to determine
24 using judgment between perhaps dialogue between the auditor
25 and the audit committee, where should we focus our efforts
1 this year and let's make sure that over a period of time, and
2 perhaps it's a three year period that we looked at all major

3 areas of the control systems for the business, but it's
4 really a facts and circumstances driven question because as
5 businesses evolve and change, the risks in that business
6 evolve and change, so spending the time in the right areas is
7 absolutely essential as opposed as beating on all areas every
8 year.

9 MS. DOLAN: I want to follow up. I -- again I
10 think there's a lot of consensus from the various players in
11 the whole 404 area that this would be a good idea. How do we
12 customize this? How do we get it back in the hands of the
13 auditors and the audit Committee and the company management
14 to triangulate about what's really important and let's tailor
15 it to every company. And yet we don't seem to be able to get
16 there. So my question is: What needs to be done? I mean
17 you mentioned that PCAOB perhaps has to give clear guidance.
18 How do we get there? What are the steps to getting to the
19 point where you and the audit committee and the management of
20 the company feel that you have what you need to actually
21 customize 404 for a particular company?

22 MR. TRAVIS: Well I think to a large degree we have
23 to move towards more of a principles based and a judgment
24 based approach so that we have competent people on the audit
25 committees and there's competent people in management

1 positions and there's competent people in the audit firms,
2 they can work together and use their intellect as well as
3 their knowledge of the business and their judgments to figure
4 out where to spend the time each and every year. If you
5 begin to get too prescriptive, then you get exactly the
6 situation we have with smaller companies which is one size
7 does not fit all situations. So I think the only way, as far
8 as I'm convinced, as far as I'm concerned or at least the
9 best way is we have to move back to some degree to giving the
10 experts the judgments to do the right things.

11 MS. DOLAN: Okay. We started with AS 2, then we
12 got to the interpretations and other frequently asked
13 questions disclosure from PCAOB that came out on May 16, and
14 now we're here. And we have some people who think we are
15 there, enough latitude has been given because the term "use
16 good judgment," and "don't over audit," "use a risk-based
17 approach" has already been laid out as the standard, and yet
18 we have others who come it's still not clear enough that we
19 don't have enough latitude to take that approach you're
20 suggesting, so what does it take, what more would it take as
21 you're the head of an audit firm? What more would it take
22 from the PCAOB or the SEC to give you the confidence that
23 you're in that kind of environment where you can use that

24 professional judgment?

25 MR. TRAVIS: Well, I think, first of all, the work
1 of this Committee is absolutely part of that process where
2 you begin to recognize that the needs and the resources
3 available for General Motors is a lot different than the
4 needs and resources that Don Perkins talked about. And so
5 you really can't have the same requirements because investors
6 in smaller public companies and the smaller public companies
7 themselves can't deliver all of those requirements year in
8 and year out.

9 If you're the head of an audit committee of a
10 company that has a 2000 subsidiaries worldwide, you probably
11 need some very sophisticated controls and business processes
12 to make sure that you're getting good information, not only
13 do your job in the audit committee chair, but also that the
14 CEO and CFO has good information to manage the business. A
15 smaller public company can't really afford all of that stuff
16 and doesn't necessarily need all of that information because
17 the audit committee folks and the board folks and the CEO are
18 much more knowledgeable of all the activities going around in
19 the business. So Janet, it's a great question, but I think
20 really having different sets of rules and guidelines for the
21 two types of entities or the three types of entities if you

22 want to get into micro caps, I think is the starting point.

23 Let's not have AS2 apply to everybody. Let's have a

24 different set of rules for the smaller public companies.

25 MS. DOLAN: I just want to close with saying -- I

1 just want an answer. Do you feel that right now with the

2 interpretation you have from PCAOB you have the latitude with

3 your smaller customers, your smaller company clients to bring

4 the kind of judgment to bear that you would like to?

5 MR. TRAVIS: I think there's still some question

6 about the level of judgment that is available. There is --

7 obviously when the Act was enacted, there was a lot of

8 uncertainty around what the requirements really were. Over

9 time that as people are implementing the Act uncertainty is

10 diminishing. But there's a very significant hangover yet

11 which is the uncertainty of what happens when there's a major

12 failure, and what is going to be the expectations of the

13 company and the audit company and the auditor once there is a

14 major failure reported in the system. And so it's great to

15 say we have all the guidance on judgment, but until we see

16 the results of a mistake somewhere, and I'm talking about an

17 unintentional mistake, I think we're going to have

18 conservatism in audit firms, you're going to have some

19 conservatism in management teams, and if audit committees are

20 relatively smart, you'll have some conservatism in the audit
21 committees.

22 MR. WANDER: Yes, Rusty?

23 MR. CLOUTIER: I want to ask you a question. In
24 the last panel we talked quite about transparency, and this
25 is something I think that that Sarbanes-Oxley really brings
1 up. And I think it is very interesting we're meeting right
2 next to the Chicago Board of Trade, because when we came in
3 here earlier today, I don't think Alan Greenspan had raised
4 rates, but I think he was planning on it at 2:15 this
5 afternoon. And God only knows what the price oil is at this
6 moment. My question is on transparency. We're trying to do
7 things -- let me just give you a story and let me ask you how
8 you deal with this as an auditor. I have a friend runs a
9 small oil company, and he was CFO there. He just retired.
10 He said Sarbanes-Oxley did him in, because he says he's
11 always trying to guess how many barrels of oil he has in the
12 ground and what it's worth.

13 No matter when he makes that guess he's wrong
14 everyday. Of course you know you've got FASB -- he's doing a
15 great job by trying to get it right. There's just so many
16 variables. Goodwill accounting rules have changed. You know
17 some companies don't have goodwill and others do, just the

18 same type of transaction, depending on what year they did it.
19 Now they're talking about mark-to-market. My question to you
20 is: Is it ever going to be possible to have real
21 transparency on financial statements or do we live in a world
22 that moves so fast that by the time you print a financial
23 statement -- you could print a financial statement of a
24 healthy corporation today, and 60 days later it couldn't be
25 healthy just due to the changes that have happened in the
1 marketplace out there?

2 MR. TRAVIS: Well Rusty, I don't think we'll ever
3 get to a situation where there is exactness in financial
4 statements. There are so many estimates involved in
5 developing the financial numbers, that reasonable people can
6 differ on how to make those estimates, whether it's the
7 number of barrels of oil in the ground or it's even the value
8 of inventories. Most people don't realize that the valuation
9 set for inventories is standard cost systems or estimates.

10 And so there are many numbers in financial
11 information on financial statements on a specific point in
12 time that are estimate based. As it relates to transparency,
13 I think the key for sophisticated companies is to provide
14 enough information for the users of that information to
15 understand how those estimates are being put together.

16 Smaller companies have much simpler financial statements and
17 much simpler transactions, so transparency hopefully should
18 be easier to accomplish, but we'll never get to exactness in
19 financials. And I think one of the key issues is what are
20 the expectations of investors and users of financial
21 information as relates to exactness.

22 MR. CLOUTIER: Could you tell -- let me ask you
23 this question. Sarbanes-Oxley kind of gives a feeling that,
24 well, as long as everybody is doing everything right in the
25 company, nothing really can go wrong, and if you got a good
1 audit committee, good external auditors and you got this and
2 got that. The fact of the matter is, you could have great
3 auditors of financial statements, you could be running an
4 excellent company, and a lot can still go wrong on a given
5 day.

6 MR. TRAVIS: A lot of things can change on any one
7 day. That's part of the risk of investing. Giving
8 transparency to what you do know is important. But guessing
9 what might happen tomorrow is another challenge. Businesses
10 go out of business all the time because of bad strategies. I
11 think what Sarbanes-Oxley tries to do is try to make sure
12 that the numbers are correct. The question is what's the
13 definition of correct, and how reasonable are the numbers,

14 not how exact are the numbers.

15 MR. THYEN: Jim Thyen. I would like to have a
16 little more clarification or get your viewpoint building off
17 of Dick Jaffee's comments on capitalization versus float.
18 And help me understand why affiliated capital is not float.

19 MR. TRAVIS: Well I didn't make the rules, so
20 you're asking the wrong guy.

21 MR. THYEN: I mean just at a high level I'm really
22 trying to understand in a common sense way why affiliated
23 capital would not be float.

24 MR. TRAVIS: Well I think -- let me give you an
25 extreme example where a family or an individual owns 75
1 percent of a small public company. That individual probably
2 will not only have control but they certainly understand
3 every little piece of what's going on in that business or the
4 ability to understand a real piece of what's going on in the
5 business. So my belief is that the focus around float has to
6 do with an investor like me in General Motors. I don't know
7 about you, but I can't walk into the CEO's office and ask a
8 lot of questions about how the business it doing or where
9 it's headed. I think it's really trying to define who is a
10 sophisticated inside investor versus who is not. That would
11 be my perspective on the difference.

12 MR. THYEN: And I guess relating that to myself and
13 my company, I would be an affiliated shareholder, so I would
14 be in that category. Yet I don't consider myself as a holder
15 of long term debt. I consider myself an investor in the
16 equity, but I know that there are restrictions on my equity.
17 I can't just go right out and sell it like a non-affiliated
18 holder of equity. And I guess I'm asking for some help. But
19 it seems to me affiliated and non-affiliated are just
20 different kinds of float but they all are part of capital,
21 otherwise it would be debt.

22 MR. TRAVIS: We're not debating the accounting
23 characteristics of your equity versus the equity of third
24 parties. What we're trying to get at with our recommendation
25 is if you have a company that is all venture capital owned,
1 those folks are sophisticated investors and have the ability
2 to ask whatever questions they want. What we're trying to
3 get at is identify the companies that have significant
4 external and third party investors who really rely on the
5 publicly available information to make their investment
6 decisions.

7 So whether it's float or some other definition,
8 what we're really trying to get at is those companies with
9 significant external investors who can't go into the CEO's

10 office and say, hey, I'm your grandma and I would like to
11 know what the heck's going on.

12 MR. THYEN: That helps me a great deal. Thank you.

13 MR. WANDER: Dan?

14 MR. GOELZER: Dan Goelzer. Thank you for your
15 testimony, Richard. It's very interesting and helpful. I
16 just wanted to follow-up on two things that you had discussed
17 with Janet Dolan. First, what do you see to be the aspects
18 of Auditing Standard No. 2 as it exists today that prevents
19 you from planning and conducting a risk-based audit,
20 particularly of a smaller company?

21 MR. TRAVIS: Dan, I think the major issues have to
22 do with the interpretations of the intent, and I think that
23 each time an issue is raised about what's the intent and the
24 PCAOB provides further guidance, it increases clarification.
25 So without getting into a lot of details, I think we're
1 narrowing the expectation gap on what you really want and
2 what you really expect. And frankly, one of our biggest
3 concerns one of our biggest challenges, shall I say, was the
4 rule was written. The rules were written, great commentary
5 coming out of your office in Washington, D.C., but then when
6 the inspectors come out there seems to be different levels of
7 expectations on what the rules really mean.

8 There's the first round of inspections, -- our
9 experience and the communications we had with other major
10 firms that went through the inspections was: what did you
11 learn from the process? A lot more auditing. That was what
12 came out in the process. So again there's a little bit of an
13 expectation gap, nobody wants to get beat up and be the first
14 pelt hung on the wall so to speak. And so being very
15 conservative, we're probably all trying to do the right thing
16 but we're probably all being fairly conservative and to some
17 degree I don't know fearful is the right word, but we're
18 probably spending a lot of time doing things that judgment
19 would -- better judgment would give us a better answer. So I
20 don't know if that helps you.

21 MR. GOELZER: It really anticipates the second
22 question of mine was -- is part of the problem or is the
23 problem that you feel you're getting a different message from
24 our inspection staff from the words of the --

25 MR. TRAVIS: I would say our first year experience
1 was yes. And believe me, as you know you have very talented,
2 very dedicated people, but we felt like there was a gap
3 between what we were hearing, what we were seeing, and then
4 what was happening in the inspections. And frankly that's
5 fairly normal in a new rule and a new process. It doesn't

6 help matters, but it's part of the process implementing
7 something that's brand new, is to narrow that expectation
8 gap.

9 MR. GOELZER: The other thing I wanted to ask, if I
10 understood correctly, I thought you suggested that perhaps
11 Auditing Standard Number 2 shouldn't apply to smaller
12 companies. There should be a different standard for their
13 internal -- if that's what you were suggesting. How do you
14 see that whole alternative standard as different?

15 MR. TRAVIS: What I think at the minimum what I
16 think we need to have is clear guidance on if you're General
17 Motors, what does it mean? If you are the small company that
18 Don Perkins had, what does that really mean in terms of
19 applying the standard? I'm not necessarily saying we need to
20 rewrite the standard, but guidance on how to apply the
21 standard I think would be very, very helpful. You're smarter
22 than I am, you might know what -- you might have a different
23 view of whether we need to rewrite another standard. Fewer
24 standards would be good.

25 MR. WANDER: Kurt?

1 MR. SCHACHT: Nice to hear your testimony. Just a
2 quick question for you in terms of trying to reduce costs by
3 increasing competition in the auditing world, getting more of

4 the smaller firms involved so it's not just the Big Four or
5 Big Six. Is there a way to do that that would reduce costs
6 in your view?

7 MR. TRAVIS: Well first of all, I think as you
8 know, the Big Four are very, very talented and expertised
9 firms. I think our firm and many others also have a level of
10 expertise that can certainly serve the needs of public
11 companies, especially smaller public companies. Every
12 business has to have a focus. Our focus is on mid-sized
13 businesses and we price according to the resources that they
14 need, the resources we have, and I do believe that there
15 would be some cost benefit if more companies, more audit
16 firms could compete successfully for public company audits.

17 It's not the audit firms that are in the way, it's
18 better awareness of the capabilities of the audit firms to do
19 the job. And frankly the willingness of audit committees and
20 investment banking firms to recommend someone other than a
21 Big Four firm. What I am told time and time again is if I'm
22 on -- if Joe or Suzie is on an audit committee or in an
23 investment banking firm, there is no down side to
24 recommending the Big Four. That's kind of an interesting way
25 of looking at things. To see what you ought to is match the
1 right needs with the right resources.

2 MR. SCHACHT: It's not probably as simple as
3 telling issuers they need to shop around for these services a
4 little more, or is it that simple?

5 MR. TRAVIS: I don't think -- I wish it was that
6 simple. We've tried that method. I think there needs to be
7 an education process, but certainly the firms like ours need
8 to be part of, I think getting us involved, getting firms
9 like us act more active with the organizations like the
10 PCAOB, and the SEC, and others to build awareness of the
11 capabilities that we truly have.

12 But the bottom line is are the audit committees and
13 the investment bankers going to be willing to take -- to give
14 the advice to choose somebody else. Now fortunately market
15 conditions are really driving some change out of necessity.
16 Big Four have limited resources and they're allocating those
17 resources to wherever the highest and best use of what those
18 resources are which the major clients that they serve, the
19 major clients that they focus on. Firms like ours are
20 benefiting from that indirectly in that the very high
21 quality companies have to go find other audit firms and we're
22 receiving many inquiries whether we're capable of doing the
23 work and we're winning the work along with I think others
24 including Grant Thornton or BDO are having the same sort of

25 success. So the market conditions are doing a lot more than
1 any marketing communications that any us could have done in
2 the past.

3 MR. WANDER: Yes, Drew.

4 MR. CONNOLLY: Sir, this is a very irreverent
5 question, but I've often wondered why if we have moved from
6 the Big Eight to what is now the Big Four and, God willing,
7 remains Big Four I guess, given the concerns there for one of
8 the four, why you just wouldn't move up the next four and
9 continue the Big Eight with the next four as part of that.

10 And I mean there's a seriousness behind that question a
11 little bit in that so many public companies are actually, and
12 I don't mean to say this inaccurately, but have been
13 intimidated into having a Big Four accountant because the
14 perception is the institutional investors require it.

15 And I have been with -- involved with companies
16 that have had Big Four auditors. I remember Peat Marwick
17 very fondly. And I've worked with companies that are dealing
18 with second tier and some small slightly peer reviewed
19 accountants because that's what they can afford. So I guess
20 my question is, from a self involved marketing standpoint
21 you're obviously making that case in the marketplace
22 everyday, but the patina of specialty by size of the Big

23 Four, is there -- other than the fact that they are the Big
24 Four and have gotten the bulk of the 98 percent of the
25 Fortune 500, how do you in fact break through that ceiling
1 and become part of the newly constituted Big Eight?

2 MR. TRAVIS: My answer is five cents a share. I
3 think the reality is enormous global companies require
4 massive auditing resources to get the job done. And only
5 collective organizations, because there really isn't a global
6 audit firm, even the Big Four are conglomerations of firms
7 located in a variety of countries, rather. Being able to put
8 together that resource base is required to audit a company
9 with 2000 subsidiaries located across the world.

10 So just by definition, many, many firms are just
11 not qualified. I think many of the so-called second tier
12 firms certainly have the capabilities to serve the needs of
13 very large mid-market companies with global facilities around
14 the world. If they had 2000 subsidiaries around the world,
15 I'm not sure that's a true statement. So I think matching up
16 expertise and matching up resources to the needs of the
17 companies is the way I would answer your question. I don't
18 think we're a legitimate competitor for General Motors. I
19 don't think -- I don't see that client in our portfolio
20 anytime soon and wouldn't recommend it to the audit

21 committee.

22 But a five hundred million or a billion dollar
23 manufacturer with a manufacturing plant in Germany and one in
24 the U.K., there is no reason in the world we can't do that
25 work because we all have foreign affiliates using the same
1 methodology having all the communication capabilities, et
2 cetera, et cetera to get the job done. So the resource
3 capabilities are there to do a lot bigger percentage of
4 publicly-traded companies especially those who we're talking
5 about with smaller mid -- smaller public companies. And I
6 think market conditions are helping and hopefully increased
7 awareness and education will help too.

8 MR. WANDER: Alex?

9 MR. DAVERN: I wanted to make an observation from
10 personal experience and see if you can confirm it or not --
11 my perception had been going beyond the Big Four would result
12 in a lower quoted audit fee, and our company went through the
13 process this year post-404, did refer to the non Big Four,
14 inquired of two of them, got a formal quote from one along with
15 three Big Four and, my experience with that is that the audit
16 fee was right in the middle of a Big Four audit fee. There
17 was no differential in price and was made very clear to me by
18 Grant Thornton that their competitive advantages they saw was

19 better service, more attentiveness to their customers, not
20 lower fees. So I just wanted to make sure, ask your opinion.
21 My perception is that moving to a non Big Four does not
22 necessarily result in a significant change in cost. I'm just
23 asking you to comment on that, if that's your experience or
24 not.

25 MR. TRAVIS: I would say that certainly I've heard
1 that situation in the past, but I would also say that number
2 one, I think that if you're a public company, if you want
3 better service and you want better attention, you should go
4 to a firm where you are important to them. As it relates to
5 price, I think if you look at one bid at one point in time,
6 you can get all kinds of goofy answers. I think the
7 realities are if you look at the cost structures of the Big
8 Four, where are their offices, what's the partner
9 compensation level, what kind of resource capabilities do
10 they have, and you compare it to a mid-tier firm, obviously
11 the cost structures are going to be a lot different. Pricing
12 decisions are a whole 'nother issue, and -- but my point I'm
13 trying to make is that over time for the services you buy I
14 think you would see a difference in cost.

15 MR. DAVERN: Would you have any rule of thumb that
16 you would share the with committee as to what that would

17 likely be, so we have an accurate perception of the
18 difference?

19 MR. TRAVIS: We used to believe that in the normal
20 market, that certainly doesn't exist today because of supply
21 and demand issues, that our rates were in the 85 percent mark
22 of the Big Four and local firms were 85 percent of ours, and
23 that is really a broad-based rule of thumb. And I don't
24 think it's true anymore today.

25 MR. DAVERN: I assume from your comment that the
1 likelihood is closer to a hundred percent than it used to be.

2 MR. TRAVIS: I don't believe that's the case. I
3 think again, if you have a variety of competitors for your
4 business, if there are enough of them, somebody wants that
5 business bad enough, that they will price it accordingly
6 regardless of what their cost structure is. You really need
7 to look at it if you buy other services over a period of
8 time, what's the collective rate going to be.

9 MR. WANDER: Bob?

10 MR. ROBOTTI: Bob Robotti. It seems to me that
11 Nanophase's testimony in my mind is really interesting and
12 unfortunately since you're the auditors you have to do the
13 work that really is important too. It seems that the process
14 and the execution process of 404 is fundamentally flawed.

15 And it's not a design problem in the law necessarily. It
16 seems as if it's the rules themselves. I am struck by the
17 fact that a company with nine million in cash with 120
18 million dollar market cap is paying \$259,000 internal costs
19 to do its internal control process. The cost benefit in that
20 situation is clearly out of line, not when you've got a Big
21 Four auditing firm that's concerned about it. So it's not a
22 Big Four auditing issue. It really is the process. The
23 process is fundamentally flawed.

24 If you stole the nine million dollars from
25 Nanophase, the market cap would be unaffected by it. So the
1 cost here is dramatic. And the fact is it's just plain and
2 obvious. A lot of other things, it gets more nebulous; this
3 is a dramatic situation. So therefore I'm asking you, how is
4 it that the rules are such, because I can't understand it.
5 One time way back when I was an auditor myself. I can't
6 understand how there's any logic to the process, of how this
7 is being implemented and what rules you feel as you have to
8 do this work and have to force the company to do work that
9 clearly, clearly is out of line. Everybody else the range of
10 how out of line it is and how reasonable it is becomes
11 probably less dramatic.

12 But in this case we know it is dramatic and obvious

13 that anybody and how big that is just to kind of narrow it
14 down to everybody else. It's clearly a problem, and it's in
15 the implementations, it's not in the law. Which is also
16 helpful which means we can make a change here. How did that
17 work? Did they have to spend that kind of money? And I
18 guess part of it PCAOB and everybody else in the process,
19 that's my confusion. I can't understand how it works.

20 MR. TRAVIS: Well I can't comment specifically on
21 what Nano -- what the company spent or who they pay, but what
22 I will tell you is there a big difference between General
23 Motors and that company is that General Motor probably
24 already had very detailed processes and systems and
25 documentation in place, and small companies aren't starting
1 from that point of view. They have tone at the top, they
2 have a few controls and documentation's pretty minimal.

3 So to get them from ground zero in year one to
4 being in the ballpark of complying with the PCAOB's rules and
5 expectations and being able to issue a clean opinion on the
6 quality of their controls, management's assessment of the
7 quality controls, and to avoid being the first pelt on the
8 wall of coming up with, we have a material weakness, that
9 takes a lot of time and dollars and hours to get the right
10 answer. And I would guess, and I can't say about this

11 company, as I said before, I would say I guess there was some
12 excessive work done by the company, some excessive work done
13 by the auditors, and some excessive work done by the
14 consultants.

15 But you have this massive expectation gap between
16 what was the intention of the rules and how is it going to be
17 enforced. And there's a period of time, I believe, where
18 people are doing a lot of work to make sure that they're
19 meeting with this spirit and the details of the rules and not
20 enough judgment is being applied. Let me give you an example
21 which I just find amazing and this isn't necessarily the
22 SOX-404 issue, but the fact that firms were having trouble
23 talking to clients about accounting issues, things we've done
24 for years and were fearful of doing that, that was driven by
25 some sort of uncertainty and fear, but it made so sense
1 whatsoever. The one thing that we've always known about
2 auditing smaller public companies is you not only have to do
3 the audit work but you have to add value because they have
4 limited resources and they need your help and advice.

5 They don't have five thousand people on executive
6 row. They don't have a lot of excess cash to do unnecessary
7 things. So the point I'm trying to make is the start up to
8 get a small public company from where they were to what the

9 perceived expectations of the rules were and what the
10 enforcement was going to be, is very, very expensive. And I
11 think what we're learning is well intended people spent a lot
12 of time and effort doing things that probably didn't need to
13 be done to get good answers. Learning, more judgment, some
14 clarification on expectations, some consistency involved
15 around what the inspection teams are asking for versus what
16 the PCAOB really wants, all of that's going to take some
17 time. And the faster it gets ferreted out the better and
18 sooner we'll get the good answers.

19 MR. WANDER: Janet?

20 MS. DOLAN: I have one follow-up point. From the
21 testimony that we heard at other -- the New York hearing and
22 here, if you really listen, what people were saying is not
23 only was it not a good idea to take the 404 structure for
24 transactional auditing and apply it to small companies. But
25 small companies actually have the reverse of what big
1 companies have in terms of real risk. If you're really
2 looking of what creates risk for the shareholder, it kind of
3 flips.

4 It's really done at the top and it's really the
5 controlled environment and the entity controls. If you
6 really wanted to say our real goal is match what we ought to

7 be asking auditors to certify to what the real risk is, that
8 risk is greater there, not transactional. And it sort of
9 flips when you get to bigger companies. As you look at what
10 we have in place for auditing for tone at the top and entity
11 controls, is it very good? Would you recommend that we
12 actually do something different? Is there a role -- a
13 greater role that auditors can play in actually going after
14 what apparently is the biggest risk for the smaller companies
15 which is entity controls and tone at the top?

16 MR. TRAVIS: Well that's a terrific observation. I
17 long believed in smaller companies because the transactions
18 are less complex usually, and less volume of them, the tone
19 at the top, the culture, those sorts of things, the
20 competency of the people are really the guiding lights.

21 So I think one of the problems, Janet, is if you
22 ask auditors to report on something that creates a whole
23 level of activity and documentation, that may not always be
24 cost beneficial for the value that the investors are getting.
25 So the real key question -- the number one question for me

1 would be, do the investors really even care if the auditors
2 opine on management's assertion about internal controls.

3 The way the auditors and the audit committee have
4 to get at the issue is by -- for auditors it's the client

5 acceptance and reevaluation process. Do they have a good
6 culture? Do they have competent people? Are they making
7 good decisions? And the audit committee has to kind of do
8 the same thing. I think as Don said earlier, they either do
9 it right or he's gone. And so I think -- is the reporting of
10 the quality of the internal control system, is the reporting
11 by auditors on management's assessment really valuable to
12 investors given the nature of small company businesses?

13 So I don't know that -- I don't know that you want
14 auditors -- you need auditors to report on tone at the top.
15 I don't know that you need auditors to report on competency
16 of people. That's the role of the audit committee as far as
17 I'm concerned. Auditors need to make sure those things fit
18 the profile for responsible public companies before they do
19 the work.

20 MS. DOLAN: Thank you.

21 MR. WANDER: I think we ought to move along.
22 Michael, would you like to address the Advisory Committee
23 please.

24 MR. MOLITOR: Thank you. My name is Mike Molitor.
25 As I mentioned before, I'm a professor at Cooley Law School.

1 Let me first say thank you very much, Committee members, for
2 inviting me to testify today here. I am greatly honored to

3 do so. I promise I won't say anything about Section 404 in
4 any of my remarks.

5 What I would like to talk about today is the Pink
6 Sheets. Now your Committee's mission has to do with smaller
7 public companies. And largely what I'm talking about today
8 the public in the true sense of the word. They're
9 non-reporting companies, they're not subject to Section 12 of
10 the Exchange Act. So it's not necessarily right down the
11 center of what you're considering by and large. You did
12 mention in item 5.7 of your agenda, also at the last meeting
13 you heard Cromwell Coulson at the Pink Sheets give a lot of
14 testimony that I'd like to expand on today.

15 I did submit a written letter. It was dated June
16 29 -- I'm sorry, July 29th. And what I'll talk about today
17 is largely to amplify on that so I'll keep my comments brief.
18 Now as I mentioned, I am a professor but only been doing that
19 for a year and a half now. Before that I was in a large law
20 firm in Grand Rapids, Michigan for about nine and a half
21 years and I did a lot of Exchange Act work, I helped the
22 companies file 10-K's, their proxy statements and did a
23 number of securities offerings. And the thing that got me
24 interested in the problem with the Pink Sheets is that I had
25 a client that decided after Sarbanes-Oxley, enough of this.

1 404, all the other requirements of Sarbanes-Oxley, this
2 client said this is ridiculous, we're going to go dark. That
3 client had about 230 record shareholders.

4 And so as a result of this very easily was able to
5 simply go off to the exchange that it was on and go dark, and
6 all perfectly above board. And as we've seen from comments
7 that other people have made very common as well. But that
8 left a bit of a bad taste in my mouth. I thought we have
9 shareholders in these companies that are doing this. They're
10 going from this nice position of having great information
11 about the company and they're getting 10-K every year or at
12 least having access to it, 10-Q's every quarter, there's a
13 nice proxy statement that comes out once a year. All of a
14 sudden the shareholders go from tons of information to
15 "poof," to basically nothing. So it got me thinking about
16 this.

17 Another thing that got me thinking about this, I
18 had friend who actually was a bit of a Pink Sheets investor,
19 a Pink Sheets gambler. A friend of his taken a little bit of
20 money and turned it into 50 thousand dollars in the Pink
21 Sheets without really understanding why. He just got lucky.
22 So this seems to me a lot of people are viewing Pink Sheets
23 as more like a casino than a stock market.

24 So this led me into this topic. What did I find?
25 Well, we've heard a lot of anecdotal stories of companies
1 that have decided to go dark in response to Sarbanes-Oxley.
2 They are able to do that because, and I guess this is a bit
3 of a strong term, but there's a loophole in the 1934 Act that
4 says that if you have fewer than three hundred record
5 shareholders, you can decide not to be a public company
6 anymore. This was adopted in late 1963. The Commission
7 promulgated rules 12g5-1 in 1964 and the definition of a
8 record shareholder by and large means somebody that has an
9 actual stock certificate. That's really pretty rare today.
10 And so a lot of these companies that are able to exploit this
11 loophole and go dark like this, even though they have fewer
12 than three hundred record shareholders, probably have
13 hundreds or thousands of beneficial shareholders, who just
14 like my former client have gone from this position of having
15 great information to having very little now. So what should
16 we do about this?

17 It seems to me that there's two goals that we
18 should have. And I guess just to back up a little bit here I
19 forgot to mention the eligibility rule. Back in 1999 the
20 NASD passed a rule that said that all securities that are
21 listed on the Over the Counter Bulletin Board basically need

22 to be Section 12 registrants with a few exceptions for
23 banking companies and insurance companies. This basically
24 led to a mass exodus from the Over the Counter Bulletin
25 Board. About three thousand companies took a look at the
1 Exchange Act, and this is before Sarbanes-Oxley was even
2 thought of, and said "we're not going to do that".

3 Where did these companies end up? They ended up on
4 the Pink Sheets. Sometime before 1999 there were about a
5 thousand securities or so that were listed on the Pink
6 Sheets. How many are there today? There's more than seven
7 thousand securities that are listed on the Pink Sheets. 4600
8 of those are exclusively, and when I say listed, what I mean
9 is quoted on the Pink Sheets, 4600 of those are exclusively
10 quoted on the Pink Sheets. So we've seen a massive
11 population increase in the Pink Sheets. It also appears that
12 trading volume in terms of dollars is increasing at the same
13 time. And so again, what should we do with this?

14 It seems to me that we have two basic goals that we
15 should be looking at here. We should be giving investors in
16 these companies information. Obviously that's the whole goal
17 of the Exchange Act. If you are an investor, you should look
18 at a company, you should do some research on it before you
19 decide to invest. The Exchange Act, the whole point of it is

20 to give you the tools to it that.

21 And at the same time, even though we should be
22 giving investors information about the company, I don't think
23 that we should go too far in doing that. We've seen a lot of
24 companies fleeing the Exchange Act after Sarbanes-Oxley,
25 we've seen a lot of companies fleeing the Exchange Act even
1 before Sarbanes-Oxley. So I think the two guiding principles
2 that we should be thinking about when deciding what to do
3 about these thousands of companies that have securities,
4 traded in the Pink Sheets without publicly available
5 information -- let's balance these two competing goals. So
6 there have been a couple of other suggestions that have been
7 made toward this end.

8 The first was a 2003 rulemaking petition that was
9 filed by a group of institutional investors. They also sent
10 the committee a letter concerning some of the same points
11 that they raised in that letter. What they were suggesting
12 in that letter was, well, let's change the definition of
13 holders of record. If the Exchange Act says that you have to
14 have fewer than three hundred holders of record, and the
15 Exchange Act gives the Commission to define that term
16 "holders of record," which it does, then why don't we just
17 have the Commission change it to say we're not looking with

18 people with actual physical stock certificates, we're looking
19 at beneficial or street name holders. Well, this sounds like
20 a fine solution, but the problem I see with it is that
21 Sarbanes-Oxley, the Exchange Act, despite the good work that
22 this Committee is doing, despite the ongoing efforts of the
23 Commission, still is by and large one size fits all. And so
24 if we were to take all of these companies who are able to
25 avoid the Exchange Act and suddenly subject them to the
1 Exchange Act overnight by simply changing the definition of
2 holders of record, I think that's a bit much to ask of these
3 companies.

4 Many of them were never publicly traded to begin
5 with. Many of them decided to go private due to legitimate
6 concerns like Sarbanes-Oxley. So what could we do to create
7 a bit more of a tempered approach to this? Another
8 suggestion that was made by Mr. Coulson when he testified to
9 you in June, and what Mr. Coulson's main point was, well, we
10 should require companies -- non-reporting companies who are
11 traded on the Pink Sheets to make public disclosures in two
12 situations. First situation is where its insiders
13 are buying and selling its securities. The second situation
14 is where the issuer is undertaking some sort of promotional
15 activities that are designed to encourage other people to

16 trade its securities.

17 Now this also sounds fine when you first thing
18 about. We would at least have these companies going about
19 making some publicly available information in some
20 situations, but I think that we can do better than that. I
21 think what we should do, like what the Exchange Act does is,
22 is make disclosures continuous. If you are a Pink Sheet
23 company, not an Exchange Act registrant, but you've taken
24 some steps to become a Pink Sheet company, you've taken some
25 steps to facilitate a trading market for your stock, it seems
1 only fair to me we should require you to disclose some
2 modicum of information, not full-blown Exchange Act Reporting
3 status, but what I would suggest is that the Commission or
4 this Committee recommend to the Commission that we explore
5 some sort of what I'll call a "minor league disclosure
6 regime" for companies that are traded on the Pink Sheets.

7 I've written a law review article on this. I write
8 in the article and I won't bore you with all the details on
9 this, but I looked at a number of possible disclosure models.
10 The Pink Sheets itself has a disclosure policy. There's
11 Regulation A under the Securities Act which is where
12 securities offerings of five million dollars or less. There
13 is the small corporate offering registration form which is

14 promulgated by NASAA, which is for small securities
15 offerings. Each of these forms has a number of ideas that we
16 can look at to create the regime that gets investors
17 important information -- financial statements, something
18 resembling an MD&A Section, good information concerning the
19 issuer's business and its management. I mean without going
20 too far overboard, these issuers, many of which are quite
21 small.

22 The current regulation I don't believe does the
23 job. It's Rule 15c2-11. Mr. Coulson talked about that in
24 his letter to you and in his testimony to you. But basically
25 the current rule that we have is that if a broker-dealer
1 wants to go about entering a quotation in the Pink Sheets,
2 the broker-dealer has to go about gathering issuer
3 information. So the rule that we have now imposes the duty
4 on the broker-dealer. The end result of this rule is that
5 information rarely gets into the hands of investors. It's
6 riddled with exceptions, what they call the "piggy back
7 exception", the "unsolicited quotation exception". So I
8 think that what we should do is change the definition Rule
9 12g5-1 to come up with a two-tier approach. What I think,
10 and I do believe that the statute, if you look at Section
11 12g5 in the Exchange Act, gives the Commission the power to

12 define the term "holders of record" as it deems necessary in
13 the public interest.

14 What I would like to see the Commission do is adopt
15 a two-tier approach. What I think should be done is to say
16 well, if you are a company that's listed on something like an
17 exchange, the New York Stock Exchange, AMEX, or traded on
18 something like NASDAQ, something that requires you to be a
19 Section 12(g) registrant, well then we'll continue to hope to
20 count simply your traditional holders of record. But if you
21 are listed on -- listed is the wrong word -- I should say
22 quoted on the Pink Sheets, and you've taken some steps to
23 facilitate that market, well here's what we're going to do.
24 We're going to change the definition of holders of records to
25 count your street name holders. And if you have more than
1 five hundred street name holders, well guess what? You're
2 going to be a Section 12 registrant. But hold on, we'll cut
3 you a break. If you comply with this minor league disclosure
4 regime that the Commission should design, we will continue
5 only to count your holders of record. This way you would
6 have people voluntarily complying with this disclosure regime
7 that's much less onerous than the Exchange Act for fear that
8 if they don't they will be stuck with the Exchange Act.

9 I guess I'll make a couple of last points before I

10 conclude my comments here. One thing that I talked about in
11 my letter, okay, well if we do this, where should this
12 information be available? Right now, as I mentioned Rule
13 15c2-11, the information largely ends up in a broker-dealer's
14 files without reaching the investor. The one thing that you
15 might think of off the top of your head, is just make them
16 file it on the EDGAR System. What I would suggest on that
17 end, is let's take a look at the system that they have in
18 Canada which is called SEDAR.

19 EDGAR, as some of you who are small business owners
20 know, is not very simple. You just can't simply push a
21 button and convert your nice Microsoft word document and nice
22 spread sheets into EDGAR format. You by and large have to go
23 to a financial printer to do this. With SEDAR what they
24 allow you to do is essentially take all of these documents
25 that you've done, turn them into a PDF, and post them on the
1 website for nominal fees, and there you go. Much easier than
2 doing EDGAR and much less costly than doing that.

3 The last observation I would like to make about
4 this issue with the Pink Sheets is, if we do adopt some sort
5 of disclosure regime for these non-Section 12 registrants, we
6 should be sure to couple it with investor warnings. You may
7 have an investor out there who sees something that

8 superficially resembles a 10-K or superficially resembles a
9 10-Q and may think, well my Pink Sheet investment, well it's
10 a publicly traded company. It's subject to all the
11 protections that Sarbanes-Oxley gave me. One thing that we
12 should think about is to make it clear in whatever disclosure
13 documents that are required of these companies, the many
14 differences between those companies and full fledged Exchange
15 Act registrants. Again, the goal here should be to get
16 critical information to investors, financials, something
17 along the lines of MD&A, but not go too far. So I guess
18 that's all I am would like to talk about today. That
19 concludes my remarks. I'll be happy to answer any questions.

20 MR. WANDER: Mike, thank you very much. I did read
21 a letter that you submitted, and I would hope that you would
22 send us a copy of your article that's going to be published I
23 guess in the Indiana Law Journal where you elaborate a little
24 bit more on your what you call minor league disclosure, which
25 would be disclosure for these companies. Let me ask you, we
1 are going to consider tomorrow a working definition for
2 smaller public companies, and it will be probably, if
3 adopted, a two-tier situation where there will be companies
4 up to 600 million, 700 hundred million in size, market cap --
5 total market cap, which will be essentially smaller public

6 companies, and then companies with below let's say a hundred
7 million would be in effect micro-cap companies. Do you think
8 it would be appropriate to adopt your minor league disclosure
9 for either of those two kinds of entities?

10 MR. MOLITOR: By and large the companies that are
11 traded on the Pink Sheets are micro-cap companies. So by and
12 large many of them would fall within in the definition to
13 begin with. The thing that I looked at in my research is
14 more along the lines of the numbers of shareholders rather
15 than the market cap. But I think off the top of my head it
16 sounds like a promising idea.

17 MR. WANDER: And do you think investors would be
18 well served with that or that there are other additional
19 items that they might need?

20 MR. MOLITOR: Well served by some sort of reduced
21 reporting obligation?

22 MR. WANDER: Yes.

23 MR. MOLITOR: I guess what I was trying to
24 accomplish with my comments is something is better than
25 nothing. Right now we have essentially nothing for these
1 Pink Sheet companies other than Rule 15c2-11 which doesn't
2 particularly work very well. So I think that anything that
3 we can do to give investors information would be a step in

4 the right direction because they don't really have that now.

5 MR. WANDER: But I think your put your finger on
6 the question maybe. I'll put it as you have done. The
7 non-reporting Pink Sheet companies give us nothing, so
8 anything is better. But now let's say these companies at a
9 hundred million that are public or full -- they're not S-B
10 companies, so they're fully complying with the Exchange Act
11 disclosure rules. Would it be appropriate or in the public
12 interest to downgrade them to something like your minor
13 league disclosure system?

14 MR. MOLITOR: It would be in the public interest to
15 the extent that it reduces the burden on those companies.
16 That's obviously one of the main issues that you're looking
17 at them with this Committee. I would think that it would not
18 be in the public interest to the extent it reduces
19 information to investors. Where you balance those two things
20 is obviously one of the things that you're looking at with
21 this Committee.

22 MR. WANDER: Well I would hope that once we adopt
23 our size definition that we'll send it to you and you think
24 about it and think about how your minor league disclosure
25 might be helpful to us in calibrating the disclosures for
1 these companies.

2 Any other questions? Drew.

3 MR. CONNOLLY: This is Drew Connolly. Professor
4 Molitor, thank you very much for focusing this Committee's
5 attention on an area of the marketplace that is particularly
6 near and dear to me, and a place where I do whatever minimal
7 magic in the corporate finance world I do. I'm very
8 supportive of certainly the first part of the beneficial
9 owners versus the record holders, that's an obsolete, archaic
10 rule when everybody held their shares prior to DTC and prior
11 to stock loan being the second largest profit center of the
12 investment banking community, by lending those shares that
13 are no longer physically in their position to facilitate
14 short sales.

15 The concern I have is really a public interest
16 question here. And it's really broader than do we put up the
17 warning signs to the investors? As much as -- and I am
18 deeply consumed with the idea, how do we get some more
19 investors? Because I'm finding that investor confidence, and
20 I'm really speaking of perhaps less sophisticated, but retail
21 investors, not the outback riverboat gamblers who have to
22 sign that penny stock letter, which by the way is another
23 part of what I would like to hear your thoughts on. Because
24 in the regime of the penny stock world, the definition of a

25 stock is a penny stock, is on one level, is anything trading
1 for under five dollars. Well that now encompasses large
2 parts of the American Stock Exchange and some parts of the
3 New York.

4 But given the strictures, and I speak as a former
5 broker, if I were to effect a customer transaction in a,
6 quote, "penny stock", prior to effecting that transaction, I
7 would have to have a signed back penny stock letter that
8 basically swore that my investor was completely aware of all
9 risks, a riverboat gambler, totally prepared to lose every
10 dime he made as an investor. And I'm not sure that we have
11 perhaps not taken investor protection mandates on -- and this
12 is a strange thing to say in an era of WorldCom, Enron, but
13 if we have not taken some of that too far down the road such
14 that small companies, reporting non-reporting, many of whom
15 were in fact thrown into the Pink Sheets by that eligibility
16 rule, the enforcement overnight of that eligibility rule, do
17 we not create a scenario where we're creating not just a farm
18 team or a minor league, but essentially a ghetto?

19 And I think my colleague Mark in our first meeting
20 talked about his fear of creating regulatory schemes that
21 would forever create that ghetto. So we have this -- the
22 series of Pink Sheet rules, Pink Sheet penny stock rules, we

23 have a trading venue which is now -- Mr. Coulson has done an
24 inordinately good job in creating transparency. Those quotes
25 are available to me on any computer system in the world.

1 Previously I had to be a subscriber to the National Quotation
2 Bureau and get my quotes once a week.

3 So the information, at least in terms of pricing
4 information, is certainly available. The 15c material, as I
5 think we talked about in June, is traditionally resident in a
6 brokerage file, but it's also true that the NASD has a rule
7 that a broker is supposed to maintain reasonably current
8 financial information.

9 MR. MOLITOR: Yes.

10 MR. CONNOLLY: I think we'll hear, either by letter
11 or perhaps by testimony, that there's an organization,
12 MOBIUS, who absolutely for several years attempted to get the
13 NASD to publish that data. They themselves -- the broker
14 gets it and the NASD get it when it's filed. The NASD, and I
15 believe I tried to have Mr. Knight talk about, is refusing to
16 release that information to data purveyors who would make it
17 publicly available, and I can only assume because they are in
18 violation of their own rules, not keeping it current. So
19 there is a format for that information to be available
20 without too much more regulatory oversight. The rules exist.

21 They need to be enforced. And my hope is that as we look to
22 layer on additional strictures on these small little -- the
23 smallest of the small, that we look to simultaneously
24 increasing their viability to attract investor capital.

25 MR. WANDER: I think we're going to move on. It's
1 already 5:00 o'clock. We're going to terminate at 5:30, but
2 since I took some of your time, we'll stay to hear our final
3 two speakers. We're ready.

4 MR. BROUNSTEIN: Hi. Rick Brounstein. Just maybe
5 a quick clarification on this minor league disclosure, and
6 that is -- is it something that is less than full GAAP
7 disclosure?

8 MR. MOLITOR: No, I would suggest that GAAP is
9 something that is needed. Audited financial statements, I'm
10 not sure that we can go that far. 15c2-11 just says, give us
11 your most recent balance sheet and profit and loss statement,
12 it doesn't say anything about GAAP at all right now.

13 MR. WANDER: Okay. Joe, would you like to continue
14 please?

15 MR. STIEVEN: Sure. Thank you. Before I get
16 started I would like to thank Rusty Cloutier for providing my
17 name to Gerald Laporte regarding the impact of Sarbanes-Oxley
18 on the banking industry. As said previously, I am with the

19 Stifel Nicolaus Financial Institutions Research Group. I
20 have been there over twenty years. In investment banking
21 terms is sort of like dog years, it's a long time. But we've
22 been slowly focused on analyzing small to mid-sized financial
23 institutions.

24 When they asked me to provide some thoughts, there
25 were three areas that I wanted to talk about. The first was
1 the impact of Sarbanes-Oxley on small banks. I'll do that
2 very briefly.

3 Number two, what is then the impact that those have
4 had on small banks in dealing with the customers. And
5 finally third, which is not directly related to
6 Sarbanes-Oxley, what is happening to the research coverage of
7 small and mid-sized corporations out there? A little bit
8 related to a previous speaker.

9 First is me drafting up some new documents. I
10 wrote a piece of research three years ago which I think
11 Sarbanes-Oxley came about really. There was an article in
12 The Wall Street Journal, not that the journal is ever trying
13 to be a little flamboyant, it said "Where's the Next Enron?".
14 I took this to heart because somebody who has looked at the
15 banking industry so long, and prior to coming to Steven
16 Nichols, I was an examiner with the Federal Reserve. So I've

17 been on both sides of the table.

18 We've responded with an editorial comment that said
19 it's not in the regional banking sector, and we tried to,
20 without making any recommendations, talk about it. And I'm
21 just going to briefly very quickly read some comments. I
22 know I'm competing with a warm dinner, so I will be brief.

23 Setting the banking industry apart from all other
24 industries is that there is a truly independent set of extra
25 eyes out there. The watchdog groups is comprised of various
1 banking regulatory agencies that look at banks on a daily
2 basis. In most cases the average regional banking
3 institution has at least two regulators looking at it;
4 there's three separate agencies, Federal Reserve, the FDIC,
5 the Office of the Comptroller and Currency. In general
6 banking regulators are trained to spot problems before they
7 become big. And are they perfect? Of course not. Do they
8 make mistakes? Of course. But in general the regulators
9 have been phenomenal. In fact, a common line that I put out
10 is I defy anyone in this room to name five major non-bank
11 corporate failures in the United States. It would be
12 WorldCom, Enron, Adelphia, easy. But if I challenged anybody
13 to name the last major bank failure in the United States, my
14 guess is that I'd probably clean up all the money. Most

15 people can't. Bank of New England, 1989.

16 So my point is let's talk about this for two
17 minutes. The FDIC recently put out data that the banking
18 industry is again as profitable as ever. If you look at
19 this, most experts now agree. But when you look down to the
20 facts at why is it so healthy, the banking regulators have
21 been the police of the banking highway. But more importantly
22 why are the small banks the most profitable? I tell people
23 it's because the regulators are tougher on the small banks.
24 Why are they tougher on the small banks? Look around the
25 room and say that does anybody here have a small little
1 brother or little sister? Do you ever pick on them? It's
2 the same thing in the regulatory environment. It's the exact
3 same thing. You pick on who you can.

4 And my bank CEOs that I've worked with for that
5 last 20 years, they never complain. They don't. The truth
6 of the matter is we actually thank them -- they have kept the
7 regional banking industry as healthy as it's ever been, and
8 it's so important for our economy because the small banks are
9 the ones providing the capital for the small businesses that
10 are out there. You need these small banks out there. So my
11 point, to try to sum it up quickly, is that the banking
12 industry a lot of Sarbanes-Oxley is already covered by the

13 banking regulations. They've done a phenomenal job. I'm not
14 just saying it because I was one; I was there twenty years
15 ago. They've done great job. A lot of it is just redundant.
16 What is the average cost for a bank right now, under a
17 billion dollars. We've done our own internal but we've seen
18 other reports. The average bank they say is spending
19 somewhere if you're under a billion dollars -- five percent
20 of the profits on Sarbanes-Oxley.

21 What happens though, which leads to point number
22 two. What happens? Or do they just eat that or pass it
23 along? Of course they pass it along. That's how things work
24 in America.

25 But the third point was with Sarbanes-Oxley costs
1 that companies are now trying to de-list, it really presents
2 a situation that I think is unhealthy, is that you got
3 companies who want to delist. You've got fewer companies who
4 want to provide research on small companies because you've
5 got a smaller base out there. And I think it could
6 potentially threaten the formation for small companies and
7 the capital that goes into those companies. So I was asked
8 to talk about my three comments. I tried to keep my comments
9 very brief because I assume we still have one other speaker.
10 I provided a copy of my speech to, I think, Kevin earlier.

11 And again, since the time I'll try to open it up for
12 questions.

13 MR. WANDER: Mark?

14 MR. JENSEN: I was just going to try to make a
15 point. I'm hiring Rusty as my adviser. It's an inside joke.
16 Everybody from the community banks has said -- and I'm going
17 to say this in a flip way but it's a serious question. But I
18 want to make a point. Most of the banks have said it's
19 redundant, that Sarbanes-Oxley is redundant on top of things
20 you're already doing. If it is truly redundant, why is it
21 causing any cost?

22 MR. STIEVEN: Well, most of the banks -- one of the
23 reasons is you're having to hire additional professionals to
24 re-package a lot of the information that was already
25 provided. We've got some very noteworthy accountants,
1 representatives of the accounting firms here, because of the
2 liability attached to anything that comes from a professional
3 provider, nothing is free.

4 MR. JENSEN: Most of -- most of the firms use what
5 we learned, I can't say it's FDICIA, right, what we've
6 learned to do in terms of internal control audit. We had
7 experts who had done that, that used the framework similar to
8 the internal controls structure, and then we used -- we just

9 leveraged that knowledge down into the company. So it's
10 really kind of modeled after the same thing. So I was just
11 curious. Thanks for clearing that up. That does make it a
12 little more understandable.

13 MR. STIEVEN: I can go on the FDIC website and pull
14 down the vast majority of the data I need. That --
15 unfortunately that gets reformatted time and time and time
16 again into other documents.

17 MR. JENSEN: There is no question. If you got to
18 report once about the same thing, it should look the same
19 every time every time you report it.

20 MR. STIEVEN: But it doesn't.

21 MR. WANDER: Janet?

22 MS. DOLAN: We've heard from Mr. Travis and others
23 from the accounting industry that maybe the problem with 404
24 is that it's just so new. If we go along further we'll get a
25 little more clarity, and the clarity will eventually get us
1 to a stage where it's a more workable implementation process.
2 If you're very familiar with the FDIC, what can PCAOB -- I'm
3 sorry, -- PCAOB learn, why do we have to reinvent the wheel?
4 What is it about -- what does the FDIC do that the PCAOB
5 isn't doing? To either set the standards or make it clear or
6 how do they create a risk-based approach to the auditing of

7 banks that the community bank representatives who come here
8 say they aren't getting with their Sarbanes-Oxley 404
9 approach? So there's a disconnect here somewhere. They're
10 being asked to do a lot of stuff they don't have to do for
11 the FDIC. So what could one agency learn from the other?

12 MR. STIEVEN: That's a very encompassing question.
13 I would guess I'm going to answer your question with another
14 question. There are a lot of things that are required of
15 these small banks with some of these new rules and
16 regulations. I guess the question is, who is it benefiting?
17 Because the industry's obviously exceptionally healthy. We
18 just had our test on bank failures, and that went over. So
19 the question is who benefits from these additional
20 regulations? And my point is we've had a lot of people do
21 very bad things with regulations and need to try to stop
22 that. And so I actually -- as somebody who was on the
23 regulatory side, I understand it. But I think the issue is
24 that the small companies don't have the resources, or if they
25 do want to incur the costs, the percentage incurred by them
1 is so much higher compared to somebody 10 or 20 times their
2 size. And the final question is, who does it benefit? I
3 don't know who it really benefits.

4 MS. DOLE: Well that wasn't my question. I think

5 there's a lot of alignment around your conclusion that it
6 isn't providing enough benefit. That's a separate issue.
7 But if 404 is requiring too much audit activity on things
8 that don't make -- that are inconsequential, and you don't
9 have that situation when you have the FDIC doing the same
10 kind of thing, which is audit to prevent -- I'm trying to get
11 at what is different about the way the FDIC is choosing, is
12 implementing their audit requirements from what PCAOB is
13 doing?

14 We're getting back a lot of feedback that we need
15 more clarity in the 404 arena in order to get away from this
16 one size fits all. We have to figure out how to get there.
17 So since the FDIC has been doing this a lot longer. What
18 have they finally gotten to in terms of providing a message
19 to the examiners? You were an examiner for 20 years. What
20 do they do that gives the message to you to use a more
21 rational, reasonable approach than apparently the examiners,
22 so far at least, are given to the audit firms? Because audit
23 firms are saying they're not getting that message yet on 404.
24 What kind of message, what do they do to make it work in the
25 banking arena that isn't being done in this corporate arena
1 yet?

2 MR. STIEVEN: I think banking regulators have an

3 unfair advantage in getting responses from corporations, both
4 the Federal Reserve, the OCC and the FDIC. When they go into
5 a bank, as Rusty can attest, they have the utmost attention
6 of the people involved. And basically what they ask for has
7 to be provided. You cannot get out using a shield of public
8 information. You have to provide it. And if you do not
9 there are very serious consequences. So I would say that
10 structure for all of the public companies, I think would be
11 virtually impossible. And I think the reason that you have
12 the banking regulators who have that ability was all related
13 to the deposit insurance reforms, et cetera, from the early
14 or the mid 1900's.

15 MR. CONNOLLY: Sir, you're the Director of Research
16 for regional banks at a major regional investment banking
17 firm?

18 MR. STIEVEN: Yes.

19 MR. CONNOLLY: For a regional banking firm? Thank
20 you very much. Do you have a position on sponsored research
21 in terms of its availability to cover the vast majority of
22 public companies that are not covered how the money would be
23 able if it's not sponsored by the company as long as it's
24 credible and some form of standard?

25 MR. STIEVEN: When you say sponsored research, can

1 you define that for me?

2 MR. CONNOLLY: Where the company or one of its
3 shareholders on a completely disclosed basis would hire a CFA
4 or an independent research firm to provide standards-based
5 CFA quality research. A major regional investment banking
6 firm is not going to do a research report on a 20 million
7 dollar micro cap that trades on the Bulletin Board. But
8 their investors need that research nonetheless.

9 MR. STIEVEN: I would have a hard time thinking any
10 research could be considered independent if you're paying
11 somebody to provide it. I would think that would be more
12 called public relations. So I would --

13 MR. CONNOLLY: How is that different from paying
14 for an independent attorney, or an independent auditor, are
15 they not all professional?

16 MR. STIEVEN: I guess the difference is that your
17 accounting firm is saying that what you have done in the
18 past -- for the past twelve months or whatever, those
19 statements are accurate. Okay? Your attorney is saying that
20 what you have done in the past is "legal" but you're asking
21 someone else to make a prediction about the future. And I
22 would say that is totally different than asking someone to
23 certify the past was accurate. I would say then -- then

24 you're getting into somewhat something that can be
25 promotional. I would find a conflict in paying somebody to
1 "paint a picture of the future".

2 MR. CONNOLLY: And that would be different than an
3 a investment banker doing the same thing.

4 MR. STIEVEN: I would think it would be.

5 MR. WANDER: Okay. Sure Rusty.

6 MR. CLOUTIER: Believe me this is not a banking
7 question, but I asked Joe to come for one reason. Joe is,
8 and he will not say this, is considered one of the most if
9 not the premier analyst on the street for financial
10 institutions, he's one of the best. He is leaving the
11 business. And I would like for him to talk about that for
12 just a moment. But the other thing I would like Joe to talk
13 about in just a moment is the impossibility that's coming.
14 Forget banks, talk about any company, technology company,
15 medical company, any small company, it is getting almost
16 impossible to get coverage, to get research due to that
17 you've just got to have tremendous size to get that out there
18 and to get some firm to sell your stock retail-wise. I mean
19 MidSouth Bancorp or anything else, it's getting more and more
20 difficult for any company to go out there. You've been in
21 the business twenty years. You and I have talked about this.

22 I would like you to give the Committee a little insight of
23 what all this stuff has brought about as far as the coverage
24 of research and why firms are nervous about doing that.

25 MR. STIEVEN: Sure. I'll answer Rusty's second
1 question. In general there is diminishing research on
2 smaller companies out there. And there are several facts.
3 Some of them, not caused by Sarbanes-Oxley, some of them
4 related to Sarbanes-Oxley. But when you have smaller
5 companies trying to de-list, if an analyst is out there
6 working with these companies and all of a sudden they de-
7 list, you have invested time with these companies, and all of
8 a sudden they -- you have invested time notice companies, all
9 of a sudden your investment is worthless. So you are
10 watching street analysts move their coverage uptown to make
11 sure they don't have that happen to them. That's number one.

12 Number two, is that there have been numerous
13 changes in the investment banking business that have caused
14 people on what we call the sell side of the street, the
15 research side to leave because of very complex regulations,
16 and those regulations came about by the sins some of the
17 investment banks committed, the bigger ones, and it's called
18 the global settlement, over the last number of years. Again
19 I've told this to people. They've said you're leaving. Are

20 you bitter that you're leaving? I said no, I'm not bitter.
21 I was a regulator. Regulations happen when people lie, cheat
22 and steal, and there were people lying, cheating and
23 stealing. But it is causing -- not commenting on myself what
24 people would say -- is causing the brightest and the best to
25 leave the street, to get into other businesses. And I think
1 that's a challenge for small companies like Rusty's, et
2 cetera, you want coverage on these companies out there,
3 because if you look at where the economy gets fueled, it's
4 fueled by the small corporations.

5 MR. WANDER: Do you have any suggestions on what we
6 could advise or recommend to increase the research coverage?
7 Or at least stem the flow of it?

8 MR. STIEVEN: I think there are regulations not
9 related to Sarbanes-Oxley that have been detrimental to the
10 securities industry and that's, again, not something that's
11 involved in Sarbanes-Oxley. Michael had some great thoughts
12 regarding some of the small companies. I think investors --
13 I don't care if there's 150 investors in a company, I think
14 they deserve more information. In the age that we are in
15 today, investors deserve more information, not less
16 information. So I think we would like to try to encourage
17 companies to keep their shares on exchanges, or at least

18 quoted, and give information to people. And I think the fine
19 line that we all have to walk is making sure that the burden
20 is not excessive.

21 You cannot expect a company with a hundred million
22 dollars of revenues to have the same resources as a company
23 with ten billion dollars in revenues. That's obvious. You
24 have to have a tiering structure. What I think is very right
25 that you were talking about are setting levels for market
1 capitalizations, and I think you talked about a three-tiered
2 level somewhere around six or seven hundred. I fully endorse
3 that. I would actually like to see it a little bit higher,
4 but that would be a great start.

5 But I do think companies that are even under two
6 hundred million dollars need a different level. I think they
7 need an even reduced level. Because I forgot what speaker
8 said this, but to comply when you are small, you still
9 probably have to have the same amount of resources as
10 somebody five and ten times your size, but you don't have the
11 revenues to take care of that.

12 MR. WANDER: Okay. Thank you. Any other
13 questions? If not, our last speaker is an old friend of
14 mine, Jim Hickey.

15 MR. HICKEY: Good afternoon, everyone. As I said

16 originally, I'm A principal of William Blair & Company which
17 is a Chicago-based investment banking and investment
18 management firm. For 70 years William Blair & Company has
19 provided capital market services and advice to small and
20 medium-sized growth companies and to new investors seeking
21 opportunities to such businesses. I've been at Blair for 22
22 years, first as an equity research analyst, covering the
23 technology sector for 11 years, and then as an investment
24 banker focused on technology companies since then.

25 I appreciate the opportunity to appear before you
1 this afternoon to talk about the impact of Sarbanes-Oxley
2 compliance on small businesses. I believe it's clear that
3 the Sarbanes-Oxley regulations have made an important
4 positive contribution in restoring investor confidence in the
5 integrity of financial reports by public companies after the
6 disclosure of egregious misbehavior by several large high
7 profile companies with very complex operations and capital
8 structures. Regulations requiring more active involvement by
9 more independent boards and audit committees, CEO and CFO
10 certifications, expanded disclosures, and other actions that
11 have improved the timeliness and transparency of financial
12 information have had a good effect.

13 However, the zeal which attended the drafting of

14 the legislation and subsequent rulemaking has just as clearly
15 caused negative outcomes, particularly for smaller companies.
16 The lack of distinction in the regulation for large and small
17 enterprises is a fatal flaw, in my opinion, as is the
18 apparent absence in practice of any consideration of the cost
19 benefit trade-off in the new rules. Rather than making the
20 capital formation process more efficient, Sarbanes-Oxley has
21 made capital-raising much less sufficient and more difficult
22 for smaller businesses. The managements and directors of my
23 small and medium-sized company clients universally see
24 Sarbanes-Oxley as a major cost burden that generates little
25 or no benefit to them or their businesses.

1 My clients commonly cite the overall cost burden
2 from the new regulations including out-of-pocket in lost
3 productivity, the deterioration in their relationship with
4 their outside auditors, the difficulty in recruiting
5 independent directors, and the difficulty in obtaining
6 research coverage as the main drawbacks of the new regulatory
7 environment. I see firsthand how regulations interfere with
8 the capital-raising process.

9 Examples include a local company I worked with for
10 several years, that originally desired to go public to raise
11 growth capital and provide liquidity for its owners.

12 Sarbanes-Oxley burdens were a major factor in its decision
13 last year to sell the company rather than go public despite
14 boasting strong growth and record results. A company we took
15 public took several years ago decided to go private in 2002
16 due in part to the looming burdens of Sarbanes-Oxley
17 compliance and difficulty in generating research coverage.
18 Recently despite outstanding financial performance as a
19 private entity, this client elected to sell control to a
20 private equity firm instead of considering a public offering
21 for the same reasons. The new owners contemplate an IPO in a
22 couple of years, and as a result brought in a new CEO, and
23 the CFO resigned because she did not want to have to deal
24 with burdens of being a CFO in a small public company.

25 A local client that achieved strong sales and
1 profit and clearly had the skill necessary to be a successful
2 U.S. IPO candidate elected to go public earlier this year on
3 the AIM exchange in the U.K, despite the fact that 95 percent
4 of its business was generated in the United States, expressly
5 to avoid the incremental costs and productivity burdens of
6 Sarbanes-Oxley compliance which they estimated to be as much
7 as an incremental two million dollars per year.

8 A venture-backed client that is in the midst of a
9 self-imposed 12 to 18 month delay in its planned IPO to

10 ensure its directors that it will be fully Sarbanes-Oxley
11 compliant before it goes public even though it's not required
12 currently under the Act.

13 Several public equity offering projects with which
14 I've been involved, that experience unprecedented delays due
15 to the inability or unwillingness of the auditors to provide
16 timely responses during the registration process. Initially
17 auditors can no longer be looked to for advice on how to
18 handle various issues. It seems the response to almost every
19 issue now needs to be "run through the national office". And
20 those responses take weeks longer to be produced than was the
21 case a couple of years ago. Such delays leave potential
22 issuers to additional market risk that did not exist in the
23 past.

24 My discussions with clients confirm the findings of
25 the recent studies we heard talked about today that
1 illustrate the costs of Sarbanes-Oxley compliance are falling
2 disproportionately on smaller companies, particularly in
3 terms of revenue and profits, and are increasing at a faster
4 rate than they are for larger companies. Audit fees that
5 have tripled, director fees that have increased 50 percent or
6 more, and substantial increases in SEC-related legal fees are
7 common experiences.

8 Furthermore, it is the least costly requirements,
9 such as executive certifications, director independence, and
10 enhanced disclosure that are perceived to have the most
11 benefit to these companies, while the most expensive and time
12 consuming requirements, such as section 404 requirements, are
13 perceived to have the least benefit.

14 I understand that the Advisory Committee is
15 considering establishing new definitions of small companies
16 and recommend that Section 404 compliance with such a company
17 be deferred for an additional year. I support this proposal,
18 but believe that more relief is necessary. I urge you to
19 consider establishing different standards for such companies.
20 Standards which sustain the spirit of Sarbanes-Oxley but
21 which better consider the cost benefit trade-off to small businesses.
22 Such issuers should be required to work towards the standards
23 of larger companies, but not necessarily meet every single
24 requirement and perhaps have a more liberal materiality
25 threshold apply.

1 I've heard talk today of a three-year cycle of
2 Sarbanes-Oxley compliances requirements for such companies.
3 That might be a benefit, but I see a situation where you'd
4 have a furious effort every three years, a substantial
5 incremental cost to these companies to jump through the hoop

6 on that process. That to me seems to be a waste of time for
7 these companies, a very inefficient way to go about it and
8 likely to cause noticeable deviations in the results of these
9 small businesses as they pay those costs every third year and
10 suffer this. I think a better process would be to divide up
11 the areas covered by Sarbanes-Oxley requirements for those
12 companies who are required to a review a third of the
13 requirements each year so that they have a steady expense and
14 a steady process of going through it, and can still
15 accomplish it all every three years.

16 One other point I would like to make, as someone
17 who spent over a decade each as a research analyst and as an
18 investment banker, is to urge the Advisory Committee to
19 consider the effect of the regulations related to research
20 analyst conflicts of interest are having on the
21 capital-raising process. Certain of these rules are very
22 beneficial, such as increased disclosure of conflicts,
23 financial interests and compensation practices as well as
24 prohibitions related to analyst supervision and promises of
25 favorable research coverage connected with underwritings.

1 However, other rules clearly make the capital
2 raising process less efficient. Two examples include the prohibition on

3 communication between analysts, bankers and issuers, and on promising
research coverage in connection with underwriting engagements. The
communication restrictions

4 simply make the process much more time consuming for everyone
5 involved. Much less of that and much less productive for
6 issuers by having effectively forced them to duplicate a
7 substantial portion of their communication to bankers and
8 analysts as part of their capital-raising process.

9 Furthermore, I believe an investment bank has an
10 obligation to provide research coverage to its investor
11 clients to whom it has sold securities in connection with an
12 underwriting. While favorable coverage should not be
13 promised, coverage itself should be part of the commitment
14 that an investment bank makes to its clients, issuer and
15 investor alike.

16 In closing I hope the analysis and recommendations
17 of your Committee inject a greater degree of common sense and
18 a consideration of the cost benefit trade off and regulations
19 applicable to smaller companies, and contribute to restoring
20 some of the efficiency that has been lost in our capital
21 markets since the adoption of the Sarbanes-Oxley regulations.
22 That's my statement, and I'd be happy to answer your
23 questions.

24 MR. WANDER: And you're going to stand on it.

25 Thanks very much, Jim.

1 MS. DOLAN: I too have a question. I've heard --
2 now not necessarily any testimony here, but I've heard
3 anecdotally from companies that are getting ready to do an
4 IPO, and they're trying to get their 404 compliance
5 activities all lined up and ready; that they're being told by
6 auditors who will be doing their 404 that they need to freeze
7 their activities so that -- such as investing in new IT
8 systems, acquisitions, anything that might be considered a
9 new activity that will change the status of their control
10 environment.

11 They were told originally 90 days and then 180
12 days. Are you hearing anything as you work with clients
13 that -- these are the very clients who are generally
14 investing and moving very quickly and investing and changing
15 and, you know, maybe a freeze for them for 180 days is
16 significant. Are you hearing that it's having that kind of
17 chilling effect on what would be normal business activity
18 that they would otherwise engage in just to make sure they're
19 ready?

20 MR. HICKEY: Absolutely in the case of
21 acquisitions. They could have gone through all the effort

22 and pain to get themselves Sarbanes-Oxley compliant, but they
23 go make an acquisition of a company and they have to start
24 over with that entity. So it has absolutely stopped from
25 considering that. I haven't heard as much on the system
1 side, but that's not something we get exposed to in our
2 normal services to the client.

3 MR. WANDER: Other? Yes, Rusty?

4 MR. CLOUTIER: I would just like to ask you one
5 follow-up question from various testimony we heard today that
6 Microsoft could never start under this environment and some
7 of these companies would have had a real hard time. I guess
8 my question is: Do you see it very difficult for technology
9 companies to continue to evolve in the United States? And my
10 second part of that question is: I recently had a visit from
11 Chinese bankers, and last year from Russia bankers and both
12 told me the same thing: it's a lot easier in their
13 countries. They have less rules and regulations. Is that
14 something we should be concerned about with technology coming
15 out of India, China, Pakistan, young companies being formed?
16 Is it something we should worry about? Have you all done any
17 research on that?

18 MR. HICKEY: We haven't done any specific research
19 on it. There's lots of technologies that will come out of

20 those regions of the world, vis-a-vis Sarbanes-Oxley issues.
21 Could a good company start today? Absolutely. There are
22 hundreds of billions of dollars of committed capital into
23 venture into private equity funds that are looking to be
24 employed. When they can get through the door of going public
25 is going to be later in their development, that will decrease
1 their cost. At the margin you make the argument that it
2 could reduce the internal return and put more power in the
3 hands of private equity or capital venture funds.

4 But I don't think good ideas are going starving for
5 investors here. Our firm has made an initiative over the
6 last couple of years to develop business opportunities in
7 Israel because it has been historically the aspiration of
8 Israeli technology companies to go public on NASDAQ, and they
9 were looking for U.S. firms that could help to provide that
10 distribution. If you go over there today, they're all
11 talking about going public on AIM. They're not talking about
12 going public on NASDAQ.

13 They all view the Sarbanes-Oxley hurdles they have
14 to jump through as an unreasonable burden compared to what
15 the alternative market is for them is now. And that may not
16 mean a lot to American jobs and American technology
17 development, but it does mean something to American

18 investment opportunities for investors in our country.
19 They're not going to see these companies here because they're
20 not going to be thinking about going over and trying to
21 invest in the AIM market.

22 And the earlier question today about purchase
23 research, the AIM market is entirely driven by purchased
24 research; you get a nominee or a Nomad, where you pay 50 or a
25 hundred thousand dollars to and he writes a report, puts your
1 earnings estimates into it, and that is the basis he's the
2 sponsor of that company. So I'm less opposed to the concept
3 of paid research. The other question about how do you fix
4 this in terms of research. That's her question. You've got
5 to figure out how to have research paid for in our capital
6 markets. You've taken away the link for investment banking
7 activities.

8 The institutional investors are finding more
9 efficient markets to do their trading that doesn't require
10 the research connection. If you're not paying for it, it's
11 going to disappear. And there was some analysis in the last
12 two years, for companies between 10 and 50 million dollars at
13 the end of '02 to the end of '04, companies with market cap
14 to 10 to 50 million dollars seen on average, an 89 percent
15 decrease in the number of research analysts that follow them.

16 Between 50 and 100 million it's a 76 percent decrease in the
17 number of an analysts. One hundred to two hundred million
18 it's a 50 percent decrease in the number of analysts. And
19 that's partly the burdens, it's partly the inability to
20 efficiently meet with these companies and have their firms
21 get involved in the capital raising activities, and have that
22 subsidize the research being paid.

23 It's a big problem, I think more than 404
24 compliance. It's being able to provide a way to have small
25 firms sponsored in the market. People willing to go out on a
1 limb, stake their reputation, credibility for their
2 investment clients by making recommendations on these
3 companies that's one of the biggest impediments.

4 MR. WANDER: Jim, could you provide us with those
5 statistics?

6 MR. HICKEY: Yes.

7 MR. WANDER: Just get them to me. Did Alex have a
8 question?

9 MR. DAVERN: I had an observation at the last
10 Committee meeting. I qualified first as a chartered
11 accountant in Ireland and the U.K. before becoming a CPA in
12 Texas. The quantity of GAAP in the U.K. is physically,
13 dramatically smaller, and the scale of regulation I think has

14 significantly more common sense applied to it. My question
15 is: Do you notice or are you aware in your experience any
16 significant differential in the perception of investors about
17 the quality of regulation and reporting in U.K. companies
18 and valuations on the U.K. exchanges that are significantly
19 different than those on the U.S. exchanges?

20 MR. HICKEY: It's hard to generalize on that. I
21 think for many years the U.S. was perceived to have better
22 financial reporting, more accurate financial reporting and
23 generally at higher multiples for its companies. The events
24 that gave rise to Sarbanes-Oxley substantially eroded that;
25 these actions were necessary to restore that confidence. It
1 has come back. I don't know that there's -- capital markets
2 have become more efficient as well. Information flows, the
3 internet, other things. There are things that help that.

4 I don't know that there is as dramatic a valuation
5 difference geographically as there used to be. I'm not sure
6 if that's because of the degree of confidence in the
7 financial information today as it -- I think the level of
8 most investors that I talk to, domestic and institutional,
9 all viewed the degree of burdens put on small companies, the
10 hurdles being made to jump through, as a waste of time. They
11 do not derive incremental confidence by knowing that all

12 these tests or transactions have been performed in the
13 business and they understand the kind of risks that are
14 there.

15 Smaller companies -- and someone earlier was
16 talking about is it the culture at the top or the transaction
17 testing at the bottom, and they want someone who can help
18 them evaluate the culture at the top.

19 MR. WANDER: Anybody? Mark?

20 MR. JENSEN: A couple of things.

21 MR. WANDER: Could you speak into the mike?

22 MR. JENSEN: I'm sorry. The questions you gave in
23 your comments said a lot about the reaction to compliance
24 with Sarbanes-Oxley. I'm assuming what you really are
25 meaning is 404 compliance more than anything else.

1 MR. HICKEY: It's actually everything. You'll hear
2 the comments about everything. The least perceived value is
3 the 404 components, but I would be lying if I didn't say
4 there were a lot of small company managements who resent
5 having to have independent boards. They have fully
6 independent audit committees. That's probably something you
7 can't back away from.

8 MR. JENSEN: This is kind of new testimony. I'm
9 not sure we've heard that before, that everything is swept up

10 in it. The question that I had about is there any
11 research -- one comment, one question following. Is there
12 any research available on the impact of Sarbanes on companies
13 going public or companies being acquired that would quantify
14 somehow the real impact to the American investing community
15 of, say denied access to the opportunities -- investment
16 opportunities and things like that?

17 MR. HICKEY: Not that I know of. There's the Foley
18 study, the Foley and Lardner study that talks about the
19 number of companies considering going private or who are not
20 any longer considering going public.

21 MR. JENSEN: That's an issue we need to think
22 about, opportunities denied to the American investment
23 public. Obviously these are investment opportunities that
24 suit the American investor very well. We just don't allow
25 them to make any investments and their money will be safe.
1 I'll guarantee.

2 The last question. This is this one. As an
3 underwriter, if companies going public were allowed some kind
4 of a phased in approach to 404 compliance, so whatever that
5 might be, first year, maybe nothing, next year they get
6 something, in a control environment. Next year they get
7 maybe 404 audit, would that help companies go public and

8 would you as an underwriter accept companies that would be
9 phasing their way into 404 without it being able to prove
10 that they were in compliance with 404?

11 MR. HICKEY: I think the answer is yes and yes. It
12 would help companies go public because they would have less
13 bureaucratic work to do as opposed to the development of
14 their business with their products in the markets. Yes, we
15 would be willing to take those kinds of company's public, if
16 it wasn't a set of standards that said, the term that was
17 used earlier, a ghetto, but it was a set of standards that
18 reflected common sense application of where risk was to the
19 scale of these businesses, because I believe investors in
20 these kinds of companies are very comfortable that they are
21 taking on incremental risk than they are if they are buying,
22 say Coca-Cola -- and they're willing to live with that.

23 MR. JENSEN: The auditing profession gets to at the
24 end of the day, whoever is looking at that, it would be
25 looked at again in a courtroom later and judgment is called
1 into question, that's where the auditors come from. It's not
2 so much common sense today. It's the fact that five years
3 from now we're going to be in a courtroom, and somebody's
4 common sense is going to be applied to my common sense five
5 years earlier.

6 MR. HICKEY: That came up earlier. Asking the
7 auditors or the audit committees to use there judgment isn't
8 going to happen because everybody's going to cover themselves
9 for the fear of getting put out of business or sent to jail.
10 So you need standards, explicit standards of what you have to
11 cover and what you don't, what the materiality levels are.
12 And those need to be developed with common sense by bodies
13 such as yours that then can be applied universally to all
14 companies of a given size.

15 MR. WANDER: Yes, Drew.

16 MR. CONNOLLY: At the risk of keeping anybody from
17 a hot meal, I would like to just compliment you, Mr. Hickey.
18 I find myself and also the Chair and the Co-Chairs, of
19 selecting of witnesses on today's panel. I find myself
20 wanting to invest in Nanophase. I want to have a community
21 banker when I get home to New Jersey, and I'm going to really
22 want to open a brokerage account at William Blair. The
23 quality and caliber of the commentary -- I might even be
24 willing to go back to school. But the truth is --

25 MR. TRAVIS: You need an auditor?

1 MR. CONNOLLY: The truth is your comments are
2 incredibly well received. The research comment is one that I
3 am personally and deeply concerned about. I have a

4 relationship with an independent research provider who does
5 do sponsored research. I'm very concerned about that. But
6 also I want to make you aware that you're hitting it on the
7 ground; that after last month's testimony we went down to
8 Westminster Securities, a New York member firm, and got the
9 following presentation document from the director of listing
10 from the AIM, from the London Stock Exchange. Just so
11 happens he was in New York on his rotation on his way to BIO
12 2005, which is the biotech conference with three hundred
13 companies, where they were standing shoulder to shoulder with
14 Archipelago and the American Stock Exchange looking for
15 listings.

16 Now I brought this, but the fact of the matter is,
17 that he sat there bald-facely and said, Sarbanes-Oxley is the
18 best thing that ever happened to us, because they are getting
19 companies from all over the world. Westminster was
20 interested because they had various clients who were
21 unwilling to list in the United States. And I am concerned
22 about that both from the corporate finance stuff, which is
23 what I do professionally, but I'm also as an investor, I
24 don't want to be frozen out of the best deals. I want access
25 to those deals. I'm not big enough to be a private equity
1 firm, I'm just little old me. But my hope is that those

2 private equity deals find their ways to the American
3 investment public some day without being overburdened with
4 regulations and precludes American investors from
5 participating. So thank you for being here.

6 MR. WANDER: Actually our September meeting, maybe
7 if we have enough time, we can take a half an hour and
8 discuss -- Gerry and I did actually talk to some
9 representatives from AIM. The difficulty -- and I'll tell
10 you this that I see here, is the Nomads won't work in this
11 country because of the liability which they don't have in the
12 U.K. Any other questions for Jim or any of our other
13 panelists?

14 (No response.)

15 Would any of our guests like to make some final
16 concluding remarks?

17 (No response.)


18 If not, let me go through for the Advisory
19 Committee just some housekeeping addendum items. You're
20 finished.

21 (Whereupon, at approximately 5:00 p.m., the meeting
22 was adjourned.)

23 * * * * *

24 CERTIFICATION

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


Herbert S. Wander
Committee Co-Chair

10/28/05
Date

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

Advisory Committee on Smaller Public Companies

1. Written Statements Received and Presentations Made

[Release Nos. 33-8560; 34-51417; File No. 265-23]

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- Aug. 10, 2005 Slide Presentation of Size Task Force, Alex Davern
 - Aug. 9, 2005 Bill Travis, Managing Partner, McGladery & Pullen LLP
 - Aug. 9, 2005 Donald S. Perkins, Chairman, Nanophase Technologies, Inc., Romeoville, Illinois
 - Aug. 9, 2005 David Bochnowski, Chairman and CEO, NorthWest Indiana Bancorp Munster, Indiana, and Member Government Affairs Steering Committee America's Community Bankers
 - Aug. 9, 2005 Joseph A. Stieven, Director, Stifel, Nicolaus & Company, Inc.
 - Aug. 9, 2005 James P. Hickey, CFR, Principal and Technology Group Head, William Blair & Company
 - Aug. 9, 2005 Charlotte M. Bahin, Senior Vice President, Regulatory Affairs, America's Community Bankers
 - Aug. 5, 2005 Cary J. Meer, Kirkpatrick & Lockhart Nicolson Graham LLP
 - Aug. 3, 2005 Charles J. Urstadt, CEO; Willing L. Biddle, COO and President; James R. Moore, CFO and Executive Vice President, Urstadt Biddle Properties Inc.
 - Aug. 3, 2005 Mark A. Schroeder, President & CEO, German American Bancorp

Aug. 2, 2005 Mark B. Barnes, Ice Miller, Indianapolis, Indiana

Aug. 2, 2005 James A. Clark, Chief Financial Officer, Critical Path, Inc.

Aug. 1, 2005 McAllister Consulting L.L.C.

Jul. 29, 2005 Vicki W. Li, Stevens & Lee, King of Prussia, Pennsylvania

Jul. 29, 2005 Michael K. Molitor, Assistant Professor, Thomas M. Cooley Law School, Grand Rapids, Michigan

Jul. 29, 2005 Geoffrey Grier, Senior Vice President, Marketing & Sales Proxy Service Division, Research Data Group, Inc.

Jul. 22, 2005 Benjamin Gettler, Chairman and CEO, Vulcan International Corp.

Jul. 19, 2005 Charlotte M. Bahin, Senior Vice President, Regulatory Affairs, America's Community Bankers

Jun. 30, 2005 Arnold Orlander

Jun. 29, 2005 Brian Small, Director of Finance, Amtech Systems, Inc.

Jun. 27, 2005 Merlin E. Zitzner, Chairman & CEO, The Baraboo Bancorporation, Inc.

Jun. 22, 2005 Gregory Pusey, President Advanced Nutraceuticals, Inc

Jun. 17, 2005 Professor William J. Carney; see also [slide presentation](#)

Jun. 17, 2005 Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, Inc.

Jun. 16, 2005 Murray S. Cohen, CEO, Epolin

Jun. 16, 2005 John P. O'Shea, President, Westminster Securities Corp.

Jun. 16, 2005 David L. Cox, Chairman, President and CEO, Emclair Financial Corp., Farmers National Bank

Jun. 15, 2005 Opening Statement of David N. Feldman, Managing Partner, Feldman Weinstein LLP

Jun. 14, 2005 Gayle Essary, Managing Director, Investrend Research and CEO, Investrend Communications, Inc.

Jun. 13, 2005 Andrea Psoras, Principal, Strategic Advisory; Member, New York Society of Security Analysts

Jun. 12, 2005 Samuel J. Yake, Paoli, Pennsylvania

Jun. 10, 2005 R. Cromwell Coulson, Chief Executive Officer, Pink Sheets

Jun. 08, 2005 William (Bill) A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank on behalf of the Independent Community Bankers of America

Jun. 08, 2005 Stephen J. Nelson, The Nelson Law Firm LLC

Jun. 08, 2005 Philip V. Oppenheimer, Oppenheimer & Close, Inc.

Jun. 08, 2005 Steve Nagel, President, Kolorfusion International, Inc.

Jun. 08, 2005 Karl Kirwan

Jun. 08, 2005 Victoria Duff, CEO, Bold Ventures Group

Jun. 07, 2005 Michael Ramos, CPA

Jun. 07, 2005 Karl R. Barnickol, Barbara Blackford, Linda K. Wackwitz, Subcommittee on Smaller Public Companies, Securities Law Committee, Society of Corporate Secretaries & Governance Professionals

Jun. 06, 2005 Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial

Executives International and Member of the SEC Advisory Committee on Smaller Public Companies

- Jun. 06, 2005 Richard D. Brounstein, Chairman of the Small Public Company Task Force, Financial Executives International
- Jun. 01, 2005 Deloitte & Touche LLP
- May 31, 2005 Karen Kerrigan, President & CEO, Small Business & Entrepreneurship Council, Washington, District of Columbia
- May 31, 2005 Robert J. Kueppers, Chair, Center for Public Company Audit Firms
- May 31, 2005 Ernst & Young LLP
- May 31, 2005 Charles W. Barkley, Attorney at Law, Charlotte, North Carolina
- May 31, 2005 Ronald J. Simpson, Chief Financial Officer, Minefinders Corporation Ltd.
- May 31, 2005 Debra Fiakas, CFA, Managing Director, Crystal Equity Research, New York, New York
- May 31, 2005 Stephen M. Brock, CEO & President, Public Company Management Corporation, www.PublicCompanyManagement.com , www.PubcoWhitePapers.com
- May 31, 2005 Joel Jameson, President, Silicon Economics, Inc., Cupertino, California
- May 31, 2005 BDO Seidman, LLP
- May 31, 2005 KPMG LLP
- May 30, 2005 Michael T. Williams, Esq., Williams Law Group, P.A., Tampa, FL
- May 30, 2005 David N. Feldman, Managing Partner, Feldman Weinstein LLP
- May 26, 2005 Peter Chepucavage
- May 26, 2005 Steven J. Sharp
- May 26, 2005 Phillips W. Smith, Ph.D., Paradise Valley, Arizona
- May 24, 2005 Kathryn Burns, Vice President and Director of Finance, Monroe Bank
- May 24, 2005 John B. Williamson, III, Chairman, President and CEO of RGC Resources, Inc.: RGCO; Director and Audit Committee Chairman of Optical Cable Corporation: OCCF; Director and Audit Committee Chairman of Botetourt Bankshares Inc.: BORT.OB
- May 24, 2005 Gayle Essary, Managing Director, Investrend Research (<http://www.investrendresearch.com>), CEO, Investrend Communications, Inc. (<http://www.investrend.com>)
- May 24, 2005 Brad Smith, President, WBS&A, Ltd.
- May 23, 2005 Scott Shaw
- May 17, 2005 James A. Brodie, Managing Director, Carr Securities
- May 11, 2005 Frederick D. Lipman, Blank Rome LLP, Philadelphia, Pennsylvania

Written Statements Regarding First Meeting

- Apr. 12, 2005 James A. Brodie, Managing Director, Carr Securities Corporation, Port Washington, New York
- Apr. 12, 2005 Catherine Connally, CIA, President, Issues Central Inc., Toronto, Canada
- Apr. 08, 2005 Christopher Cole, Regulatory Counsel, Independent Community Bankers of America

Apr. 07, 2005 Richard D. Brounstein, Executive Vice President and Chief Financial Officer, Calypte Biomedical Corporation

Apr. 07, 2005 Nelson Obus, Wynnefield Capital, Inc.

Apr. 01, 2005 Financial Executives International

Mar. 31, 2005 Independent Community Bankers of America