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RECORD OF PROCEEDINGS

MEETING OF
SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE
ON SMALLER PUBLIC COMPANIES

Wednesday, December 14, 2005

9:00 a.m. - 4:00 p.m.

SEC Headquarters
100 F Street, N.E., Room L-006
Washington, D.C.

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P R O C E E D I N G S

The following Members were present in person:

- HERBERT S. WANDER, Co-Chair
- JAMES C. THYEN, Co-Chair
- PATRICK D. BARRY
- STEVEN E. BOCHNER
- RICHARD D. BROUNSTEIN
- PASTORA S.J. CAFFERTY
- JAMES A. "DREW" CONNOLLY, III
- E. DAVID COOLIDGE
- ALEX DAVERN
- LEROY DENNIS
- JANET DOLAN
- RICHARD M. JAFFEE
- MARK JENSEN
- DEBORAH D. LAMBERT
- RICHARD M. LEISNER
- ROBERT E. ROBOTTI
- KURT SCHACHT
- TED SCHLEIN
- JOHN VEIHMEYER

The following Members were absent:

- C.R. "RUSTY" CLOUTIER
- SCOTT ROYSTER

1 The following Official Observers were present in person:

2 DANIEL L. GOELZER

3 JACK E. HERSTEIN

4 The following Official Observer was absent:

5 GEORGE BATAVICK

6 The following SEC staff were present in person:

7 GERALD J. LAPORTE

8 KEVIN M. O'NEILL

1 CHAIRMAN WANDER: Why don't we begin the meeting.
2 It's a little bit after 9:00 and I would like to personally
3 welcome all of the members of the Advisory Committee and our
4 observers. As you can see from the recommendations from our
5 subcommittees, everybody has been quite busy since our last
6 meeting, and we look forward to a very lively discussion
7 today and hopefully to vote on the preliminary
8 recommendations and then begin the task of formalizing our
9 recommendations in a report to the Commission.

10 To begin the meeting I would like to call on my
11 Co-Chair, Jim Thyen.

12 CHAIRMAN THYEN: Thanks, Herb. Thanks, everybody,
13 for coming today, and welcome. Dan, thank you last night for
14 the excellent evening and the fine dinner. As Herb
15 mentioned, we are approaching our convergence phase on our
16 journey. Maybe to give a little context for everyone
17 listening as well as here, we were formed in March. That's
18 when we were given our charters and our goals. Clearly we
19 focused on four areas, and we are to recommend to the SEC
20 four aspects of the federal security laws that should change,
21 specifically to ensure that the cost of regulation is
22 commensurate with the benefits for smaller public companies.

23 We were given our four over-arching principles to
24 kind of guide our work. We added in August a clear, concise

1 definition of a smaller public company.

2 For the past 10 months we spent a lot of time on
3 fact-finding, on listening, on research. We have heard from
4 the "best and the brightest" in the fields. We have sought
5 their advice and counsel, and we have heard a diversity of
6 viewpoints and diversity of experience and diversity of
7 background.

8 So our work now in these five subcommittees, it's
9 been pretty intense the last 10 months. It's been heavy on
10 collaboration and it's brought us here to this point. So
11 what we are trying to do here today is, first of all, seek to
12 understand each other and each other's work -- the
13 recommendations we bring, understand the context of the
14 subcommittee work in the perspective of the whole advisory
15 committee and also in context of our charter, and then we
16 want to gain a solid perspective on that collective work, and
17 finally vote on these preliminary recommendations so it can
18 take us to the next phases -- the preparing of the
19 preliminary drafts, the submission for public comment,
20 finally leading to our final report and our presentation in
21 April of all recommendations.

22 Hopefully those kind of contextual thoughts help
23 for our next step. Herb?

24 CHAIRMAN WANDER: Before going into our agenda,
25 just let me give everyone an idea of our schedule for today.

1 This morning each of our subcommittees will make a
2 short presentation of their recommendations and then the full
3 committee will have an opportunity to ask questions, make
4 suggestions, and we can go through a very thorough discussion
5 of each of the recommendations.

6 Hopefully we will get done sometime around noon or
7 12:30 with that phase of our meeting today. We then plan, as
8 soon as that is over, to break for lunch, have an hour lunch
9 break, and then come back and vote on these preliminary
10 recommendations.

11 The way we would like to vote is if there's
12 something that is not controversial or a series of
13 recommendations from a subcommittee are not controversial, we
14 could sort of bring them all on the table and have a hands-up
15 or hands-down vote on those. Ones that may need further
16 debate we would probably save for a little further debate but
17 pass the ones that are not controversial.

18 I think one other comment. Jim and I are both very
19 pleased with the work so far, and my only suggestion to the
20 whole Advisory Committee to keep in mind is that we are not
21 going to be as successful if we have 60, 70 recommendations
22 to make to the SEC, and so we should try and make sure we
23 prioritize those that are really important and those that are
24 less important, it doesn't mean that they get dropped off the
25 table, but they get put in for further work by the SEC and

1 further study and perhaps even attacking the issues involved.

2 Before we begin, I did bring with me an Advisory
3 Committee report from 1977, which is around the table, so
4 people can have a look-see what that looks like.

5 It is actually two volumes. It was too heavy to
6 bring, but there were some "heavyweights" on that
7 committee -- Al Summer and Warren Buffett and Marty Lipton
8 and Homer Kripke. There's even a dissent, and it's very
9 interesting the dissent says, well, the committee didn't
10 consider cost benefit analysis, so since 1977 I'm not so sure
11 how far we have gone.

12 In any event, with that brief introduction, I would
13 like to call on Janet to provide us a report from the
14 Internal Controls subcommittee.

15 MS. DOLAN: Thank you very much, Herb, and thank
16 you very much, Jim.

17 I am pleased to lead off today's hearing, and to
18 put before the committee the recommendations of our
19 subcommittee on internal controls. Before I do, I want to
20 welcome those who are attending in person as well as those
21 who are attending by webcast. We appreciate your interest in
22 the work of our subcommittee as well as that of our entire
23 Advisory Committee.

24 To my fellow members of the Advisory Committee, I
25 am leading the presentation and discussion of our

1 subcommittee's recommendations but I am speaking for our
2 subcommittee. As we get into the discussion phase, I will
3 call on individual subcommittee members to assist in the
4 questioning. This is to ensure you benefit from our
5 collective know-how and experience in developing these
6 recommendations.

7 In beginning our presentation I want to reiterate
8 that although we are recommending changes in the application
9 of certain parts of the Sarbanes-Oxley Act to small
10 companies, we believe that a number of the requirements of
11 the Sarbanes-Oxley Act and the listing requirements of the
12 various exchanges are very effective. More importantly, they
13 can be implemented by all companies at a reasonable cost.

14 These include whistleblower programs, independent
15 directors on boards and especially on audit committees,
16 Section 302 certifications by management, and the greater
17 focus of companies on the importance of internal controls to
18 provide greater confidence in the integrity of public
19 companies.

20 While we support all of these reforms, we are
21 concerned that the way that the auditor attestation
22 requirement of Section 404 has been implemented has resulted
23 in the deployment of company resources, both time and money,
24 that exceeds the intended benefits of the law. While this is
25 a concern for all companies, it is particularly for small

1 companies, on which this burden falls so disproportionately.

2 We are not alone in this concern. Corporate
3 leaders, business trade associations, SEC members, and even
4 members of Congress have raised similar concerns. This has
5 led to not only this committee's work but to an effort by the
6 GAO to do a cost/value analysis of how this section of the
7 Act has been implemented.

8 Before I review our conclusions and
9 recommendations, I want to address an important issue
10 head-on. That is, whenever you have the audacity to suggest
11 that a law as implemented does not have an acceptable cost to
12 value relationship, you are attacked by some as undermining
13 the intent of the law or, even worse, going soft on would-be
14 violators.

15 This is a very simplistic response to a very
16 challenging burden borne by the SEC and other regulatory
17 agencies. The natural tension between our capitalistic
18 economic system and our democratic political system is what
19 makes this country work. Striking the right balance is
20 critical to maintaining our vibrant economy. Underregulating
21 can leave us vulnerable to the excesses of unchecked
22 capitalism. Overregulation discourages the innovation and
23 risk-taking needed for strong economic growth. Striking the
24 right balance is not easy and no regulatory agency knows that
25 better than the SEC.

1 I believe that is the spirit in which this Advisory
2 Committee was formed. I can assure you that is the spirit in
3 which our subcommittee approached its work and the spirit in
4 which we are making our recommendations today -- that is, how
5 to strike the right cost/value relationship for SEC
6 regulatory oversight.

7 To begin, I want to succinctly lay out how we
8 arrived at our conclusions and recommendations.

9 First, in an effort to quickly respond to the loss
10 of public trust created by corporate scandals such as Enron,
11 WorldCom and Global Crossings, the Sarbanes-Oxley law was
12 enacted very quickly. Next, AS2 was developed and
13 implemented without field testing or other steps to
14 realistically assess whether the legislation could be
15 implemented in cost effective manner. Had it been, the
16 issues facing us might be significantly less, however, we are
17 where we are.

18 Therefore, although we strongly recommend that the
19 SEC review AS2 to ensure there is adequate clarity as to the
20 level of granularity in the external audit of internal
21 controls needed to provide quality assurance without
22 prompting overauditing, we had to assume that AS2 will be the
23 standard to which all companies -- large, small, and
24 micro -- will be held.

25 Recognizing this, we had to look at the cost/value

1 relationship of expecting all companies regardless of size to
2 expend the resources and effort needed to obtain the external
3 auditors' attestation of compliance with AS2, as it is
4 currently being applied by auditors.

5 We conclude that whatever value micro and small
6 companies would get out of that level of auditor involvement,
7 it is not proportional to the costs and burdens such
8 involvement puts on those companies.

9 Therefore, we are recommending exempting those
10 companies from external audit requirements of AS2.

11 As you know from our previous meetings, we looked
12 for a way to implement the external auditor involvement in a
13 way that would right size it for micro and small companies.
14 This is because in these companies, unlike large companies,
15 the external auditor relies much less heavily on internal
16 process controls to audit the financial statements.

17 Therefore, the value of requiring the micros and the small
18 companies to build the same kind of control environment as a
19 large company simply to meet the external auditor attestation
20 requirements of AS2 is far outweighed by the expense and time
21 commitment to do so.

22 There is no readily apparent way to right size AS2
23 for micro and small companies short of developing a new
24 auditing standard or developing a COSO framework for micro
25 and small companies.

1 While both of these might ultimately occur, we had
2 to consider what relief could be provided now.

3 Considering the extensive time it takes to do a
4 good job of developing, adopting, and field testing something
5 as significant as a new auditing standard, we decided that
6 the most effective relief to be granted is to exempt those
7 companies for which the application of the external auditor
8 requirement of AS2 seems least valuable.

9 With that as background, let me present our
10 conclusions and recommendations, and then answer any
11 questions that you.

12 You have our report, so I will not go through our
13 conclusions individually. Rather, let me pull them together
14 to paint a picture of the foundation upon which we built our
15 recommendations.

16 The overarching conclusion is that micro and small
17 companies are very different from large companies and they
18 are being greatly disadvantaged by the attempt to apply a
19 one-size-fits-all approach to all companies.

20 This one-size-fits-all approach is really that part
21 of AS2 that requires the external auditor to annually test
22 and attest to the operations of the internal process
23 controls. Because there is no clear standard for management
24 or the auditors as to what constitutes adequate internal
25 process controls, the COSO framework has become the default

1 standard relied on by all comers. We are all well aware of
2 the unanticipated cost to business for management to
3 document, test, and affirm the breadth of controls required
4 by COSO only to then have the external auditors repeat the
5 same process.

6 Not only do auditors not rely on the work done by
7 management but then the entire process must be repeated
8 annually, rather than testing only that which has changed.

9 This level of activity and cost may not have been
10 anticipated by Congress but that is how Section 404 has been
11 implemented.

12 While businesses of all size are questioning the
13 value of this level of regulatory oversight, the burden is
14 hitting small companies particularly hard. As our slides 20
15 and 21 show, whether you look at the external audit fee only,
16 or the total costs of compliance, the largest companies may
17 pay a negligible percentage of revenues while micros pay
18 significant percentages of revenue just to comply with 404.

19 This puts small companies at a significant
20 disadvantage when trying to compete with those larger
21 companies or, worse, with the foreign and private companies
22 who do not have to bear these same costs at all.

23 If we are going to try to justify this huge
24 disparity in financial impact on the micros and small
25 companies, we should have a very good reason for doing so.

1 Although it is not always easy to get a straight answer as to
2 what risks 404 will actually prevent, what you generally hear
3 is that it will increase the integrity of the financial
4 statements and/or it will help to prevent fraud.

5 While many are now questioning whether 404 will
6 actually do either of those, in the case of micros and small
7 companies, auditing the internal controls is a much less
8 effective tool for doing either than it is in large
9 companies.

10 As to improving the integrity of the financial
11 audit, it has already been said, that in micros and small
12 companies the auditors rely less heavily on the internal
13 controls to do the financial audit than they do in larger
14 companies. As companies get larger and more complex, the
15 auditor relies more heavily on the internal controls. This
16 is the basis for us drawing a line as to where to grant an
17 exemption.

18 As to preventing fraud, or helping to prevent
19 fraud, in micros and smaller companies, internal controls are
20 much less reliable as a vehicle for preventing fraud than in
21 larger companies, the reason being that management can much
22 more easily override internal controls.

23 Therefore other mechanisms are more effective for
24 preventing fraud. These include whistleblower programs, the
25 presence of independent directors, and other good governance

1 checks on the power of management.

2 Therefore, overlaying the same complex, expensive
3 internal control documentation, testing and audit
4 requirements on small companies when it does not provide the
5 same level of quality assurance that it can for large
6 companies is imposing form over substance at a very high
7 premium for what it provides.

8 An additional factor supporting our recommendations
9 is that while micros and small companies represent a large
10 number of companies, they represent approximately 6 percent
11 of the total market cap. The concern with a very large
12 company like Enron, WorldCom, or Global Crossings is that
13 undetected fraud in just one company can have a significant
14 impact on the capital markets. With micros and small
15 companies, undetected fraud in any one company is
16 inconsequential to the market as a whole. This does not mean
17 that fraud in any one company is not a concern to the
18 investors in that company, but, as we have indicated,
19 auditing the internal controls is not the most effective way
20 to detect or prevent that fraud.

21 Recognizing these unique features of micro and
22 small caps, we are proposing recommendations based on the
23 overarching principles of this Advisory Committee:

24 One, further investor protection;

25 Two, seek cost/value inputs;

1 Three, keep it simple;

2 Four, maintain culture of entrepreneurship; and

3 Five, encourage capital formation.

4 Turning your attentions to Slides 33 to 45, I will
5 now lay out our five recommendations. They are interdependent
6 and they build on one another

1 MS. DOLAN: Recommendation 1. Exempt microcaps
2 from 404 subject to achieving certain corporate governance
3 standards.

4 Microcaps are companies with market capital under
5 approximately \$125 million and revenues under \$125 million.
6 We added a revenue filter to catch those outliers that have
7 large, complex operations, but which happen to have a small
8 market cap because they are in financial distress.

9 Although we recommend exempting companies from
10 Section 404 -- micros from 404 -- for all the reasons I've
11 just set forth, they should remain subject to all other SEC
12 regulations and requirements, such as 302 certifications,
13 external financial audits and applicable corporate governance
14 standards set by the exchanges on which they trade.

15 Our subcommittee believes these measures are the
16 kind that do provide real value to microcap investors and
17 should be extended to more companies. Therefore, for
18 companies that do not trade on an exchange, such as pink
19 sheets or the over-the-counter bulletin board companies, we
20 recommend that to be eligible for this exemption, they need

1 to comply with the corporate governance standards established
2 by the Corporate Governance and Disclosure Subcommittee of
3 this Advisory Committee.

4 Consistent with current 404 rules, companies
5 relying on this exemption would be required to disclose all
6 material weaknesses known to management, including those
7 uncovered by the external auditor and reported to the audit
8 committee.

9 Recommendation number 2. Exempt smaller public
10 companies from external audit requirements of 404. Small
11 public companies would still be required to complete a
12 management assessment of internal controls under 404. Small
13 companies are companies with less than approximately \$750
14 million market cap, and less than \$250 million in revenues.

15 The big question for our subcommittee, I'm sure, is
16 why are we imposing a revenue test on this committee's size
17 recommendation? The answer comes from my earlier remarks.

18 If we had the ability to write size AS2 for smaller
19 companies, or if AS2 had been implemented in a much less
20 complex manner, we would be able to provide relief to more
21 companies; that is, to all of those within our committee's
22 small company definition.

23 However, since we have to deal with AS2 as it is,
24 we tried to determine at what point many company operations
25 become large enough and complex enough that auditors rely

1 heavily enough on the internal controls for the financial
2 audit to justify the external auditor involvement prescribed
3 by 404.

4 While we may debate, and believe me, we did debate,
5 where to draw that line, the smaller the company, the less
6 the need for external audit involvement in Section 404.

7 As with the micros, these companies remain subject
8 to all other SEC regulations and requirements and must comply
9 with all applicable governing standards set by the exchanges
10 on which they trade. Those seeking the exemption which are
11 not listed would be required to follow governance
12 requirements of our Governance and Disclosure Committee.
13 They would also have to disclose all know material
14 weaknesses.

15 Current companies subject to 404 would be exempted
16 immediately. However -- and this is a very important
17 however -- exempted companies can elect voluntary compliance
18 with the external audit involvement portion of 404. If
19 companies think their exemption status will undermine their
20 ability to access capital, they can choose to not take
21 advantage of the exemption. This allows the capital markets
22 to work efficiently to strike that right balance between
23 capital formation and capital regulation.

24 Regulation 3, ASX. This may strike you as an
25 enigma, so let me put it in context. First, we strongly

1 recommend that the SEC adopt our recommendation 2. It is
2 clear and straightforward. It provides for ease of
3 implementation. Most importantly, it provides immediate
4 relief.

5 However, if for public policy reasons the SEC feels
6 that some level of external auditor involvement in 404 is
7 desirable for small companies, then, as an alternative, we
8 recommend that the SEC change its rule for the implementation
9 of the external audit requirement of 404 to a cost effective
10 standard providing for an external audit of the design and
11 implementation of internal controls. We call our proposed
12 auditing standard ASX.

13 The reason for this alternative recommendation is
14 that even if the SEC cannot accept our exemption
15 recommendation for small companies, their problems do not go
16 away. Small companies still need a cost effective external
17 audit of their internal controls.

18 We spent a considerable amount of time developing a
19 proposed ASX for small companies within the committee's size
20 definition. As I said, because of the time, complexity and
21 uncertainty of developing a new standard to provide relief,
22 we came down on the side of granting immediate exemption
23 relief for a smaller population of companies. However, if
24 the result is no exemption relief for small companies, then
25 we recommend that the SEC pursue the development of a new

1 standard for small companies.

2 We do not make this recommendation lightly. Asking
3 for a new standard is a very risky proposition. We have seen
4 the challenges that have arisen with the implementation of
5 AS2. In our highly litigious and regulatory environment,
6 each new standard brings its own set of problems. However,
7 we have seen the cost and the diversion of management and
8 board time that AS2 has caused for the accelerated filers.

9 I think it is safe to say it is well beyond
10 anything Congress anticipated when it enacted the
11 Sarbanes-Oxley legislation. This has been the experience
12 with the largest companies, those with the most sophisticated
13 staffs who are best able to navigate the complexities of AS2.

14 That burden to date will be nothing compared to the
15 time, effort and expense that small and microcap companies
16 proportionately will face trying to take on the
17 one-size-fits-all AS2.

18 The AS approach we would recommend is the
19 following:

20 Ask the SEC to direct the PCAOB to develop a new
21 standard for smaller public companies that would be an
22 external audit of the design and implementation of the
23 internal controls only, to make it more efficient and
24 effective for those companies. This report would be similar
25 in scope to the report described in Section 501.70 of the

1 AICPA's Standards for Attestation Engagements Plus
2 Lockthroughs. It would not involve any testing of the
3 operating effectiveness of controls.

4 This recommendation should be subject to a cost
5 value analysis prior to such a standard being issued in
6 proposed form, with follow-up analysis prior to issuance. We
7 think the lack of field testing of AS2 contributed to the
8 extensive, unintended consequences with which we are dealing
9 today.

10 In the interim, there would be no external 404
11 audit requirement for the small public company. Again,
12 because of the problems of recommending another auditing
13 standard to solve the inequities of the first auditing
14 standard, we are recommending exemption as the preferred
15 remedy.

16 Recommendation 4. Additional guidance. While most
17 of the criticism of 404 has been about the implementation of
18 the external audit testing and attestation portion, there is
19 also a significant shortcoming in the management assessment
20 requirement.

21 404 requires that management assess the internal
22 controls over financial reporting, and yet there is no
23 standard to guide management as to what constitutes adequate
24 internal controls. Therefore, the default standard becomes
25 AS2, which is actually an auditing standard.

1 All companies could benefit from greater focus on
2 the management assessment, but certainly micro and small
3 companies can. While COSO is the default standard used, we
4 recommend the SEC ask COSO for assistance to develop further
5 guidance.

6 We all want the same thing, which is efficient and
7 effective internal controls over financial reporting. The
8 more we can do to help every company design, build and
9 operate them, the more likely we are to reach that goal.

10 We've listed a number of recommendations that we
11 think COSO could incorporate into that guidance for small
12 companies, such as expanding the monitoring guidance. These
13 are just suggestions which we have received through
14 testimony. They are not at all inclusive. Rather, they are
15 only meant to be illustrative of the kind of guidance that
16 make a significant cost and efficiency difference.

17 Included in Recommendation 4 are also requests for
18 further actions by the SEC and the PCAOB to provide greater
19 clarity and assistance in meeting the current and future
20 requirements of AS2 and other regulatory requirements. Both
21 agencies probably feel they've made everything abundantly
22 clear.

23 However, we continue to hear that the auditing on
24 the front lines, first by the external auditor and then by
25 the PCAOB, checking the checkers, continues to create a

1 risk-adverse culture. It's easier to say we are better off
2 overauditing than underauditing. However, overauditing comes
3 at a price. And when that occurs on a large scale across all
4 of our capital markets, the cost to our economy is huge.

5 We all acknowledge that we are operating in an
6 increasingly more complex legal and regulatory environment.
7 The more we can do to help companies find their way through
8 these complex standards and requirements, the more quality
9 -- quality assurance we can build into our financial
10 reporting. Helping assure compliance is a much better
11 approach than prosecuting failures.

12 There is no perfect place to inject a comment about
13 global competitiveness, so I will do it here. We have all
14 seen what happens to companies and cultures when they mature
15 and become unduly bureaucratic. They get challenged and
16 often overtaken by the young upstart that is innovative,
17 entrepreneurial, and able to create a new game with new
18 rules.

19 We are all looking down the barrel of the 21st
20 century and a new, more competitive global economy. Our
21 capital markets were the envy of the world in the 20th
22 century. They can continue to maintain their leading
23 position if we make smart rules that create value and a
24 competitive advantage.

25 However, if our solution to every problem is to

1 continually build more rigid and complex structures in which
2 we must operate, we will eventually sink under the weight of
3 our old, bureaucratic old game. No one knows where that
4 tipping point is. But we all need to ensure that in
5 implementing significant regulations like 404, we do so in a
6 way that adds value but does not add unnecessary complexity
7 and rigidity. I think I speak for our whole subcommittee
8 when I say that has been our goal in making these
9 recommendations.

10 Recommendation 5, Special cases. In any
11 broad-based regulation, there are special cases that need to
12 be treated separately to minimize the unintended consequences
13 of painting with too broad a brush. Therefore, as the SEC
14 implements any of our recommendations, we urge it to look for
15 those companies that fall between the crack; those that do
16 not fit neatly into well defined boxes.

17 We have not had time to identify them, but we urge
18 the SEC staff to do so. The only one that comes easily to
19 mind is the debt-only issuer. But we know there are other
20 types of entities that are currently exempt as nonaccelerated
21 filers and that should be looked at separately based on the
22 nature of their corporate structure.

23 In closing, I want to thank all the members of our
24 subcommittee. We are not in full agreement on everything.
25 However, we have great respect for each other, and the

1 sincerity with which each of us has wrestled with these
2 issues. These are not easy issues and there are not easy
3 answers. If there were, we would not be here today.

4 On behalf of our subcommittee, I want to thank Herb
5 and Jim for their engagement, their support and their
6 guidance. We all appreciate the time and the effort that
7 they have devoted to all of our subcommittees.

8 On behalf of our subcommittee, I want to thank Dan
9 Goelzer, the PCAOB observer for our subcommittee. Dan has
10 provided great value and input, and he has represented the
11 PCAOB very professionally throughout our work.

12 And finally, I'd also like to thank Allan Bellers,
13 Gerry LaPort, Mark Green, and the whole SEC staff that
14 provided us technical expertise and support whenever called
15 upon. We have appreciated it very much.

16 With that, I will close. We welcome your comments,
17 your questions and your insights. This is a work in
18 progress, and we want to ensure that our finished product is
19 the best that we can deliver. And we know that the added
20 contributions of our entire Advisory Committee as a whole
21 will add to our efforts.

22 Before we open it up to questions, I would like to
23 call upon one of the members of our subcommittee, Kurt
24 Schacht, who would like to make a statement as well.

25 Thank you.

1 MR. SCHACHT: Thank you, Janet. Thank you,
2 Chairman Thyen, Chairman Wander for allowing me a brief
3 moment here just to add a bit of further commentary, because
4 I was the one dissenting vote on these recommendations of the
5 subcommittee.

6 I do want to recognize all the hard work of this
7 group. WE went through lots of things in our discussions,
8 and it was a pleasure to work with you. I think our work is
9 half done, but we've had a good collegial relationship.

10 As a committee overall, we focused on a number of
11 issues affecting smaller public companies, but I think by far
12 the issue of Sarbanes-Oxley 404 and its cost of
13 implementation has been proven to be one of the more
14 challenging issues that we have talked about. And while I do
15 not agree with several of the recommendations of the
16 subcommittee, I think Section 404 is one of the key things
17 for us to focus on overall.

18 Notwithstanding that I am the lone dissenting vote
19 on the subcommittee, I do want to acknowledge that this group
20 has considered my views. It has considered the commentary of
21 many other groups that have put in ideas and raised issues
22 with respect to how to properly fix the 404 problem. And we
23 have discussed dozens of ways and dozens of options for
24 reducing costs while maintaining investor protections. And I
25 would say that even my New York cabbie last week weighed in

1 on Sarbanes-Oxley, so the debate has come full circle indeed.

2 (Laughter.)

3 MR. SCHACHT: I think we all agree that the cost
4 issue is really the thing that we should be focusing on.
5 It's been too high. It's exceeded all estimates. It's hit
6 small companies much more significantly. And I think
7 depending on which study you look at, they have been -- these
8 costs have been very stubborn in terms of mitigating, at
9 least in the near term. And I think obviously there are a
10 number of companies waiting in the wings that have yet to go
11 through this process and will certainly experience very high
12 costs. There's no question about that.

13 I also think that we agree that the internal
14 controls at public companies are important. They are an
15 important feature of investor protection, an important
16 feature of accurate financial reporting, and an important
17 feature of market integrity overall.

18 I think some argue that Sarbanes-Oxley has actually
19 brought a bit of remediation to a problem that has been
20 festering for a long time, and that is that internal controls
21 have been somewhat neglected at public companies and that
22 Sarbanes-Oxley has brought about some assurance that internal
23 controls are in place, and that they're working as desired.
24 How the markets get that assurance, and that is, what level
25 should there be in terms of verification and testing by

1 management and outside audits is the rub.

2 The subcommittee goal was to reduce the cost burden
3 but to maintain investor protections associated with Section
4 404. And in my view, in our view, these need not be mutually
5 exclusive. My concern is and my dissent is based on the fact
6 that these recommendations before you make them mutually
7 exclusive.

8 We seem to say that we cannot have meaningful cost
9 reduction without throwing out 404, including the investor
10 protection piece, for a fairly significant portion of public
11 companies in this country, which will effectively be over 80
12 percent of the companies that are public in this country.

13 One could cite several flaws with respect to that
14 approach, but I want to mention three specifically this
15 morning. First of all, I think the entire premise of
16 Sarbanes-Oxley was to bolster investor confidence by
17 requiring meaningful corporate governance and financial
18 reporting reforms.

19 Properly designed and functioning internal controls
20 over financial reporting was and I think is the cornerstone
21 of this legislation. Proper structuring and proper
22 implementation of 404 requirements is very different than
23 throwing those out completely for a broad segment of U.S.
24 companies. And I think that approach while it may be
25 simplistic, but I think it's factual, is against the

1 legislative intent of this statute, and I think it's also
2 against the directive that we heard from both Chairman
3 Donaldson and Chairman Cox earlier in this process.

4 The second thing that I would raise is that it is
5 unclear to very many folks out there whether the broad
6 exemptive recommendations of this subcommittee are even
7 within the legal authority of the Commission. Comprehensive
8 and sweeping exemptions for Section 404 may not even be
9 possible under the current legislation which specifically
10 excludes Section 404 from the Securities and Exchange Acts of
11 1934.

12 And I think perhaps as this work of this larger
13 committee continues toward a final recommendation, it would
14 be well served to try to resolve that issue, because I think
15 if it goes forward with these broad exemptions, we're subject
16 to almost certain legal challenge on that point.

17 And finally, and maybe most importantly, it is the
18 small public companies that need checks and balances over
19 financial reporting most of all. They are consistently the
20 ones that have more misstatements and restatements of
21 financial information, and they make up the bulk of the fraud
22 cases under review by both regulators and the court system.

23 We think that a more balanced approach to fixing
24 404 is to continue to require the manager assertions and the
25 auditor attestation of internal controls but to direct the

1 appropriate regulatory and de facto standard-setting bodies
2 of COSO, the PCAOB and the SEC to develop specific guidance
3 for small companies. These would specifically outline
4 appropriate control structures for those companies,
5 specifically outline the proper scope of an audit for smaller
6 public companies under 404. To use a popular catch phrase,
7 this is a Sarbanes-Oxley lite approach.

8 In fact much of the outline for this approach
9 already appears in the recommendation, Recommendation number
10 3 and 4 of the subcommittee. However, it only comes after
11 the main recommendation of exemptive relief as a fallback or
12 an alternative position. I think that for the sake of
13 continued investor confidence in our markets, we deserve an
14 approach that is not mutually exclusive. We need one that
15 preserves the investor protection piece as well as reduces
16 costs of implementation.

17 It is clear I think to all of us that something
18 needs to be done for small companies, but I think giving them
19 a pass on any verification and any oversight of internal
20 controls will come back to haunt us. If nothing else, as we
21 have talked internally here, these recommendations will now
22 be subject to a much fuller public debate, and hopefully
23 we'll get more input on some very important policy issues.

24 I would offer this challenge to investor groups and
25 related groups out there, and really to anybody that is a

1 consumer of financial information or a participant in the
2 financial reporting process to get involved in commenting on
3 these recommendations, because as we mentioned, it's
4 important to get this balance correct, the balance between
5 cost and protection.

6 We think that realignment, not elimination of
7 Section 404 is the way to do that.

8 So, thank you, Janet and thank you Chairman Thyen,
9 Chairman Wander.

10 CHAIRMAN WANDER: Thanks very much, Kurt.

11 MS. DOLAN: Obviously, that completes the report of
12 our 404 committee.

13 CHAIRMAN WANDER: Thanks, Janet. Why don't we open
14 up the floor for questions and comments? But I'd first give
15 an opportunity to anybody on your subcommittee to make any
16 comments, and then I'd like to perhaps go around the room
17 clockwise. Is there anyone on the subcommittee who has any
18 further comments, discussion?

19 Okay. Dick?

20 MR. JAFFEE: I think, Janet, you anticipated my
21 question, and I raised it an e-mail the other day, was the
22 revenue test issue. And last night at dinner, somebody
23 explained to me that that was to bring in some people who
24 maybe hadn't had financial problems but still had large
25 sales.

1 I looked at it from the other point of view,
2 because we had testimony on this issue a couple of meetings
3 ago. And I looked at it from the point of view that if the
4 overarching principle is investor protection, that a company,
5 taking the example of either a biotech or a dot.com or
6 something, that had very little revenue but had for whatever
7 reason gotten huge market cap, shouldn't get a pass out of
8 the 404 issue.

9 So, I'm not 100 percent clear, frankly, on the
10 recommendation. You're saying that you have to have both of
11 them or one of them, or -- can you just give me a little
12 explanation on the revenue --

13 MS. DOLAN: Right. We are saying it is the
14 combination, that is, depending on which group you pick, but
15 either one, you have to be under the market cap, and then you
16 look at the revenue cut as well.

17 MR. JAFFEE: So if you had a large market cap but
18 small revenues, would you be exempt?

19 MS. DOLAN: No.

20 MR. JAFFEE: You would not?

21 MS. DOLAN: No.

22 MR. JAFFEE: Okay. All right. Well, then that
23 seems to make -- clarifies for me then. Thanks.

24 CHAIRMAN WANDER: Although I should say we've
25 gotten a letter just recently from --

1 MS. DOLAN: Biotech.

2 CHAIRMAN WANDER: Biotech Association group.

3 MS. DOLAN: A trade group.

4 CHAIRMAN WANDER: Who has made the recommendation
5 to us that -- would you want to -- Rick?

6 MR. BROUNSTEIN: This is Rick Brounstein, and I'm,
7 among other things, I guess I'm representing the biotech.
8 And indeed, one of the proposals, and I guess I'm willing to
9 put it back on the table here, the biotech companies raised,
10 and we discussed it, and we ultimately eliminated it just
11 because of complexity.

12 But the issue is if you look at our report on page
13 34, there are about 534 companies that have small revenues
14 but are in that middle market cap. So, zero to \$125 million
15 in revenue. We're going to get an exact number, but I
16 believe there's a couple hundred companies that are typically
17 biotechs that start up, get well funded, but are very simple
18 organizations.

19 You know, they have a few R&D people and they're
20 working on, you know, a very long-term process. But their
21 revenues are somewhere north -- I mean, their market cap is
22 somewhere north of 125 to 700 million, our small public
23 company definition.

24 So the question is, you know, in Recommendation
25 number 1, should there be an exemption for companies that are

1 very simple that have, say, less than \$10 million in revenue,
2 but have a larger market cap?

3 And that's really what this letter was proposing,
4 and it's something that we discussed within our subcommittee
5 pretty extensively, and it's probably worthwhile, you know,
6 hearing opinions from the rest of the group.

7 CHAIRMAN WANDER: Okay. Thank you, Rick. Janet?

8 MS. DOLAN: Also, I want to respond, Dick, that the
9 way our subcommittee used the revenue filters was really
10 quite different for the micro versus the small. For the
11 micro we, you know, cut it off at the market cap. And then
12 we sort of said, are there any unintended consequences here?
13 Would somebody sort of fall into it because of a circumstance
14 that we really didn't intend? And so that's why we used sort
15 of the outlier concept.

16 When we debated a revenue filter for the small
17 companies, then it was a very different approach, which is
18 how big should this category be? And as we said, there's no
19 science to this. We just debated and tried to come to a
20 cutoff point that we thought had some rational foundation to
21 it and provided relief to the companies we thought could most
22 benefit.

23 So, anyway, we used the revenue filter in very
24 different ways when we were doing this.

25 CHAIRMAN WANDER: Steve?

1 MR. BOCHNER: Janet, I was just -- that was an
2 excellent report. I was just wondering whether you would
3 comment on your thoughts about an IPO phase-in, your thoughts
4 about a company going public and 404 compliance.

5 MS. DOLAN: I hate to say that we didn't have
6 enough time to get everything under the sun evaluated, but we
7 really, unfortunately perhaps for those very important kind
8 of special cases, left special cases to the end of work.
9 Because as you can see, we've been down many different paths
10 on the big part of our work.

11 And so we just realistically said we wouldn't do a
12 haphazard job of trying to pick different kinds of special
13 cases and say what should or shouldn't be done. So we
14 largely said -- but we certainly know there are examples like
15 that, and certainly the emerging IPO company was that kind.
16 But we just said, we didn't give it the kind of quality work
17 it deserves. Maybe we'll get more time before now and the
18 end of the report. But we certainly wanted the SEC staff to
19 do that.

20 MR. DAVERN: And if I could just add one point to
21 Janet's comment, too. We did feel that for certainly
22 microcap IPOs that they would receive relief. And for small
23 public companies, if they were under \$250 million, they would
24 also receive some relief in the first year. So there would
25 be some effective relief. And then I certainly support

1 Janet's point 100 percent that someone needs to really
2 examine any unintended consequences of pulling in the rest of
3 the nonaccelerated filers.

4 CHAIRMAN WANDER: If any of you have any additional
5 sort of special cases other than -- we've got three really on
6 the table. Janet mentioned debt-only issuers, biomedical and
7 IPOs. If any of you have any other suggestions, please do
8 mention them so they can be put on the table for further
9 consideration.

10 Anyone over on this side of the room?

11 CHAIRMAN THYEN: Could you, building on that
12 classification, Alec, could you calibrate for our Advisory
13 Committee then what is the percent of companies or the number
14 of companies that fall in that area? Smaller public
15 companies under 750 market cap but above 250 revenue that
16 effectively then do not receive any relief.

17 MR. DAVERN: Yeah. If you look at the data on
18 Chart Number 34, for smaller public companies, 68 percent of
19 the companies that qualify as small public companies, i.e.,
20 those under 750 million, 68 percent of them have revenues of
21 less than \$250 million. And that 68 percent would receive
22 relief from the external audit attestation portion of 404.

23 As you move down in market cap -- or, excuse me, as
24 you move up in revenue to 500 million, that incorporates
25 another I think about 15 percent. And then the next I

1 believe 17 or 18 percent is over 500 million.

2 So the proposal we have on the table right now, a
3 \$250 million revenue cutoff, captures 68 percent of the
4 companies in the small company category. It will also pick
5 up another 3 percent of the microcap companies.

6 So those microcap companies that have revenue over
7 125 million, another portion of those will fall under the
8 relief of the small company category.

9 But if we look at the small company category in
10 particular, there will be about one-third roughly of the
11 companies that would not receive any relief under this
12 proposal.

13 CHAIRMAN WANDER: Drew, and would you -- would
14 everyone -- I forgot to mention this earlier -- state your
15 name?

16 MR. CONNOLLY: Thank you, Jim. This is Drew
17 Connolly. Firstly, I did not prepare remarks, and for that I
18 reluctantly say we're going to attempt to respond. But,
19 Janet, I will never come to a meeting without prepared
20 remarks again.

21 Thank you so very much for that erudite
22 presentation and the length and breadth of what I discovered
23 in talking to both Alec and Rick last night of, you know,
24 overnight, weekend meetings in Chicago, offline with Herb,
25 and really taking witness testimony and exhaustive committee

1 work. And for that, I'm certainly grateful and the microcap
2 community that, some of whom I represent, is entirely
3 grateful for your recommendations.

4 But I have one overriding concern to one area that
5 you mentioned, and it really is -- I've decided to finally
6 say it. We here are the Capital Formation Subcommittee. And
7 from the very beginning of the founding and the bylaws and
8 the statement of mission for this committee, somehow
9 encouraging capital formation has always come fifth.

10 And it occurs to me that without capital formation,
11 without investors being able to access opportunity, and
12 without companies being able to approach and attract
13 involvement, the rest of it, the regulators, the lawyers, the
14 accountants, the brokers, the research analysts, would
15 literally be unnecessary.

16 So my request the next time you make this
17 presentation is can we move up encourage capital formation
18 slightly higher in the pecking order?

19 The other thing I wanted to just mention is that,
20 unfortunately, the statistics that you all have and that we
21 all have and that the SEC has been able to make available to
22 us, largely ignore the several thousand companies and the
23 data that is not available here from pink sheet-listed
24 companies.

25 And I am trying very hard to sit with Cromwell

1 Coulson with the pink sheets because there is some data
2 collection and gathering and statistical analysis that I
3 think we need to have of pink sheet-listed companies.
4 Because there are a couple thousand of them that are not part
5 of the calibration and the numbers here.

6 And that would go I think to Kurt's -- one of
7 Kurt's points, which is that it is very definitely true that
8 microcaps represent in terms of numbers of open enforcement
9 actions an outsize proportion.

10 I am reminded, however, as early as today -- or as
11 late as today -- with Ken Lay blaming his CFOs as opposed to
12 taking personal responsibility and having a depth of internal
13 controls that one Enron more than compensates from the
14 financial loss perspective, and more importantly, the
15 difficult money, the pension money, the 401(k) money, the
16 widows and orphans money that rightly is attracted to
17 allegedly investment grade equity opportunities.

18 I don't think anybody is using that portion of
19 their involvement dollar -- or shouldn't be, and there are
20 rules in place to not allow that -- in the microcap space,
21 and certainly not in the pink sheets.

22 So, while I am mindful of the extensive enforcement
23 actions that are unfortunately still required in the microcap
24 space, the investor losses, potential losses, are
25 insignificant comparative to an Enron or a WorldCom, which

1 brought the entire Sarbanes-Oxley issue to the fore, number
2 one.

3 And number two, it is deeply distressing to me that
4 we are at this late date, because I do know there is some
5 confusion, and it was a concern of mine back last year, as to
6 the legislative intent. And I think the legislative intent
7 of Sarbanes-Oxley is in fact at slight variance to the
8 legislative intent of other federal securities laws and other
9 congressional interpretation.

10 So I am concerned that we're looking for ways to
11 blunt this committee's recommendation. While I support very
12 much the minority view and understand the basis of it, I am
13 concerned that we're looking for or calling for potential
14 congressional response, questioning whether the SEC has the
15 right to an exemptive authority, pointing out the fear of
16 litigation, and finally calling upon investor groups to come
17 forward in vast numbers to object.

18 Because frankly, I've worked very hard over the
19 last six months with this committee to get the issuer
20 community, the microcap issuer community, and the small,
21 independent broker-dealer community, to -- who are on the
22 front line every day, make their livings doing this and work
23 very hard to get it right, to have them have a voice here as
24 well.

25 And it is disturbing to me that there is not

1 enough -- in the House, we are already being heavily lobbied.
2 The American Bankers Association has I guess the first
3 comment letter on our desks today objecting to some portion
4 of the draft recommendations. I know the AFL-CIO has weighed
5 in on one side. The Consumer Federation and the Chamber of
6 Commerce have weighed in on the other. And there's no
7 question that there are some boxes to be gored with whatever
8 this committee does, including inaction.

9 So, in an attempt to balance the competing
10 stakeholder interests here, I can understand where calling
11 upon the outrage of the citizenry and the legislators to
12 blunt the rather bold efforts of your fellow committee
13 members may be an effective tool, but I think that ultimately
14 I appreciate the fact that you have that position, and I know
15 that the certified financial -- chartered financial analysts
16 are a significant gatekeeper for investor protection.

17 As you know, I work with and represent a firm that
18 retains a number of them and provides independent research.
19 It's a critical element. By the same token, we do have a
20 problem, and I think Janet's majority recommendations go a
21 long way to addressing some of those.

22 Thank you.

23 CHAIRMAN WANDER: Further comments along this bank?

24 MR. SCHACHT: Herb, can I just make one response to
25 Drew? I appreciate your comments. Just to be clear, I have

1 not requested anybody to come forward to object to this.
2 What I have simply said is that these are very important
3 policy issues.

4 I think you've hit on precisely the policy issue as
5 to whether we should worry about that bottom 1 percent or
6 bottom 6 percent of market cap and concentrate on the more
7 important financial impacts with fraud at the higher end of
8 the market cap spectrum.

9 But I'm not suggesting that any group or any
10 individual should come forward and object to this. I'm
11 simply saying that people that an interest in this debate or
12 participating in the financial reporting system ought to
13 have -- ought to take note of what's going on and weigh in
14 with their views of how they should be resolved.

15 MR. CONNOLLY: I completely support that, Kurt. In
16 fact, we have -- and I'm making, the folks I'm talking to,
17 there's one more on the schedule, there's one more 30-day
18 window pretty much in the month of February where comments
19 are going to be open-ended, and I think the more, the
20 merrier.

21 MS. DOLAN: Herb, I just want to respond to both
22 Drew and Kurt and to say that I know I speak on behalf of our
23 whole subcommittee, we certainly all recognize and agree that
24 there's a very large number of companies in the micro and
25 even, as we say, listed or unlisted. So we all acknowledge

1 that.

2 And I think we all want to see good internal
3 control environments developed as early as we can in
4 companies so that they can mature as they get bigger. And
5 that's why we're recommending that this is not all a
6 takeaway. This is -- in exchange for the exemption, you now
7 have to do some things that you wouldn't otherwise be
8 required to do, to create as good governance climate as you
9 can have.

10 So, we're all for starting to build as much good
11 governance as you can. We just don't happen to think that
12 the external auditor involvement in the 404 as it is
13 currently implemented is the be all and end all of how to do
14 that.

15 And in fact, it just, for the cost of it, doesn't
16 provide enough value. But that many of these other things
17 create -- cause -- create a great amount of value, and
18 they're at an implementation price that is -- creates enough
19 cost value benefit for the companies that it's fair to ask
20 them to do it in exchange for the exemption.

21 MR. BROUNSTEIN: Let me just -- this is Rick
22 Brounstein. Let me just kind of maybe just reinforce that,
23 because definitely there was a lot of discussion at the lower
24 end as to, you know, how much is too much, how much is not
25 enough. And, you know, to me, there were a couple of

1 significant pieces.

2 If you take a look at how the simple organizations
3 are audited today, the financial audit, it is a far more
4 substantive audit than a larger company where you need to
5 rely on the processes to produce the numbers.

6 So there is clearly auditor involvement in both the
7 micros and our definition of smaller company with the revenue
8 cap.

9 When you get down into the smallest of the micros,
10 those on the pink sheets, the bulletin board and a lot of
11 those that may be, you know, with the definition of
12 beneficial ownership should now be reporting that aren't, I
13 think our overriding thought was transparency.

14 And it didn't seem to high a price to pay to have
15 something as simple as, you know, an independent audit
16 committee from whistleblowing, and, you know, file a 10-K and
17 10-Q to get some audited financial statements. And people
18 then have the information to make the decision.

19 And so that's where -- that's how we ultimately
20 came out.

21 CHAIRMAN WANDER: I'm going to go around. Leroy?
22 Richie?

23 MR. LEISNER: A question.

24 CHAIRMAN WANDER: Richard Leisner.

25 MR. LEISNER: This is Richie Leisner. I have a

1 question for Kurt. If I understand you correctly, you want
2 to keep 404 fully and then direct the appropriate authorities
3 to come up with standards that are tailored for smaller
4 companies. Is that right?

5 MR. SCHACHT: I think that's the solution that's --

6 MR. LEISNER: And what would you do between now and
7 when those new standards would come out?

8 MR. SCHACHT: Well, I think we've postponed any
9 responsibility to comply with this for the smallest group for
10 another year and a half. Isn't that correct?

11 MR. LEISNER: Right. But we're talking about the
12 other group between the smaller public company up to the 750,
13 what would you do with them in the meantime?

14 MR. SCHACHT: They're already complying with
15 Sarbanes-Oxley 404, and been through the cycle now I think
16 the second time, and I think it's appropriate to --

17 MR. LEISNER: I'm not sure that that's true in
18 every case, but I think, if I can put words in your mouth,
19 they would continue to be subject to 404?

20 MR. SCHACHT: That's correct.

21 MR. LEISNER: Okay. Thanks.

22 CHAIRMAN WANDER: Leroy?

23 MR. DENNIS: Richie asked a great question, because
24 that was exactly where I was headed was what was going to
25 happen.

1 CHAIRMAN WANDER: Leroy Dennis.

2 MR. DENNIS: Leroy Dennis. I'm sorry. Because it
3 seems to me, as I listened to Janet's presentation at the
4 start, she talked about a need to -- that if we had a better
5 AS2 standard -- I'm putting words in your mouth -- you might
6 have gotten to a different recommendation. And that seems to
7 be where Kurt's headed is a better AS2 definition. And I
8 wonder if there's a process or a -- it seems like you're real
9 close as a, you know, as dissenting view versus the majority
10 view.

11 I wonder whether there's some kind of phase-in that
12 you can think about, or have you thought about, where let's
13 get AS2 right for the middle group, maybe some relief in the
14 meantime, but continue providing relief for the smallest?
15 And, you know, and it may be a fairly extended period of
16 time, but is there eventually a goal to get to some kind of
17 AS2 for the microcap companies? And if you had that kind of
18 availability out there, where would you -- where would the
19 committee head, or what was the thought process? And that
20 was kind of my question.

21 MS. DOLAN: As you've probably gathered from our
22 nice weekends and holiday meetings, we have really debated
23 all these alternatives, and, as I said, there is no easy
24 answer. If there was, we wouldn't be here.

25 There is a lot of hesitation to opening up AS2 and

1 redoing it because you're just getting used to one standard.
2 You have to start all over. Will it be opened up for all
3 companies or not?

4 If you don't do that and you do a separate standard
5 for small companies, how long will that take, and what would
6 you do? That's where the majority and the minority view are
7 different. We would, of course, exempt until you got that,
8 because we're here because these companies are saying this is
9 too onerous for what we're getting from it.

10 And that's going to continue. Just because you've
11 been through it once doesn't make it any less foolish to keep
12 doing it. Because there's something about beating your head
13 against a wall that I think we should remember here.

14 So, you know, I don't think it's -- it's not our
15 view that you say to somebody, just because you've gone
16 through something that we agree probably wasn't well
17 implemented to start with, that we're going to keep making
18 you through it until we get a better remedy.

19 So we looked at let's just make the recommendation,
20 change AS2 to everybody. It has some down sides. We are
21 under the auspices -- our charter is to look at small
22 companies. We looked at making a separate recommendation, an
23 auditing standard for smaller companies, and, as you can see,
24 we've done a fair amount of work on this. We've done a lot
25 of modeling on it.

1 But when we really came down to it, we said, look,
2 let's go back to our overarching principles. What can you do
3 that is clear, easy to enforce, can provide immediate relief,
4 you know, and just -- and that's when we came back to where I
5 would say we actually started, which is -- I mean, like
6 anybody else, you start with exemption, and then you kind of
7 think, well, maybe there's another way, another way, another
8 way, and it kind of came back to it.

9 So, yes, we're not that far apart, but we would
10 take very different approaches to what you would do in the
11 interim.

12 MR. DENNIS: And I guess, Janet -- this is Leroy
13 again -- clarify for me -- I mean, your opening remarks kind
14 of talked about wishing there was a different AS2.

15 Are you recommending that we try to develop that
16 over a period of time, or just exemption, and that's the
17 permanent solution?

18 MS. DOLAN: We are recommending exemption
19 immediately because that provides immediate relief, is easy
20 to implement, and -- but then we -- as you will see in
21 Recommendation 4, we are asking both SEC and the PCAOB to take
22 a very hard look at AS2 and how it's being implemented, and
23 really ask themselves, have they done everything so far they
24 can do? Is there more than that they can do? Can they only
25 do it through interpretation? Should it be rewritten to put

1 interpretation?

2 I mean, there's all kinds of variations on what
3 they could do. We're not prescribing that, but we're
4 certainly asking them to do it. But we don't think that
5 provides the immediate, straightforward, simplistic, easy to
6 enforce remedy that we think is called for right now. And so
7 that's why we are recommending that remedy right now.

8 But we're not foreclosing, as this whole effort
9 matures, that we won't all end up, all companies, at perhaps
10 a very different point as we get more and more experienced
11 with AS2 and how to implement it and what to do about it.

12 MR. DAVERN: If I, Janet, could make one comment on
13 that to Leroy's point, and this is --

14 CHAIRMAN WANDER: Alex.

15 MR. DAVERN: Alex Davern. -- it's a personal
16 opinion.

17 I don't think it's feasible, frankly, to develop an
18 audit standard for microcap companies that would be
19 sufficiently cost effective, that auditors would be willing
20 to put their name on, where the benefit would exceed the
21 costs, is my personal opinion.

22 So I definitely feel there should be a permanent
23 exemption, because at that level of company, as I said,
24 personally, I just don't see any way you can have that
25 auditor involvement and make it cost effective.

1 CHAIRMAN WANDER: Dick Jaffee?

2 MR. JAFFEE: Jim, I think I'm convinced that there
3 is a rationale for a revenue test in both these categories.
4 But there seems to me to be a sort of lack of symmetry in the
5 numbers that were chosen.

6 And bear with me for just a minute. And I'm not
7 sure this is, by any manner or means, the best way to look at
8 it.

9 But in the microcap area, the size committee came
10 up with a percentage number that, roughly speaking, is \$125
11 million in market cap. And then you chose a revenue at the
12 same level, which would be a one-to-one ratio.

13 Then in the other category we've got a 750 market
14 cap and a 250 revenue limit, which would be a three-to-one
15 ratio.

16 And I'm looking at it kind of in a common sense
17 way. If you went out to make an acquisition of a company,
18 what do you pay times revenue? Of course, it depends upon
19 the business.

20 But in the consumer products area, you know, they
21 do sell at multiple times their revenue. In a business like
22 mine they don't. They sell at 50 cents. Our market cap is
23 50 cents, or maybe 75 cents off of our revenues.

24 And so it occurs to me that -- I have a question
25 and I have a comment. Were these numbers of 125 and 250

1 generated after the economic office did some research for
2 you, or were they very subjective numbers, based upon what
3 you think the complexity of the company is?

4 MS. DOLAN: Well, it depends. And I will tell you,
5 we -- as I tried to say before, we didn't spend as much time
6 on the revenue number for microcaps. There just was a lot of
7 alignment that -- the microcap market cap wasn't anything
8 that we were going to debate. And so, really, we were just
9 working with the microcap market cap.

10 And then as you do, as you fine-tune, we started to
11 say, well, but wait a minute. What if this company -- you
12 know.

13 And so we really did just put a governor on it by
14 saying, well, let's pick a revenue number --

15 CHAIRMAN WANDER: Yeah.

16 MS. DOLAN: -- that still means the company is
17 largely small enough in its operation that we could justify
18 it being exempt.

19 It was very different when we came to the small
20 companies because -- perhaps because we had spent so much
21 time trying to have a remedy for this whole bucket of
22 companies.

23 So I just want to say -- and, you know, we are not
24 at all suggesting there's any bright line that has been there
25 the whole time, and we just went and found it.

1 We just tried to say, what is the level of
2 complexity and size and scale and everything else of a
3 company when the auditing of the financial statements really
4 does depend more and more on the good controls being in place.

5 And we just drew it where it was. But we
6 recognized that it could be drawn elsewhere, but that's where
7 we agreed.

8 MR. JAFFEE: Well, I would just make a comment. I
9 think your revenue line at the microcaps is too low and that
10 ought to be just kind of re-think. Because the example you
11 gave of a company who was in financial trouble, and so the
12 market cap was, you know, tanked, could also be considered as
13 a special case.

14 I mean, in special cases, we got somebody in
15 bankruptcy and the stock is selling at pennies, that's a
16 different -- whole different deal. So --

17 Anyway, I'm sort of convinced the revenue test
18 makes sense, but I'm not yet convinced that the levels of
19 revenue that have been chosen, you know, couldn't be think
20 through a little more carefully.

21 MS. LAMBERT: If I could just make an observation
22 about how we came -- oh, I'm sorry, Debbie Lambert, and I was
23 a member of the subcommittee.

24 If I could just make an observation about how we
25 came up with those numbers. They were a little bit late in

1 the game, and we started realizing we had an unintended
2 consequence of companies that might be in those microcaps.

3 We actually had -- we were throwing around revenue
4 numbers before we had the table of statistics. The table of
5 statistics came after the fact, and the revenue numbers, as
6 we were trying -- and we looked at different revenue numbers
7 and had different proposals on the table -- we were trying to
8 really look at the underlying complexity of the company and
9 where the company and the company's auditors looked to deeper
10 internal controls for their own preparation of financial
11 statements or the audited financial statements and where
12 those underlying process type controls really aren't as
13 important, or aren't as useful in the process.

14 So we really did, I think, come at it from a -- it
15 was subjective, but of complexity and how internal controls
16 really operate within the entity. And that was where those
17 revenue numbers came from to start with.

18 So it's subjective, but it did intend to look at
19 the complexity and the nature of the operations of the
20 companies.

21 CHAIRMAN WANDER: Do I see any other questions,
22 comments? Jim?

23 CHAIRMAN THYEN: Yeah, this is Jim Thyen. Could
24 you talk a little bit about how you came to the conclusion
25 that revenue and complexity align?

1 MS. LAMBERT: Well, I think in terms of being an
2 auditor, my own input into that process was that there are
3 certain pictures that come to mind when I know -- when I'm
4 trying to think about how I'm going to approach an audit of a
5 company, and often revenue is one of the primary indicators
6 of what I expect the complexity in terms of systems and level
7 of underlying and process controls be in place.

8 Obviously, each company is a unique situation. For
9 any example you can show me an outlier that doesn't do that.
10 But there are certain factors. So if you tell me there's
11 revenues of \$100 million or revenues of \$200 million or
12 revenues of \$500 million, that, as an auditor, paints a
13 picture in my head of how I expect to likely be approaching
14 that entity because of what I expect the underlying control
15 structure and operations of that entity to be like.

16 And so from my perspective, that's one of the
17 factors that I put into that thought process and why I think
18 that that is a relative indicator of what's appropriate in
19 the internal controls.

20 MR. JENSEN: This is Mark Jensen. Jim, to try to
21 help -- and there may be some confusion in the committee on
22 how those recommendations really work.

23 In the microcap area under 125, the recommendation
24 is to exempt both management and the auditor from what they
25 do. So there would be no -- management, we would assume,

1 would do their own assessment, but they would not make an
2 assertion under Section 404 that their internal controls are
3 working, and so on and so forth, because --

4 We felt that was appropriate because, first of all,
5 it's difficult for management to do that, and, secondly,
6 there's such limited guidance out there around how management
7 would conduct that assessment.

8 When we moved into that second category, we
9 basically said the auditor would go out of the equation, but
10 management would still do their own assessment and then make
11 their assertion under Section 404.

12 There's really no change to what management would
13 do under the new proposal. It's only the auditor that's
14 going to get the change.

15 The rationale was -- and, again, just speaking as
16 an auditor -- was, at that level of company, an auditor
17 really is going to pay attention to internal controls, and we
18 felt that a company saying we want the auditor out of this
19 would not be credible to the auditor.

20 The auditor would basically say, you know, I've got
21 to audit these controls because I'm relying on them for
22 internal financial -- for your financial reporting and for my
23 audit opinion, and, therefore, you know, we didn't feel like
24 you would -- there was much left to exempt after the auditor
25 got to that conclusion.

1 And so we just kind of said that's the -- that's
2 where I felt where you would cut it off, because the auditor
3 simply isn't relying on it, or will start to rely more
4 heavily on controls at that point. That was the rationale.

5 CHAIRMAN WANDER: Ted, did I see your hand up?

6 MR. SCHLEIN: I'm Ted Schlein. I was just going to
7 chime in, I guess, mostly because I was the most vocal on
8 this whole revenue thing for the last bunch of the months,
9 although I stayed quiet for the last two meetings and didn't
10 talk about it. But since everyone brought it up here --

11 And it really had to do with the fact -- it's
12 interesting it's come back around -- for Jim, exactly what
13 you just said, to me, revenue is the greatest indicator of
14 complexity. And if the purpose of 404 was to measure and
15 assess complexity of a company, then that would have been the
16 natural way to do take a look at it.

17 There is a large number of companies in the world I
18 live in that have de minimis revenue and very large market
19 caps, and, you know, I could audit the books. And I have no
20 basis for doing that.

21 So, you know, I applaud it being brought back into
22 the fold. I could maybe argue about the different levels and
23 how it's being applied. The end of, you know, the \$700
24 million and 250 I think might break some people through that
25 barrier pretty quickly, and, therefore, not allow them to

1 have the exemption, even though they probably are far less
2 complex companies than companies that would have the
3 exemption.

4 And I don't see that as being -- I don't look at
5 those as fringe cases. I think there's actually a lot of
6 cases like that.

7 But to some extent, you know -- and I might be
8 quibbling over some crumbs here from that standpoint, but I
9 do draw you to -- which, actually, I'm sure Rich Brounstein
10 had probably brought up a lot because the biotech industry is
11 indicative of this as well, but --

12 So I -- it's kind of where do we see the purpose of
13 404 for? If it's to measure complexity and, you know -- and
14 help monitor that, then revenue is the natural indicator of
15 that from my perspective. So I'm happy to see it brought
16 back.

17 CHAIRMAN WANDER: Rick?

18 MR. BROUNSTEIN: Yeah, just a quick comment on
19 that, just more of a fact, and you can find it on slide 34
20 again. But what Ted's talking about, there's about 190
21 companies that have revenues under \$250 million, but are
22 market cap of over 750.

23 There may be a few down in the very lowest group as
24 well, but that's separate from the biotech, which I think
25 we're going to look at as an exception.

1 One other just unrelated nit, but just to get it on
2 the record on the exceptions is -- one of the things that we
3 did mention was the debt only companies, and just to point
4 out, as we sort of wrestle with that, that when the SEC
5 recently went through and defined the WICC companies, they
6 did look at the debt only companies, and they set a
7 definition of \$1 billion in debt issued over the previous
8 three years as their cutoff criteria.

9 So I just point that out for the record so we can
10 consider it as we try to figure out what that exception might
11 be.

12 CHAIRMAN WANDER: In response to a couple of the
13 questions, when you say there's no management internal
14 attestation or internal reporting for the microcaps, I assume
15 we're not going to suggest overruling the '97 amendments, the
16 Foreign Corrupt Practices Act, which does require --

17 So there still is a requirement that each company
18 have internal controls. And I also assume that you are
19 maintaining the certifications, even for the microcap
20 companies, whereby, in the quarterly and annual reports, the
21 CEO and the CFO are certifying really to internal controls as
22 well as disclosure controls once you mature.

23 So it's not quite a total exemption for management,
24 if I'm correct. Is that right, Janet?

25 MS. DOLAN: It's the management affirmation within

1 the 404, right. 302 can continue, so you start to get kind
2 of fine distinctions in terms of what your -- what base you
3 do your 302 on is still there, so -- okay.

4 CHAIRMAN WANDER: Okay, thank you.'

5 MR. SCHACHT: Just so there's no confusion
6 this -- I mean, there is -- 302 continues for the microcaps,
7 but what the committee has proposed is essentially a repeal
8 of Section 404 for microcaps. There is no manager 404 and
9 there is no auditor 404.

10 CHAIRMAN WANDER: But there still is the Foreign
11 Corrupt Practices Act and the certifications, okay. It's a
12 clarification point, not a value judgment. Bob?

13 MR. ROBOTTI: Hi, Bob Robotti. My approach to
14 looking at these questions -- and I think I'm a proponent of
15 good corporate governance. You know, I come from an investor
16 background, most of the eyes at which I look through these
17 processes. I'm not an issuer, I'm not a service provider to
18 an issuer, and I'm concerned about the unintended
19 consequences of not having the immediate exemption from 404.

20 I believe in the arsenal of good corporate
21 governance investor protection, Section 404 safeguards are
22 very low in that totem pole. And, of course, part of our
23 concern of our committee and also the corporate formation is,
24 you know, at what point does one register or deregister as an
25 SEC filing company? And today, of course, that requirement

1 is 300 shareholders of record.

2 And I clearly think that one of the unintended
3 consequences is going to be that a significant number of
4 companies probably have the ability to avail themselves of
5 the option to deregister as SEC reporting companies.

6 And I think that would clearly be, for all the
7 affected companies, a significant disadvantage, and those
8 investors would not be better protected, but clearly worse
9 off than where they are today.

10 We've talked about changing that number, and also
11 the formation committee has talked about potentially giving
12 corporate formation -- capital formation committee has talked
13 about some changes to give some kind of relief.

14 But I think the implementation of 404 to small
15 companies is going to have an impact where a company is going
16 to avail themselves and will leave SEC protection.

17 So in the context of investor protection, I think
18 that there's potentially a large disservice to be done by the
19 process.

20 And specifically since the requirement is that
21 certain companies, including all bulletin board companies,
22 that have no obligation to have the more important parts of
23 Sarbanes-Oxley, which are the corporate governance, the
24 independence, the order of committee issues, they are not
25 subject to those requirements, which clearly are more

1 important.

2 So that that group of companies clearly is going to
3 be mandated -- that we're asking them to have extra
4 regulation that they are not required to comply with today,
5 and those investors will clearly much better off in that
6 situation.

7 So I don't necessarily think that, oh, we're just
8 giving a pass to people and saying going away. Actually, in
9 certain cases, we're requiring companies to do more than
10 they're doing today, but that more they're doing has
11 relatively low cost, but with a huge significant advantage.

12 So I think we're, you know, measuring the two
13 different things. And as one investor who specifically is in
14 the small cap -- microcap area, this is my area.

15 I am concerned -- my only interest is as an
16 investor. How am I best protected? How will my constituency
17 protect their interests? I really think that 404 --

18 I've also had firsthand experience being on an
19 audit committee in the last year and see the work that's been
20 done on a company that has 17 people, and really think that
21 the benefit derived from the process and the specifics that I
22 know about, there really is almost no benefit derived from
23 the 404 process.

24 That said, you also have to -- I always stick with
25 caution -- when I talk to a management, they say, well, you

1 know, potentially we're going to deregister because this 404
2 is just outrageous.

3 Of course, you hear that from managements all the
4 time. Oh, the cost of regulation is horrible, and it's a
5 terrible thing, and, oh, it's -- we're going to do these
6 different things.

7 I really have come to the conclusion that 404 is a
8 significant expense that has relatively little benefits, and
9 that managements would almost be negligent if -- and a large
10 number of them have the ability to, based on current rules,
11 and even if we amend the rules and make it 750 shareholders,
12 to deregister, and, therefore, there are no investor
13 protections at all.

14 So that's the tradeoff in my mind and why immediate
15 implementation makes more sense. Because if we do that,
16 immediately give exemptive relief, there's going to be
17 pressure on us to say, oh, you can't let that stand as a
18 permanent process.

19 And so, therefore, that will, I think, also push
20 the other groups, including the PCAOB and the SEC, to say,
21 okay, what's an alternative process that we need.

22 In the meantime, I think, the large issue is
23 who -- as it's been pointed out, the 404 process is not cost
24 effective for them either. Fortunately, they can afford to
25 pay the money because it's relatively inconsequential. There

1 will be more of a proponent push for how do we change this
2 rule to make it cost effective?

3 So I think that we'll put in process from all the
4 constituencies and force the solution to where 404 that makes
5 sense, that is cost effective, because the current one
6 clearly is not cost effective. Thank you.

7 CHAIRMAN WANDER: Thank you. Mark and then Alec?

8 MR. JENSEN: I'm going to -- I'm probably going to
9 spark a debate here, and maybe this has been too polite so
10 far. But I wanted to -- it's something I think the committee
11 should think about as we move to voting on these proposals.

12 I just want to take my hat off for a minute. I
13 want to put my auditor hat and my Big Four hat on here for a
14 second and kind of let everybody know what's likely to happen
15 and how the profession, the people who actually have to
16 deliver these reports, are likely to see this. And if
17 somebody's got ideas around this, this would be the time to
18 get them out on the table.

19 I think universally I think you will see the larger
20 firms -- in fact, it is universal, I think -- would prefer
21 that we see -- and that if there needed to be exemptions -- I
22 think -- first of all, I think they'd prefer there would be
23 nothing, but if there needs to be some solution for these
24 companies, then their preference would be that the companies
25 be exempted from 404.

1 The firms, at least the larger firms -- I think you
2 should speak to the smaller firms so that -- I think it's
3 just in the interests of getting this in the public -- in the
4 public forum.

5 I'm not going to draw a conclusion for anybody, but
6 this is going to be the debate, and we should start to think
7 about it, and that the development of a new standard, at
8 least in the larger firms, is not going to be favorably
9 looked at.

10 And the reason is, is that the experience with AS2
11 implementation was not good, as we all know. The firms I
12 think are fearful that they're going to wind up in another
13 situation like that.

14 Secondly, there is some concern that the auditor
15 may be asked to sign an opinion that doesn't have any -- they
16 don't have any significant workarounds. That they really
17 haven't been that close to it. And so now they're being told
18 by a standard to sign something they haven't really done
19 substantive amount of workarounds, and so they're concerned
20 about that.

21 There are other concerns as well, just from a
22 practical standpoint of could you develop such a standard,
23 where does it exist in the literature today, what's the
24 theory behind it and how auditors would deal with it. And
25 then, finally, the overall question I think is around a quid

1 pro quo, and that that is that if there is a new standard,
2 then companies will expect significant reduction in work and
3 in fact an approach that comes out by the PCAOB or the SEC
4 may not result in significant work going away by the auditor,
5 and therefore, they're the ones left in the hot seat to
6 explain it all to everybody.

7 So those are going to be the concerns. I'd like to
8 address the smaller company, the smaller firm's point of
9 views so that again, I think it's important that we start to
10 have this debate. Because otherwise, we're going to go into
11 this and all of a sudden everybody is going to be surprised
12 at the letters that are coming in. And they are going to
13 come in, and there is going to be a lot of dissention to
14 this.

15 CHAIRMAN WANDER: John?

16 MR. VEIHMEYER: Thanks, Herb. Since Mark has teed
17 it up, I guess I was patiently waiting for the clockwise
18 thing to come around, but I think Mark has gotten us into a
19 couple of issues I wanted to touch on. And I just want
20 to -- and this is John Veihmeyer, by the way.

21 Janet, I think you probably had a bigger challenge
22 than Solomon, so I want to compliment you and the rest of
23 your group. I know how much effort you've put into this
24 thing. And personally, from where I sit, I think 404 will
25 ultimately be viewed as a very good thing for investors as we

1 get down the path on this thing.

2 Having said that, I think we all recognize the
3 first year implementation costs have been dramatic, and it is
4 probably largely what has led to where we are today in terms
5 of this meeting and this conversation.

6 You know, I would point out, you know, there is
7 some reason for optimism on that front. The Big Four firms
8 commissioned a study recently that was released last week
9 that indicates some positive movement in terms of year two
10 and where those total costs of implementation may be headed.
11 We'll know for sure in a short period I think here in terms
12 of whether or not actual experience in year two is anywhere
13 near the 40 percent or so projected decline that that survey
14 would show.

15 And, again, recognizing that audit costs are less
16 than 40 percent or so, based on first year implementation
17 costs, less than 40 percent of the total costs that companies
18 are incurring in implementation.

19 So having said all that, I think, and
20 notwithstanding any of that, I think clearly there is an
21 issue here that needs to be addressed, and I think your
22 primary recommendations in Recommendations 1 and 2, I think
23 try and -- are an attempt to be responsive to the concerns of
24 the smaller company spectrum of the marketplace to deal with
25 a lot of the issues we've just talked about. And I'm not

1 prepared to oppose those recommendations at all.

2 I am concerned when you get to Recommendation 3 as
3 the fallback recommendation, if you will, if 1 and 2 are not
4 accepted, and it starts to get into some of what Mark just
5 commented on, which is why I kind of jumped in, that a
6 standard that provides a different level of assurance,
7 depending upon the size company you are, and I think will do
8 more to create confusion in the marketplace and in the minds
9 of investors than it will to clarify anything.

10 When we get into an auditor's report that focuses
11 on design and implementation but not operating effectiveness
12 of internal controls, it seems to me that much of the public
13 debate since Sarbanes-Oxley was enacted in total, there has
14 been a tremendous amount of focus, and I think that focus has
15 been positive, on all parties involved in the financial
16 reporting system, whether you're talking about management,
17 audit committees, boards or auditors, there has been
18 tremendous focus on the operating effectiveness of internal
19 controls and the impact of that on the financial reporting
20 process.

21 And the key there is are the controls operating
22 effectively? I don't think the critical question is are the
23 controls designed effectively. I think the critical question
24 that the marketplace is concerned about is, are they
25 operating effectively in a company?

1 So I'm very concerned about, as an auditor, maybe
2 widening the expectation gap that already exists out there in
3 our profession around much of what we do that the public
4 doesn't understand by attaching our names to reports that
5 only run to design and implementation of the internal control
6 system and doesn't speak to what I think is the key concern
7 in the minds of all the users of those financial statements,
8 which is are those controls operating effectively or not?

9 And we've seen that somewhat, you know, we have I
10 think an example of this in the SAS 70 reporting on service
11 centers, where we have Type 1 and a Type 2 report, where Type
12 1 runs to design, Type 2 runs to operating effectiveness, and
13 I think we've seen tremendous confusion in the marketplace in
14 terms of a lack of understanding about what a Type 1 report
15 really tells you and what kind of assurance you can take away
16 from that report.

17 So, I think to, you know, the point again that Mark
18 teed up, I am concerned on a couple of fronts, one from an
19 investor standpoint as well as other users of the financial
20 statements that a Recommendation number 3 type of approach is
21 simply going to introduce more confusion into the system than
22 we've currently got.

23 And I just sit here and anticipate a conversation
24 that I'll be having with an audit committee in two years,
25 once all of the emotion around the cost benefit and a lot of

1 what we're dealing with today here is long forgotten, and
2 you're discussing an error that has popped out, you know, in
3 the company's financial reporting system.

4 And maybe it's not material, if you will, but an
5 error nonetheless. And our involvement in terms of the
6 formal reporting on internal controls has simply been to
7 design and implementation but not operating effectiveness.

8 And I think it's going to be a very difficult
9 conversation to explain to that audit committee member why
10 the work we did in the internal control system potentially
11 didn't catch that error that maybe isn't material to the
12 financial statements but maybe is important in the minds of a
13 audit committee or a board member about what that
14 demonstrates about the company's reporting system.

15 And it's just going to create I think a very
16 difficult situation in terms of trying to articulate what
17 we've done. And I think it is reasonable in the minds of
18 people relying on auditor's reports and financial statements
19 when they see an auditor's report, they're going to see the
20 reports on the larger companies, understand what that means,
21 I think in terms of an AS2-type audit of internal controls,
22 see a report on a smaller company, I think not fully
23 understand and appreciate the nuances of what we didn't do in
24 that situation in rendering our report, that we do do in
25 other situations around reporting on internal controls, that

1 I'm just very uncomfortable with.

2 And I think, you know, the follow-on step then is,
3 I think to Mark's point. And I was confused, although
4 today's presentation helped a little bit when I first read
5 the recommendations, when you get to that last bullet of
6 Recommendation number 4, it wasn't clear whether we were
7 actually recommending something.

8 Because actually I think Recommendation 4 hits a
9 lot of very key points in terms of additional guidance that
10 is needed for all the participants in this process, not the
11 least of which in my mind are the registrants themselves.

12 Because I think the points you made earlier about
13 the default position whether the registrants have de facto
14 adopted the auditing standard as their only guidance in terms
15 of how to deal with 404 is one of the major I think issues
16 that has come out of this.

17 But the last bullet that I think just indicates
18 there's a question remaining, but it's not framed in the
19 context of a recommendation. It wasn't clear to me whether
20 we are actually recommending that AS2 be reopened and
21 revised.

22 And I think for many of the reasons that Mark
23 started to articulate, I think I'd be concerned about doing
24 that right now, after we've just gone through the experience
25 we've all suffered through in terms of a first year

1 implementation.

2 We've gotten I think in the minds of the auditors a
3 tremendous amount of guidance since that first year
4 experience. I think we are in the process of trying to
5 implement that additional guidance. There are probably areas
6 where additional guidance would be helpful, and I think
7 working together, I think we continue to focus on those
8 things.

9 But to at this point, before we've even gotten to
10 year two of implementing a very difficult standard, to open
11 that up and begin to rewrite that standard I think would be a
12 mistake.

13 MR. DAVERN: Janet, if I may, I'd just like to make
14 a couple of comments. It's Alec DaVern here. I'd like to
15 first respond to Rob's point. And just to be clear on
16 recommendation, it is immediate relief for microcap companies
17 and it is immediate relief for smaller public companies. And
18 it is permanent relief from AS2 for categories that fall into
19 the size category.

20 So we're talking about immediate relief that's
21 permanent, first off.

22 The second thing, I'd then like to just comment on
23 John's comment. You know, obviously the costs will play out
24 as we see, and the Commission will know. Unfortunately, I
25 find it very difficult to believe the conclusion of the

1 survey that the Big Four published, but that will all come to
2 pass in the finish.

3 What did come out of the Big Four survey is that
4 costs for smaller public companies are 10X what the SEC said
5 they would be, and they're vastly more expensive
6 proportionately than they are for large companies, which
7 supports the basis for our conclusions.

8 On the other issue of AS2, you know, we're focused
9 on the practical relief. And your basic comment, I'm going
10 to paraphrase your words, is that re-changing AS2, et cetera,
11 et cetera, gets very impractical, and there's lots of
12 consequences to do with that, which is why we're pushing for
13 exemptions.

14 I would, however, and I think, and other people can
15 comment here, my view on AS2 is that we shouldn't view it as
16 something handed down from God, with all due respect to the
17 PCAOB, that's carved in stone and unchangeable.

18 (Laughter.)

19 MR. DAVERN: And my view on this question is that
20 we should move now to exemption for the smaller public
21 companies that are within the purview that we have been given
22 a remit to examine.

23 But I don't think that in the end of the day we
24 should conclude that AS2 is ultimately untouchable ever. And
25 I think the Commission and the PCAOB and issuers need to

1 continue to review its implementation.

2 And its implementation practically -- speaking as a
3 large public company, because I don't qualify under the
4 smaller public company for National Instruments -- but its
5 implementation needs to continue to be refined and needs to
6 continue to be improved. And as several of the commissioners
7 have said, the costs need to continue to come down
8 dramatically.

9 And if that doesn't happen at the larger company
10 scale, then in some period of time, we should not view it as
11 handed down by God. And if it doesn't work and the costs
12 don't come down over time for bigger companies, I think
13 somebody should be tasked ultimately to look at it.

14 Thank you.

15 CHAIRMAN WANDER: John, and then Leroy.

16 MR. VEIHMEYER: And I appreciate those comments. I
17 think the -- I guess a couple things I would point out. I
18 don't think any standard, you know, is exempt from refinement
19 and making sure as you go forward that it's really achieving
20 its objective.

21 So I didn't mean to imply that if that's what --
22 I do think that right now it would be a big mistake to reopen
23 AS2. We are on the front end of the second year of
24 implementation, a year in which a lot of guidance that came
25 out about a standard that was continuing to be refined up to

1 the very last minute that we were all charged with
2 implementing it, which made it a very difficult situation for
3 all.

4 I think it needs to play out to some extent, and I
5 think my concern in terms of the role where I sit in this
6 dynamic from a financial reporting system is to ensure that
7 as we go forward, if there are legitimate places to provide
8 additional guidance, which I think the PCAOB and the SEC are
9 in a position to do on an ongoing basis, or potentially amend
10 some aspect, it's very important that -- and I want to focus
11 on the comment you made about which would imply that the sole
12 focus needs to be a focus on cost.

13 And I think at some point there is a danger that if
14 in fact from a public policy standpoint we believe it's
15 important that investors and the marketplace have the
16 assurance that someone is doing an audit of an internal
17 control system, that may be expensive to achieve that
18 objective, expensive in relation to what the initial SEC
19 estimates of those costs were.

20 And I think the real fear which Mark started to
21 articulate, is that we get into a situation where because of
22 the significant concern over cost, we get some amendments of
23 AS2 which appear to significantly reduce or weaken the
24 requirements to enable you to report effectively on internal
25 controls, and somehow that gets out of whack in terms of the

1 work we're actually doing and therefore the level of
2 assurance that someone can assume they can take away from a
3 report on internal controls, if the sole focus is cost.

4 I think it needs to be balanced, and we can't -- at
5 some point in time, there will be a decision point that if in
6 fact this is the cost, it's gotten as efficient as we can get
7 it, we've gotten all the guidance we can get, and in order to
8 provide the kind of assurance on an internal control system
9 that is necessary to be able to render a report, the cost is
10 X, and I think there will be a number of companies who view
11 that, no matter what it ultimately gets down to, as higher
12 than they would like to be incurring, then I think the more
13 fundamental decision, which is why I'm not prepared to oppose
14 Recommendations 1 and 2, I think that's essentially where we
15 are as a group, I think must have given rise to the
16 Recommendation 1 and 2, that at some point, there must be a
17 belief that we can't -- we can't get to the point where we
18 can provide assurances on a system of internal control in
19 that size company, which from a public policy standpoint we
20 believe will ever be viewed as cost effective in that
21 equation.

22 And I just want to caution that we don't creep into
23 a situation where we get to a similar place for larger
24 companies by a weakening of the standard.

25 I don't know if that makes sense or not.

1 MR. DAVERN: No, certainly that makes sense, and
2 that's my belief. And that's certainly why -- I'm not sure
3 if I interpret "not oppose" as support, but I guess we'll
4 see.

5 (Laughter.)

6 MR. DAVERN: But, you know, I certainly agree
7 that's been conclusion effectively is that it's not going to
8 be cost effective, and it's an almost impossible task to come
9 up with a standard for the microcaps that will be, which is
10 why I voted the way I did.

11 And, obviously, large public companies are outside
12 of our remit. But there are some smaller public companies
13 who will still be subject to an AS2 audit. And that's why we
14 wanted to make the points clearly where we see improved
15 guidance necessary, which we did, and also leave open the
16 door that ultimately over time for these smaller company
17 group, if the cost benefit equation is not there, then these
18 things will have to be reconsidered for the group that we are
19 still leaving inside the net.

20 We're not advocating a reopening of AS2 today.

21 MR. VEIHMEYER: And my point is simply the decision
22 in my view, and whether I agree personally that there's not
23 value to an investor of a small microcap or at least a
24 smaller public company as defined in 404, and that's probably
25 the nuanced words, if I'm not prepared to oppose, as opposed

1 to support.

2 But I think irrespective of that personal view,
3 because I think there is value there and benefit, the
4 decision it seems to me is either/or. It's not -- which is
5 exactly what the subcommittee I think has put forward in
6 terms of its Recommendations 1 and 2.

7 It's either if you want, if it's important to have
8 that level of assurance on a company's internal controls,
9 then let's audit it and let's report on it appropriately,
10 which is why I can support 1 and 2.

11 But Recommendation number 3 is very troubling,
12 because I think it's in a middle ground of somebody wants
13 some assurance and is willing to pay some minimum amount for
14 some minimal involvement, but there will be no basis based on
15 that minimal involvement I think for people to come away with
16 the assurances that they're going to come away with once they
17 see an auditor's report on internal controls irrespective of
18 what it actually reports on.

19 CHAIRMAN WANDER: Leroy, did you have a comment?

20 MR. DENNIS: Sure. Leroy Dennis. I'll give a
21 couple comments and then respond to Mark. You know, John and
22 I have had a lot of discussions over the last couple weeks
23 with what's going on.

24 You know, I think one of the things we've got to
25 keep in mind is, at least what I heard on the testimony is

1 that investors do treat smaller public companies differently
2 than the treat larger or middle market companies. I didn't
3 hear a lot of support for 404 being a deciding factor some of
4 the investors in smaller public companies.

5 I also am less optimistic with the cost predictions
6 going forward on 404 than maybe what I've heard in the
7 markets. And I think a lot of the cost things are going to
8 come -- cost reductions may come from management's internal
9 costs, outside consultants, those kind of things. I'm not
10 sure the audit costs go down significantly.

11 But like Alec and John both pointed out, time will
12 tell. We'll know that in six months.

13 I did get a chance over the last three or four days
14 to talk to most of the middle tier firms. I would say there
15 is less resistance there to a design standard. I think there
16 is some concern by that group of can we audit to that
17 standard?

18 When you look at what things generated material
19 weaknesses in the last year, it really was the substantive
20 audit procedures as opposed to a design testing or an
21 operation effectiveness testing that generated 90 percent of
22 the material weaknesses that were reported out there.

23 So I think there's some concern by, at least the
24 auditors I spoke to, as to whether or not we could
25 effectively audit to a standard of design. But I think

1 that's a standard-setting problem that needs to be -- would
2 have to be addressed if your Recommendation number 3 was
3 discussed.

4 I would say there's general concern with
5 Recommendation number -- well, let me back up. I think
6 there's general support for Recommendation number 1, that
7 exemption for the smaller public companies, except for one
8 firm I talked to, which would share more of Kurt's view, that
9 everybody -- that there's a price to pay in the public
10 markets, and that price is AS2 and 404. But the other firms
11 I talked to had a general support for Recommendation number
12 1.

13 There is concern with Recommendation number 2, and
14 I would say that concern is not so much from the exemptive
15 part of the -- for the companies, but more from a concern
16 that this will lead to further concentration of auditors of
17 companies over \$250 million basically being with the Big
18 Four, Big Six, Big Eight type firms, and that the smaller
19 firms, when they only have maybe one or two of those type
20 companies in their portfolio, may have a more difficult time
21 competing effectively in the market for those kind of
22 companies, and does that effectively exacerbate the problem
23 of auditor concentration?

24 I think that's a separate issue that just needs to
25 be addressed. I don't think we're going to snap our fingers

1 by making a recommendation, all of a sudden there's only
2 going to be three firms or four firms or five firms that are
3 auditing these kind of companies.

4 But I think that is something that if we head down
5 the road of a Recommendation number 2, we need to keep in the
6 back of mind as a potential unintended consequence
7 that -- and what kind of things can the SEC and others put in
8 place to help with the competitive nature of those kinds of
9 companies.

10 Mark, I hope that answered -- I think that's what
11 I've heard from the other firms. And like I say, there was
12 general support for exemption except for one firm was not
13 supportive of that.

14 CHAIRMAN WANDER: Janet?

15 MS. DOLAN: Yes. I would just like to respond to
16 kind of the auditor input we've had over the last few minutes
17 to three points.

18 One is I would just urge, it's very easy when we
19 say, well, it just needs to cost whatever the price of it is,
20 and we should perhaps just bite the bullet and say if that's
21 what it costs, that's what it costs.

22 And that's exactly the point we're trying to raise.
23 Those costs are there because they represent activities. And
24 what we are hearing from people is we are engaging in
25 activities in these 404 audits that are not substantive

1 enough to create any threat to the integrity of the financial
2 statements.

3 I mean, that's what registrants have been trying to
4 tell us, is that we are causing companies to document and
5 test and have affirmations and attestations to low level
6 controls that simply have no relationship to what I think
7 Congress wanted, which is give us at least a reasonable level
8 of assurance that the controls are in place that we need to
9 know are in place to rely on the integrity of the financial
10 statements.

11 So, I just -- it can easily become mom and apple
12 pie, which is regulate at any cost and that should just make
13 us all feel better. That cost is there because we're doing
14 something to generate that cost. And what we're trying to
15 ask is, the other bodies, the PCAOB and the SEC, to examine,
16 have they put something in motion that is just creating a lot
17 of activity that isn't going to improving the competitiveness
18 of these participant companies in the global economy, which
19 is where their activity should be going.

20 So I just want to address that. And I certainly
21 know Leroy's raising a concern would the -- if we got to the
22 point of Recommendation 3 and it was in fact a new auditing
23 standard, we'd get caught with an auditing standard where we
24 don't know how to audit to it.

25 And that's our point of saying, look, we are not

1 only making Recommendation 3 should it come to that, but
2 we're actually trying to give some guidance as to how to do
3 it, which is field test it. Get a lot of input. Find out
4 will it work.

5 I mean, if it won't, then obviously don't do the
6 same thing we've already done, which is end up going down a
7 road with something that, if we could redo how we got here,
8 we might have done it differently.

9 So we're not blindly saying this is the answer, but
10 we're saying we just keep trying to say look in the universe
11 of all, thousands and thousands of companies that range from
12 hardly any income and no market cap to the very biggest.
13 There's just a wide variety of companies, and taking only one
14 approach and trying to say either you fit in it or we throw
15 you out, you know, maybe that's the approach.

16 But maybe there's another way, which is to say,
17 look, you have kind of an evolving, maturing approach to this
18 where you start out with exemption. Then you go to kind of
19 design and implementation, which is kind of framework. And
20 then ultimately when you're big enough, you actually go to
21 full auditor involvement.

22 As I said, we think immediate relief and exemption
23 right now is the answer for these companies that we've
24 focused on. But that's how we got there. It wasn't just to
25 say, well, let's just go make something new. We thought that

1 would actually sort of fit the maturation of companies as
2 they grow into their capability to actually implement full
3 404.

4 Anyway, so that's where it came from. And then the
5 last one, we are very cognizant of the concern that what
6 we're recommending may in fact create even more of a monopoly
7 and reduce the number of audit firms, and that is not a good
8 thing. And that's why I said, there are no easy answers
9 here. I mean, we don't like that possible consequence of
10 what we're recommending. We actually debated it. But you
11 have to weigh all the factors. And that, opposed to the
12 downside of some of the other alternatives, we simply came to
13 where we were.

14 But we are cognizant of that concern.

15 MR. DENNIS: This is Leroy again, Janet. Like I
16 said, I think that's potentially an unintended consequence.
17 I don't think that by our recommendation today if this is
18 adopted and it goes forward and it's adopted by the SEC that
19 we're going to snap our fingers and all of a sudden we'd only
20 have a lesser number of firms doing this.

21 But I do think that's something that over time that
22 the SEC and the regulators and Congress, you know, we need to
23 address that. You know, the market may work and may get us
24 to where we do have enough competition in there. You know,
25 I'm not saying I wouldn't support -- I don't support your

1 recommendation just because of that. I just want to make
2 sure we're all aware that that's a potential issue out there,
3 and that's something we need to work -- I think there is
4 continuing work that needs to happen in that to make sure
5 that we don't go further to a concentration than what we've
6 got right now.

7 CHAIRMAN WANDER: I'm going to try and move on.
8 It's a little after eleven. But having the prerogative of
9 the chair, I'd like to make a couple of comments that I know
10 were considered by the committee, didn't come up in the
11 discussion, but I think the record should reflect them,
12 because they may appear further on when we go to the actual
13 writing of the report.

14 One is the comments we've just made about
15 concentration in the accounting profession. I think that is
16 a public policy issue. The chairman spoke about that last
17 week to the AICPA meeting. I think -- I've heard Bill
18 McDonough speak on that subject a great many times. So I
19 think whatever we do, that is something that we have to keep
20 in mind.

21 The other two are what I call the 800 pound
22 gorillas, maybe the King Kongs. And one of them is
23 liability. And Janet and I both personally devoted
24 considerable amount of time trying to figure out if there was
25 some sort of safe harbor or some way to deflect this focus of

1 being litigation conscious that seems to permeate the
2 accounting firms, all of them, not just the Big Four, but
3 everybody.

4 And it's a real issue. Because, for example, if
5 I'm counsel for an accounting firm, I'm going to be
6 recommending to them they be conservative, et cetera. But
7 that's -- the cost of that possible litigation exposure may
8 be one of the engines driving all of the problems that we've
9 seen. And we thought about that issue and haven't
10 had -- haven't come up with some solutions, although I did
11 read some articles where people suggested that.

12 And the other 800 pound gorilla, frankly is the
13 inspection process at the PCAOB. I think from everything
14 that we've heard on high at the PCAOB you're telling your
15 inspectors to be reasonable, to reasonable assurance, et
16 cetera, et cetera. But I think there's a disconnect between
17 the advice and the guidance and what happens in the field.

18 And it also happens at the accounting firms. No
19 accounting firm is going to -- supervisor is going to say to
20 the audit partner, you're doing too much. I mean, can you
21 possibly believe that anybody's ever going to say that and
22 wind up having that quoted by the audit partner when trouble
23 comes up, that you did too much auditing, et cetera?

24 So I think there are built-in things in the system
25 that somehow we should rectify that's causing some of these

1 problems.

2 Jim, did you have some comments?

3 CHAIRMAN THYEN: Yeah. I think one thing that I've
4 been listening for and I haven't heard, and those of us that
5 are leading companies that are trying to create wealth for
6 shareholders, there is a disjoint in our dialogue in how
7 we're approaching these internal controls, because the real
8 heartburn comes in the fact that imposes a cost structure
9 that totally ignores the consumer.

10 And the consumer and the customer ultimately are
11 the individuals that have enough trust to buy the product or
12 the service, to give the dollar to a company, and hopefully
13 the company manages it effectively, and there are a few
14 pennies leftover that create shareholder wealth. And
15 investment in a company is not risk-free. It's not a T-bill
16 investment.

17 And in this whole discussion, we are ignoring that
18 customers, very knowledgeable, very sophisticated, know what
19 they want, when they want it, how they want, what price they
20 want to pay, and they very seldom ask where is made.

21 And when you start looking at the costs of venues
22 around the world and what it does to your cost structure,
23 there is a fixed cost structure that varies by market, and
24 they are getting tighter and tighter and tighter. And imposing
25 more and more burden for regulation that is totally disjointed

1 from what the customer wants ultimately is destroying
2 shareholder value and it's going to assure that smaller public
3 companies remain smaller.

4 CHAIRMAN WANDER: Thank you.

5 MS. DOLAN: Herb?

6 CHAIRMAN WANDER: Yes, Janet?

7 MS. DOLAN: I wanted to make one last comment which
8 I should have made. And I want to say that I want to, on
9 behalf of our whole subcommittee, thank Kurt for all of his
10 involvement. I know the fact that you have a minority view
11 can somehow suggest that there was lack of appreciation in
12 the committee for that minority view, and it is just the
13 opposite.

14 Kurt has done just a superior job of being engaged
15 and very, very well representing the input and the views of
16 the investor community. So anyway, I just wanted to
17 acknowledge that, that we have -- the very best thing about
18 any kind of advisory board like this is to get real,
19 substantive debate going. And so that it's -- we all gain
20 from it, not lose. So I want to thank him for that.

21 CHAIRMAN WANDER: Thank you. I'm going to move on
22 to Steve for the report of the Subcommittee on Corporate
23 Governance and Disclosure.

24 MR. BOCHNER: Thank you, Herb. I would first of
25 all like to acknowledge the efforts of my hardworking

1 committee, Bob Robotti, Pastora Cafferty, Dick Jaffee and
2 Rusty Cloutier. And Rusty apologizes that he can't be here.
3 He continues to deal with the aftermath of Hurricane Katrina
4 in New Orleans, and we wish him well as he deals with that.

5 I'd also like to thank --

6 CHAIRMAN WANDER: I should add, I think he was just
7 appointed co-chair of the -- I guess the committee to
8 reconstruct Louisiana.

9 MR. BOCHNER: I'd also like to thank Kevin O'Neill
10 and Gerry Laporte in particular as well as the rest of the
11 staff of the Securities and Exchange Commission that's
12 provided us with just excellent support through this entire
13 process.

14 We have ten recommendations today. Two of those
15 recommendations are now the subject of the SEC proposals that
16 were made after the time we started deliberating. So, we're
17 going to continue to keep those recommendations in our
18 preliminary recommendations and in our final to lend our
19 support to those efforts. But those are the subject of SEC
20 proposals. So that leaves eight other recommendations.

21 We don't -- we had a lot of divergent views and
22 lively debate. We don't have a minority viewpoint, I don't
23 think, at last count, our recommendations are unanimous. And
24 they are preliminary, of course. And I'm going to point out
25 a couple of areas where I think additional work needs to be

1 done to get from a preliminary recommendation to a final.

2 I do want to comment that we evaluated a lot off
3 aspects of governance and disclosure regulation, and we've
4 concluded that many of the current rules, including the
5 recent reforms in the area of governance and disclosure are
6 working well.

7 In particular, we think that the board independence
8 provisions, particularly the audit committee independence
9 requirements, the CEO/CFO certification requirements and
10 processes associated with that, in particular disclosure
11 controls are working well.

12 We think the enhanced responsibilities of audit
13 committees, the whistleblower protection, more frequent SEC
14 review of periodic reports, and the additional guidance and
15 focus that the SEC puts on the MD&A, the Management's
16 Discussion and Analysis sections of SEC Reports and
17 Registration Statements, are really creating what I think is
18 more of a tone at the top issue. And our subcommittee I
19 think believes that those types of things are more effective,
20 more cost effective than, for example, 404, as I think Janet
21 has eloquently articulated.

22 So with that, let me run through a few of our
23 preliminary recommendations. All of them have you before
24 you. Most of them we've seen and discussed in prior
25 meetings. They are on the SEC website. And I'm going to

1 skip over, Herb, unless you'd like me not to, some of the
2 things that have either been proposed -- I'll just mention
3 them -- or that I don't think are very controversial, and
4 then people can interrupt and take me back to those.

5 CHAIRMAN WANDER: Sure.

6 MR. BOCHNER: Okay. Thank you. So I'm not going
7 to talk about the first recommendation. It's
8 self-explanatory. It's the subject of a Commission proposal
9 already that smaller public companies not be phased down
10 beyond the 75 days for a 10-K and 40 days for a 10-Q, not be
11 phased down to tighter filing deadlines.

12 So the first recommendation that I want to talk
13 substantively about is something that the 404 subcommittee
14 asked us to specifically take a look at, which is that if we
15 end up recommending that 404 be eliminated for some or all
16 smaller public companies, and should the Securities and
17 Exchange Commission go forward and accept that
18 recommendation, the 404 subcommittee asked that we take a
19 look at whether there should be enhanced governance
20 requirements and perhaps other requirements as a quid pro
21 quo.

22 So that if we're taking away the 404 internal
23 auditor attestation because it's just not cost effective,
24 good idea, that internal controls are important, but it's
25 proving to not be cost effective, not helpful the way it was

1 intended, costs wildly exceeding the benefits, should there
2 be some giveback by the issuer community to provide some
3 additional levels of assurances to the issuers out there that
4 are getting this relief.

5 And so what we've taken a look at are two things to
6 recommend in this area. One is, we're calling it governance
7 hygienics or governance standards that we would impose upon
8 these issuers getting this relief. And what we -- the job
9 here again is a cost benefit. We don't want to impose,
10 because we're also talking about the smallest of public
11 companies in addition to the wider range of smaller public
12 companies, but we don't want to impose overly burdensome
13 requirements. And so we're trying to take a measured
14 approach.

15 And what we think may be useful here and is in our
16 preliminary recommendations is taking a look at an already
17 existing SEC Rule 10(a)(3) and suggesting that those be
18 imposed on smaller public companies, regardless of whether
19 those smaller public companies are subject to those SEC
20 requirements by virtue of the listing standards on the
21 markets that they're listed on.

22 The NASDAQ stock market and the New York Stock
23 Exchange, for example, would already impose those
24 requirements, but the pink sheets and the bulletin board
25 listing standards may not. And so what are those?

1 These are audit committee independence
2 requirements, responsibility for selection and oversight of
3 auditors, procedures for handling complaints, so-called
4 whistleblower provisions. And then the authority to engage
5 independent advisers and separate funding.

6 Let me also say that since we deliberated last, I
7 received a study put out by John's firm, an integrity survey
8 that suggested that when employees were interviewed, the view
9 of management integrity and the reported misconduct that was
10 perceived at these companies was substantially less at
11 companies which had legal and ethics compliance programs.

12 So one of the things I want to go back to my
13 committee, my subcommittee on between now and the time that
14 our report becomes final, is to discuss whether we should add
15 to that list I've just described perhaps an ethics and legal
16 compliance requirement, which is already defined by SEC rules
17 and implemented by the NASDAQ and the New York Stock Exchange
18 as part of their listing standard. So you may be hearing
19 more about that. And we'd love your comment on that.

20 There are governance -- we could have gone further
21 than that. We could have suggested overall board
22 independence. We could have suggested nominating and
23 compensation committee independence. We could have suggested
24 shareholder vote provisions like some of the listing
25 standards articulate for a whole range of things such as

1 stock option approval, but we decided to cut it off there,
2 because we don't -- we're trying to take a measured approach,
3 and we're mindful of this cost benefit analysis that we've
4 been asked to do.

5 So the other aspect of additional requirements in
6 the area of 404 relief, should it be granted, would be with
7 respect to enhanced disclosure of the internal control
8 environment beyond that required today in SEC rules such as
9 exist in Item 308 of Regulation S-K. And the thinking there
10 is that if we go ahead and take away this outside auditor
11 attestation, this assurance, perhaps the companies should
12 disclose more about -- self-disclose more about the
13 internal control environment.

14 We have more work to do there, but let me give you
15 some thoughts about how that might look, perhaps describing
16 the resources that exist within companies in the internal
17 control area. Is there an internal auditor? Is there a
18 controller? Is there audit committee oversight? And then
19 perhaps, and I say only perhaps, a broader discussion of
20 other types of reportable conditions maybe beyond the
21 material weakness level. And there I would like the input of
22 the accounting subcommittee and the 404 subcommittee.

23 But that's our current thinking with respect to
24 what would be required if the SEC moves forward with 404
25 relief.

1 We have also -- and we may be a little too late on
2 this one, but we've also recommended that there be some
3 clarification for foreign private issuers and the phase-in
4 date for 404, because foreign private issuer status is tested
5 at the end of each fiscal quarter, and so certain private
6 foreign issuers that are not accelerated filers may not know
7 until the end of the fiscal year in which they have to test
8 whether or not they have to test, and we think that creates
9 an unnecessary hardship.

10 But we're coming up on the -- we may be -- the
11 train may have left the station on that. But we have put
12 that into our recommendations, preliminary recommendations.

13 The next recommendation, and this one I think is
14 also controversial, is the possible amendments of the
15 thresholds under Sections 12(g) and 15(d). And these are the
16 thresholds to require registration and subsequent reporting
17 under the 1934 Act and deregistration.

18 And there's really two concepts baked into this
19 proposal. The first is what are we measuring? Are we
20 measuring record holders, or are we measuring beneficial
21 holders, equity holders, or are we measuring something else?
22 And then the second is, once we figure out what it is we're
23 measuring, what are the right numbers?

24 With respect to the first issue, I think all of us
25 believe that the use of a record holder test can undermine

1 the intent of Section 12(g). And that is that a company
2 could have a large number of shareholders but a small number
3 of record holders, and therefore not have to register.

4 And similarly, a company might be smaller but not
5 have a lot of record holders, have beneficial owners and have
6 to register. And we think that that ability to manipulate
7 that result is just not the right result, and we don't
8 believe that was the intention of the statute.

9 Now, the trouble is, where do you draw the line
10 here? And we received -- switching to the other issue of
11 where the threshold ought to be if we change the standard,
12 the measurement standard from record holder to beneficial
13 holder, what should we do?

14 And we've received comments as recent as five
15 minutes before this meeting started indicating concern about
16 the levels that we've proposed here, that the thresholds be
17 increased to \$15 million in total assets and a thousand
18 security holders, meaning beneficial equity holders, and the
19 deregistration provisions be increased from 300 to 750
20 security holders, again, beneficial, not record.

21 And the problem here -- and I think we need
22 to -- we need to get more data before I think we're all
23 prepared to move forward and turn our preliminary
24 recommendation into a final recommendation. And we've worked
25 with the SEC in deriving this data.

1 We want to know if we do these things, who's swept
2 in, who's not in, and if that data turns out to be harder to
3 get, then certainly I appreciate it, and I think we need,
4 frankly, to get that data.

5 But I think we're all agreed that the current
6 standard of the record holder test is one that can certainly
7 undermine the intention of figuring out what number of
8 shareholders should -- is a company large enough to require
9 reporting, SEC reporting?

10 And that's the fundamental question, and we think
11 an equity holder versus a record holder test is a better
12 measure of determining that.

13 The other recommendation within this particular
14 preliminary recommendation is that we exclude from the count
15 of the number of security holders, holders of exercise
16 options that are issued in compensatory transactions.

17 And we may come back and talk about that, because I
18 know a few of you have had questions about that.

19 I'm not going to spend much time on the next
20 preliminary recommendation dealing with the loan prohibition.
21 We strongly support that. But we think that issue of
22 community would benefit from some clarification in the areas
23 we've identified.

24 We then have a number of recommendations that are
25 intended to reduce the costs of smaller public companies in

1 the reporting area, while we believe not impairing investor
2 protection.

3 One of them is to change the requirements as to the
4 years of audited financial statements that need to be in SEC
5 reports from three years to two years for all smaller public
6 companies, not just SB filers.

7 And the thinking there is that that third year is
8 generally widely available on the Internet. It does cost
9 money to put that third year of financial statements in. It
10 makes changing auditors more difficult because you've got to
11 deal with predecessor auditor requirements. So we think that
12 is an area where investors won't be disadvantaged, and we can
13 perhaps achieve some cost efficiencies.

14 We then recommended -- and part of this was helped
15 along by the SEC's recent securities reform release, where
16 they decided that because 70 percent of Americans have
17 Internet access, that final prospectuses could be delivered
18 by posting the final prospectus on the website.

19 And we asked ourselves, well, you know, why
20 shouldn't all SEC reports have the ability to be delivered
21 that way, and, in particular, proxy statements and annual
22 reports.

23 And, indeed, the Commission on November 29 has
24 proposed that very thing for comment, and we're going to
25 continue to support that, as well as the concept that this

1 access equals delivery presumption be applied to a wide range
2 of SEC filings so that the production and dissemination of
3 paper copies only be made where shareholders really need it.

4 And we're also supportive of the protections that
5 the SEC has put into its proposal in this area, that
6 shareholders who desire paper versions of SEC-filed documents
7 be able to access those at no cost and on a timely basis,
8 such as through a toll-free number.

9 The next recommendation deals with allowing a
10 broader range of companies, smaller public companies, to file
11 more cost effective SEC forms, such as Form S-3, which
12 incorporates by reference information that's already on file.

13 And, again, leveraging off this thinking that maybe
14 the time has come now that most investors do have Internet
15 access, why we put companies through repeating information
16 that's already filed, already available, specifically
17 incorporated by reference.

18 So our preliminary recommendation asks the SEC to
19 allow smaller public companies to use Form S-3.

20 And we're also proposing that the requirement as a
21 condition to the use of Form S-3 that the company has timely
22 filed in the last 12 months, all reports be eliminated, and
23 that the only requirement in addition to the -- the only
24 requirement for S-3 be that the company's been reporting for
25 at least 12 months, and as of the time of filing is current.

1 And we think there that the penalty for having to
2 go back and spend the money to, again, incorporate previously
3 filed SEC documents that are widely available into a form and
4 to spend that money, that punishment doesn't fit the crime,
5 if you will.

6 That the market reaction, the risk of an SEC
7 enforcement proceeding, the listing actions that the SROs can
8 take are adequate remedies to companies that don't timely
9 file and companies should not have to go through that expense
10 simply because they might have missed an 8K along the way.

11 We -- two more. We recommend that the SEC
12 establish a task force to work with other governmental bodies
13 to reduce inefficiencies associated with governmental
14 filings, including synchronizing filing requirements
15 involving substantially similar information.

16 I've been made aware of similar efforts going on in
17 the country by U.S. banking regulators and in other countries
18 with respect to the banking regulators. I understand there's
19 a call report modernization project going on, using the XBRL
20 format, and we think that the SEC should take a look at
21 reducing duplicative governmental filings when that same
22 information is both widely available and out there.

23 And this was a recommendation that was voiced
24 particularly strongly from the local banking community, that
25 we're really just feeling the crush of regulation and the

1 crush of duplicative filings.

2 So we strongly urge all of you to support this
3 preliminary recommendation, and, if so, we will urge the SEC
4 to take this one seriously.

5 And in the same vein today many public companies
6 pay several thousand dollars to third party intermediaries to
7 get SEC reports filed on EDGAR. Is that really necessary?

8 We're all sending around documents on Word and
9 other formats. Isn't there a better, cheaper approach to
10 that? Aren't there technological advances, again, such as
11 the SBRL, XML standards that might be looked at as more cost
12 effective alternatives that might also have the benefit of
13 enhanced tagging techniques to enhance research capabilities
14 and actually end up being beneficial both to investors and to
15 issuers by cost reduction.

16 So we're going to urge you to consider that and the
17 SEC to take a look at whether EDGAR can be upgraded or
18 modified to reduce filing costs that are particularly
19 disproportionate on smaller public companies.

20 So those are our preliminary recommendations. And
21 maybe I will ask if any members of my subcommittee present
22 have anything else to add.

23 MR. JAFFEE: Just to help out -- Dick Jaffee. You
24 know, even though we labored long and I think very
25 diligently, I would characterize -- and I don't know whether

1 you agree with me, Steve, but I don't think our
2 recommendations are very revolutionary in a sense. I think
3 they are more tweaks, and they are more for the practitioners
4 who have to do this work in the securities area, and I think
5 that they seem to make sense.

6 Other than perhaps the 404, which seems to be the
7 big deal of the day -- and the only concern I have there is
8 that we very carefully consider what these additional
9 governance hygienics and so forth are so we don't throw
10 ourselves from a frying pan into the fire.

11 Finally, you know, I would say -- and I have this
12 ongoing discussion with my friend to my left about -- I think
13 the jury's out on some of the benefits of SOX, at least in my
14 experience. We're all saying, oh, yeah, independent
15 directors are great.

16 I think independent directors are good on the audit
17 committee. I'm not yet sure that requiring this majority of
18 independent directors is so great for everything. But it's
19 too early to tell.

20 Just like somebody said, you know, we've got to
21 wait a few years before we see what the actual cost of 404
22 implementation is. And I accept that as a sensible thing to
23 say and believe.

24 I think it takes -- it's going to take longer to
25 decide whether the stuff really has had much benefit. I

1 just -- well, as long as I got the floor, I'd like to add
2 something to what Jim said.

3 Jim's been focused, and I think very appropriately,
4 on -- we're all talking about the investor protection, and
5 Jim raises the issue of the stakeholder who is the customer.

6 There's a third area here, who are the employees of
7 these companies. And this cost burden that has been imposed
8 upon companies is also having an effect on the employees
9 because what is given to pay for regulation is not available
10 for compensation, either in salary or in bonus.

11 And in my own company we had a big fight last year
12 over the incentive bonus because there was a huge amount of
13 unbudgeted cost for 404 compliance. So --

14 Anyway, those are my comments. I think we really
15 did consider a lot of important things, and I support the
16 recommendations that Steve articulated.

17 MR. ROBOTTI: Hi, Bob Robotti. One of the issues
18 that concerns me, of course, is the unintended consequences
19 of companies deregistering as part of the process to escape
20 404 and the cost of 404.

21 And, you know, one of the key parts of our change
22 is also the change in how do you count shareholders. Instead
23 of counting of record, you count beneficial shareholders.
24 And, you know, the number I'm more concerned about in my
25 constituency is the 300 to 750, raising that number.

1 What I do like is the recommendation by the capital
2 formation subcommittee on potentially making it easier for
3 companies to go private. And by private, I assume that you
4 mean the deregistration process. You don't mean actually
5 completing a transaction, in which all of the outside
6 shareholders are bought out of the company.

7 So the deregistration, and potentially the
8 companies -- the interplay of our role with their role to,
9 you know, have the contingent of -- I'm a little bit hesitant
10 to raise the number from 300, because, to a certain extent,
11 you know, it's kind of the in pool and you're already paying
12 the cost and you're already in there. You know, why give
13 somebody a pass and an out?

14 I think the reason to give a pass and an out is
15 potentially the cost of 404, and if you put those two rules
16 together, you don't change the 300 up to 750. If you do, or
17 maybe even go higher -- because the concern is, once you've
18 deregistered, the obligation to disclose information to
19 shareholders who are not insiders, there is really -- the
20 only requirements are state requirements, and there's an
21 extremely minimal -- it depends on the state -- and almost
22 nonexistent.

23 So, therefore, there is no flow of information.
24 So, therefore, to give them the exit that's 300, but will go
25 to some higher number -- if you voluntarily say we're going

1 to continue to provide information on a regular basis,
2 which -- shareholders continue to evaluate what is going on
3 at the company, I think the potential interplay of our tools
4 is, you know, a logical conclusion to come to and one that I
5 would support.

6 CHAIRMAN WANDER: Pastora?

7 MS. CAFFERTY: First of all, let me agree. I think
8 ours are modest proposals, but I think that they are very
9 important proposals to really address what I believe is an
10 important cultural change in transparency in the board room
11 while offering relief from the, I think, unintentional cost
12 of 404.

13 And I think the -- I don't want to say compromise
14 because it hasn't been. I think this committee has really
15 discussed all of this, pushed and pulled in every direction,
16 and had great leadership from Steve, who has managed somehow
17 to keep herding us to conclusions.

18 But I believe that the important tradeoff is
19 granting this relief, and I think in a way many of our
20 recommendations dovetail very nicely with the recommendations
21 of the other committees.

22 But at the same time keeping what I believe is the
23 intent of SOX and the value of SOX, which is really providing
24 an independent voice and transparency to the internal affairs
25 of a company.

1 Some of that may cost a bit, but this is where cost
2 benefit, I think, starts being a tradeoff. I believe the
3 cost of transparency is something that needs to be looked at,
4 but I think also needs to be borne, and it's part of the
5 price of being a public company. It's the benefit of having
6 investors bear the cost and giving them to access to ensure
7 that indeed there is a profit, and that there is at least the
8 very great effort from management to account for the money
9 that the investors put into the company.

10 At the same time I think a lot of what we're
11 recommending is perhaps modest and perhaps so sensible that
12 it seems small, but it will significantly reduce the cost of
13 doing business. And I think that that's what we're here to
14 do, to increase the benefit and reduce the cost of
15 transparency.

16 So I enthusiastically support these
17 recommendations.

18 CHAIRMAN WANDER: Any questions? Kurt?

19 MR. SCHACHT: I have a quick question, and would
20 like to probe you a little bit on this corporate governance.
21 Governance hygienics, I like that term. It's a good term.

22 Having tracked corporate governance for many years,
23 good corporate governance is obviously better than bad
24 corporate governance, and it improves accountability and it
25 improves independent oversight of the officers of the

1 company, and so forth.

2 The question has been raised, and we've had a
3 couple of comments on this, as to whether it really is a
4 substitute for, or should be considered a quid pro quo for
5 internal controls.

6 Directors, whether you're talking independent
7 directors or you're talking independent members of the audit
8 committee, don't test, they don't design, implement, test
9 controls. They don't sign the financials. They know enough
10 to ask questions about internal controls.

11 But in terms of a substitute for verification of
12 internal controls, I'm not sure I fully understand how that
13 works.

14 MR. BOCHNER: Yeah, I don't think we're -- you're
15 making the comment, Kurt, that I agree with, which is the two
16 are little apples and oranges, right? I mean, 404 --

17 So our recommendations are not meant to say that if
18 you have an independent audit committee, whistleblower
19 protection, a legal ethics program, that's as good as the
20 auditors going in and testing the internal -- that's not what
21 we're saying.

22 What we're saying is that, for all of the reasons
23 that Janet and others articulated, that the cost of this
24 benefit, that we all agree is a benefit, this internal
25 control attestation, is just too high.

1 You know, it's great, it's not working, it's
2 punishing smaller companies, public companies, in particular,
3 and I might add a lot of companies that aren't smaller public
4 companies. The costs have wildly exceeded the benefits.

5 If we do that, then is there something else,
6 particularly the companies that are not listed and so don't
7 have the benefit of these listing standards can do to try in
8 perhaps other areas. And I admit there are other areas to
9 try to give the investor some more protection.

10 And I'd say it's better to have an audit committee
11 that's independent overseeing internal controls than not.
12 It's better to have whistleblower protection anonymously
13 where somebody can report violations that might impact
14 internal controls.

15 So I hope that's an answer to your question. I'm
16 acknowledging that it is not -- when I use the word, quid pro
17 quo, I don't think any of us here think that it somehow takes
18 the place of an outside auditor going in and doing that
19 attestation.

20 CHAIRMAN WANDER: Alex?

21 MR. DAVERN: Yeah, I'd just like to make one
22 comment, Steve. I agree with your recommendations.

23 I do personally feel, however, that the comp
24 committee is a very key committee. I agree with Dick that it
25 remains to be seen if a majority in the directors will really

1 work out for smaller companies.

2 But I'm strongly supportive of a majority
3 independent audit committee, and I'm also personally strongly
4 supportive of a majority independent directors on the comp
5 committee, because I feel that that's a key area as well that
6 needs independent oversight.

7 And then I just want to add on to Kurt's comment,
8 in that the independent directors are required to sign
9 financial statements as part of the 10-K filings. So that's
10 just a point of clarification. Thank you.

11 CHAIRMAN WANDER: Mark?

12 MR. JENSEN: This is Mark Jensen. I don't want to
13 use Alex's microphone for obvious reasons. I sit here
14 trying -- it means I'm a little sick, that's all.

15 MR. DAVERN: Yeah, I was going to --

16 MR. JENSEN: Yeah, I'm just going to keep inching
17 away. I have two comments I wanted to make.

18 The first one, I guess, is to try to respond to
19 what Kurt said earlier. And I guess maybe I'm the modern day
20 Diogenes, but I keep believing that there are honest people
21 out there who want to get things right.

22 And, you know, as an auditor, I can tell you I
23 never had a problem my client didn't have, because it all
24 started with them, you know, and it started with the fact
25 somebody got it wrong to begin with.

1 And I think this over-reliance on auditors and the
2 assumption always that an auditor has to be involved is
3 leading us down a slippery slope in this country. I really
4 believe management needs -- there needs to be higher
5 accountability. That's what Sarbanes-Oxley was about, and it
6 put all of that burden back on management and started to take
7 some of it off of the auditors' shoulders. And, frankly,
8 that's where it belongs.

9 And I think we need, as a matter of public policy,
10 to really start to focus on that one essential element.
11 Because, you know, this notion that auditors are going to
12 keep these companies out of trouble is -- it's not worked so
13 far, and it's probably not going to work in the future
14 either. So I would encourage us all to think about that a
15 little bit.

16 The other thing that I wanted to ask the committee
17 to maybe pay attention to is on page 42 of the 404
18 subcommittee's recommendations. Janet went through that
19 because it's not one of the main recommendations, but it is
20 one of my main recommendations, and has been ever since we've
21 started.

22 And it harkens back to what Irwin Fetterman said to
23 us in San Francisco when he talked about getting things right
24 the first time, as opposed to building quality in versus
25 inspecting quality in.

1 And I'd mentioned to some of the folks at the SEC
2 at our last meeting that I would really think -- I really
3 still believe the SEC in many ways is a throwback to earlier
4 management styles, which is investigate, inspect, and
5 put -- build quality in after somebody else has done it, as
6 opposed to a forward-thinking organization, which says let's
7 really help these companies get it right the first time so
8 that we don't have these kind of blowups in the future.

9 And one of the recommendations we had was the
10 creation of a center of excellence where smaller public
11 companies could go to -- and this, I mean, I guess I would
12 see as a website. It could be any number of things that
13 would allow a company to go and get free advice, quality
14 advice, in the forms of FAQs, you know, best practices of how
15 companies maintain corporate governance, whatever it might
16 be.

17 But I think the SEC would be successful when their
18 division of getting it right is bigger than their division of
19 enforcement. And I just think that reflects modern
20 management thinking versus maybe the way we thought about
21 things in the thirties, when all of this was brought into
22 being.

23 CHAIRMAN WANDER: Drew?

24 MR. CONNOLLY: Hi. This is Drew Connolly, and I
25 would like to add some candle power to your lamp, Mr.

1 Diogenes --

2 (Laughter.)

3 MR. CONNOLLY: -- because the truth of the matter
4 is that that is -- it may not be the headline recommendation,
5 but it is the one that can be implemented with just a mind
6 change here at the Commission. It does not require, it would
7 seem to me, five to three out of five or five Commissioners
8 saying yes, it's a great idea. This is a mid-management,
9 somewhere buried in the management level of the Commission
10 ability to recognize, and I think the only thing I have ever
11 heard is the concern that, you know, in reliance on our
12 advice if something goes wrong and therefore there's a
13 litigation issue, but if it's neutral enough to avoid that
14 and informative enough to address that, it would be
15 incredibly helpful, so I truly embrace and welcome that
16 recommendation, knowing that the vast majority of microcap
17 companies are looking to rely on counsel who often are
18 navigating difficult shoals of regulation themselves. Their
19 auditors have, we have certainly discovered have not been
20 able by their interpretations of some of these rules to be
21 good counselors, as I suspect they previously have been, and
22 that is a phenomenally good idea, so I thank you for it and
23 put some candle power there.

24 In terms of corporate governance, Steve, thank you
25 very much for putting it in a framework that the balance, in

1 fact, if we adopt later today or Friday, whenever we
2 finalize, and in fact the Commission implements the 404
3 committee's recommendations, it seems to me that the tension,
4 I guess, the frisson between reluctance to exempt while
5 simultaneously layering on the protections that I think
6 Sarbanes-Oxley were rightly meant to address is exactly the
7 right balance and that truly is something.

8 Pastora, very simply, you are absolutely right. If
9 we don't find ways to lower the overheads, the physical
10 costs, whether it be in, you know, access equals delivery,
11 paper versus electronic forms, we are making America an
12 uncompetitive place.

13 I harken back to our first public meeting in New
14 York. Right after we finished I went down to Wall Street,
15 met with a firm, and we were interviewed by the director of
16 marketing for the A market in London, and the man said to me,
17 "The best marketing tool we have ever had is Sarbanes-Oxley."

18 So clearly the cost structure of growing these
19 microcap companies, because I believe everybody in this room
20 would agree that if we find a way to assist those microcap
21 companies who my two good friends at the Big Four don't
22 audit, to in fact grow, they may become farm team future
23 audit clients, so hopefully some of these issues get resolved
24 that way.

25 CHAIRMAN WANDER: I would sort of like to move on,

1 if that's possible.

2 Two questions -- well, there are three. Rick,
3 Leroy, and then Jim, and then let's move on, so that we can
4 have the two other reports and then break for lunch.

5 MR. BROUNSTEIN: Okay. Rick Brounstein. Mine may
6 be more boring and maybe more just thoughts for drafting, but
7 I have three, maybe four, comments, although the fourth may
8 be more for the next committee.

9 The discussion of enhanced disclosure, the only
10 comment that I would -- you know, describing the resources,
11 all that, sounds very good -- I think when you look at what
12 is required, essentially material weaknesses, my
13 recommendation would be that is where we would probably stop,
14 that if you look at the discussions that we have had
15 internally in the recent PCAOB guidance on November 30th, you
16 know, it was made clear that the focus of the 404 audit is to
17 look for material weaknesses. Out of that you are going to
18 trip on some significant deficiencies and some deficiencies,
19 but the report on, say, significant deficiencies when we are
20 not particularly looking for them even at the S-404 level,
21 you know, will lead people to the impression that we got 'em
22 all, and that has clearly been clarified is not the focus of
23 even the 404 audit.

24 Secondly, I'm differed on the recommendation 4, on
25 the thresholds. The talk of 300 to 750 and 1,000, or if you

1 look at the ABA paper today I think they are suggesting like
2 2,500, I think we do have to get more data. I mean just my
3 little company is probably more than 30 to 1, recordholders
4 versus, you know, if you eliminate CD and replace it with the
5 beneficial holders, so I think we have to be very careful and
6 I think, you know, 300 and 750 may not even equate, but if
7 300 was in fact the right number or 500 was the right number,
8 I sense that it's a relatively larger number for de minimis
9 among shareholders.

10 On the two year financials and the S-B filers, I
11 think as we go to draft, we just have to comb through the S-B
12 filings. One jumped out at me, but there may be other
13 unintended consequences and that is right now the smallest of
14 the companies -- and we are now talking about dragging in a
15 bunch of really small companies that I think is the
16 cornerstone and really support the pink sheets, many of them
17 that may not even be reporting and should be today is that
18 we've got to be careful that we don't trip them on something.

19 So one of the things that jumps out at me, and
20 maybe there's others, is that you are an S-B filer you have
21 90 days to get a K out and 45 days to get a Q and the
22 regulations of proposal one really addressed the larger small
23 companies, and so we should, you know, not make it any more
24 onerous on the smallest of the small if we are going to bring
25 them into the system, and maybe there are a few other things

1 that are unintended consequences that we should just be
2 careful with.

3 CHAIRMAN WANDER: In fact, I would like you -- and
4 Pat as well -- aren't you an S-B filer? No, you're
5 not? -- to go through the S-B requirements to see which ones
6 should continue to be appropriate for smaller public -- for
7 the microcap companies.

8 I did, myself, but since I don't really do much of
9 that work, I may have missed some.

10 MR. BROUNSTEIN: I'm happy to work on that with
11 Steve's group.

12 The fourth thing, and it's sort of addressed in the
13 accounting standards, so maybe we'll defer to them, but when
14 we talk about wanting independent audit committees, and I am
15 100 percent and back, we should take a look at what
16 independence is, especially if the smallest of small
17 companies -- I think it was testimony -- I don't want to say
18 ABA, but it was -- I think it came from Wilson Sonsini, but
19 it was a paper written to us and it talked about for the
20 small companies are venture capitalists involved, and there
21 might be some definitions of people who really, you know, are
22 quite independent and don't meet the rules, or you look at
23 the 60,000 threshold to kick people out. If we are going to
24 want to have good people on these independent boards, we
25 should look at the population and look who's now being

1 regulated off, and maybe they -- maybe they are pretty
2 independent.

3 CHAIRMAN WANDER: Okay. Steve and then Jim and
4 then Leroy.

5 CHAIRMAN THYEN: My questions have been answered.

6 MR. BOCHNER: And I heard, I know you want to move
7 on, so yeah, I think we will look at that independence issue
8 I think you are talking about, the compensation, intolerance
9 of the current rules, and also the affiliate can't be
10 independent. It's kind of easier to draft off current
11 independence definitions in the rules, but maybe we ought to
12 step back and see if those ought to be less, and, you know,
13 that zero compensation for anything other than board service
14 is the right threshold for smaller public companies.

15 You know, I also wanted to say the comments, and I
16 think the lawyers out there would find me remiss in not
17 mentioning this, but the comment has been made
18 that -- questioning whether the SEC has the authority to
19 impose the type of governance listing standards that I
20 suggested, and I think the thing we are going to ask the SEC
21 to take a look at in that regard, would those issues be
22 implicated if indeed we're not imposing them but rather
23 companies don't have to comply with 404 if they implement
24 these standards. Is that a way around it? And if not,
25 there's an alternative that we require prominent disclosure

1 with respect to the corporate governance reforms that we have
2 mentioned, but I wanted to acknowledge that that issue about
3 how far the SEC's authority can go in imposing governance
4 standards has been raised a couple of times.

5 CHAIRMAN WANDER: Leroy.

6 MR. DENNIS: Thanks, Herb. Leroy Dennis. Steve, I
7 know you and I talked about this individually and I just kind
8 of want to get it on the record, and that's my concern about
9 the comments made in here about stock options.

10 I think we make a comment in your report that says
11 stock option holders who haven't exercised securities and
12 made an investment decision should not be counted as
13 determining the number of holders.

14 My concern is that -- I mean I believe that a stock
15 option holder does make an investment decision every day.
16 They make a decision whether to hold the option. They make
17 a decision whether to exercise it and then ultimately a
18 decision whether to exercise and sell.

19 And so I am just concerned about that. I could
20 envision a situation where I am less concerned about an
21 unvested option because they don't make that decision every
22 day -- they have no choice but to hold, but once they become
23 vested they are making a decision every day it seems to me.
24 I am a little concerned about not counting them as a security
25 holder.

1 The other question I would have for you, and I
2 agree with Kurt or maybe it was Rick that said more research
3 needs to be done on the numbers, but is your intent on the
4 conversion to a beneficial holder standard to really keep the
5 same number of reporting entities out there, or is your
6 intent to increase or decrease the number of people who could
7 report under the SEC's filing requirements by changing to
8 this different definition?

9 MR. BOCHNER: We have not yet thought about it in
10 those terms. I think the way we have thought about it is that
11 the current approach allows manipulation and results in, from
12 a policy level results in companies that are actually larger
13 in terms of equity holders perhaps not reporting and
14 companies that are smaller getting thrown in simply because
15 they don't have enough holders in street names, so I think
16 from a policy level we have looked at that, and that's been
17 where some of the comments have come from that the approach
18 doesn't make sense from a policy level. We should pick a
19 number. And I think the question is at what number of
20 shareholders is a company big enough that that number of
21 investors ought to get the protections of the '34 Act.

22 I think that is the policy level issue and, you
23 know, most of the comments we got suggest that it should go
24 up. I think we have numbers that range from 1000 to 2500.
25 There might be some outliers out there, so I think that is

1 the zone.

2 I think the first question is what is the metric?
3 Let's get a metric that's fair and that is applied in an
4 even-handed way, and once we do that, then let's decide at
5 the policy level whether we want to keep things pretty much
6 close to the status quo, if that's done, and if not
7 understand sort of who's being swept into the system, and if
8 there's people that are being swept into the system that we
9 think, you know, 2000 shareholders is a number of
10 shareholders that's big enough that companies ought to be
11 reporting, then so be it.

12 So I don't think we've quite gotten to your
13 question there.

14 CHAIRMAN WANDER: You might also consider whether
15 the number of shareholders is a relevant criteria. You know,
16 if you have a low market cap, you know, you divide the number
17 of shares, you've got people with penny shares. You know,
18 I'm not so sure that's -- I'm just throwing it out. I am not
19 making a judgment on that.

20 Janet, and then we will move on.

21 MS. DOLAN: Right, and mine may just be a subset of
22 Leroy's. I was just wondering any time you move a bar, the
23 question is why are you putting it where you are. Are you
24 saying these are just placeholders for right now? These
25 numbers could change quite a bit, or is there anything

1 magical about --

2 MR. BOCHNER: No.

3 MS. DOLAN: Okay, so these are just places --

4 MR. BOCHNER: Yeah.

5 MS. DOLAN: You're saying it's going to move. You
6 don't know what you are going to recommend.

7 MR. BOCHNER: I think it's going to move. We want
8 to look at the data and understand which is sort of
9 frustratingly hard to get a hold of, and we have tried, but I
10 think we want to look at the data and then try to make some
11 intelligent decisions and come back to you.

12 MR. ROBOTTI: On that topic, you know, my personal
13 point of view is that an investor today in certain companies
14 either has protection or doesn't have protection and bought
15 in kind of under that scenario, and so therefore the bias in
16 my mind is to give more protection on who are we going to
17 sweep into the system and make that number larger to sweep
18 less people in, because the investors in those companies
19 bought in in a situation where they didn't have that
20 protection.

21 On the other side, on raising the number on the low
22 side, I am less inclined to raise that number because those
23 people are already investors in a company. They invested in
24 a company. They have those protections. To take away those
25 protections seems to me to be, you know, inequitable, so my

1 personal bias is don't raise the 300 so much. You can raise
2 the thousand more because you don't want to necessarily
3 include it, and of course that's a regulatory issue
4 too -- how many companies come in to the burden and how big
5 that number is.

6 CHAIRMAN WANDER: All right. Leroy, we are moving
7 on to the accounting standards subcommittee preliminary
8 recommendations.

9 MR. DENNIS: Thank you, Herb. Leroy Dennis.

10 First off, I want to thank the members of our
11 subcommittee, Pat Barry and John Veihmeyer, advisor George
12 Batawick from the FASB staff, and then especially the SEC
13 staff -- Tony Barrone and Allison Spevey and Jerry and Kevin.
14 And the SEC was very accommodating to us. We would ask for
15 input from people and I would be on a call with myself and 10
16 other SEC staff people, which tends to be a little daunting
17 at times, but there was a lot of interest in the staff and a
18 lot of cooperation by the members, and we really did
19 appreciate it.

20 I am not going to go through all the
21 recommendations. We have got a summary on the first two
22 pages. I will highlight a couple of them or a few of them
23 that I think are the more important ones.

24 Recommendation number one, we have recommended that
25 microcap companies be permitted to apply the same effective

1 dates that the FASB provides to private companies in
2 implementing any new accounting standards.

3 Usually the FASB, when they adopt a new standard,
4 will apply an accelerated adoption date for SEC companies and
5 a longer adoption date for private companies. That is to
6 allow the standard time to work and get the kinks out. We
7 think that the microcap companies ought to align themselves
8 more with the private companies in adoption of new accounting
9 standards.

10 Recommendation number two, the SEC should provide a
11 de minimis provision in the application of independence
12 rules. We have noted instances where a seemingly
13 insignificant violation of an auditor independence rule could
14 have some very significant consequences to a company
15 requiring it to change auditors, at a very minimum causing
16 consultation with the SEC. We think some judgment and some
17 de minimis provisions for relatively insignificant immaterial
18 violations of independent standards should be considered.

19 And we think that also could go to allowing more
20 cooperation between the auditor and the client, and really
21 helping with a better corporate governance overall.

22 Recommendation Number 3. The SEC should consider
23 additional guidance for all public companies with respect to
24 materiality related to previously issued financial
25 statements.

1 We've all seen the large increase in restatements
2 that seems to occur in the last two years.

3 Our concern is that several of those restatements,
4 although deemed material in the accounting sense, may not
5 have been as meaningful to the investor and material to an
6 investor, and certainly when a restatement happens, there are
7 very significant consequences on the company's stock.

8 We're also concerned that, you know, if this trend
9 continues, at some point in time, a restatement will be less
10 of a big deal and just be a normal part of an operating
11 business for a public company, and we don't think that's
12 appropriate.

13 So we're asking that the SEC look at materiality
14 specifically as it relates to prior financial statements and
15 prior quarters, and we've got some recommendations
16 surrounding that.

17 We support Steve's recommendation and actually our
18 Recommendation Number 4 deals with the same recommendation to
19 move to a two-year financial reporting versus three-year
20 financial reporting for smaller public companies.

21 We believe that in addition to the comments that
22 Steve made, it also helps with -- we heard a lot of comments
23 about the high cost to change auditors, and we think by
24 pulling out one less year for a consent, that that would help
25 drive competition and lessen that cost for an audit committee

1 to change it.

2 Recommendation Number 5 is very theoretical. We
3 don't have a lot of solutions for the SEC, although there's a
4 lot of comments around Recommendation Number 5.

5 But it says that the SEC should formally encourage
6 the FASB to pursue objective-based accounting standards. I
7 think it has done that in speeches and other comments.

8 We also would recommend that, and I know this has
9 been taught by some of the folks at the SEC, that simplicity
10 and ease of application should be important considerations
11 when adopting new accounting standards.

12 We feel that in order -- that comparability is one
13 of the best things you can have in any accounting standards
14 on the U.S. economy, and the more complicated and theoretical
15 that a standard is, the less likely it is applied
16 consistently and correctly, and we would actually give up a
17 little bit of theoretical correctness to get ease and
18 simplicity in the accounting standards.

19 Recommendation Number 7 we talked about earlier
20 with Janet's committee on the concern about auditor
21 concentration.

22 We think that the SEC and the PCAOB should work
23 together to promote competition among the audit firms using
24 their influence to include non-Big Four firms in committees,
25 public forums, et cetera that increases the awareness of

1 those firms in the marketplace and their ability to audit
2 especially smaller public companies.

3 We also are concerned, and there are a lot of
4 registered firms with the PCAOB, I think at last count well
5 over 900 U.S. registered firms, and I don't think there's any
6 formal education requirements for partners serving SEC
7 accounts, and we think that the PCAOB might want to look at
8 that as a way to more equalize and make sure their views are
9 being communicated.

10 And I think just what the AICPA and the SEC did
11 here last week with the AICPA conference is an excellent
12 vehicle to do things like that.

13 Those are the recommendations I wanted to
14 highlights. We did have 10. We do have unanimous approval
15 of those recommendations by our full committee.

16 And with that, again, I'd like to thank everybody,
17 including Jerry and his staff, and open it up to Pat or John
18 if they have any comments or questions or comments they want
19 to make.

20 MR. VEIHMEYER: I would just make one quick
21 comment.

22 I think as you go through our recommendations, it's
23 fair to say that for many of them they are just as applicable
24 to large companies as they are smaller public companies, so
25 some of you may be sitting there with that reaction as you

1 read through them.

2 We didn't think that should discourage us from
3 making recommendations that we thought would benefit all
4 registrants, recognizing that the proportionality that we
5 talked about in 404 exists no matter what you're talking
6 about.

7 By definition, regulation is not proportional. The
8 costs of an audit of a financial statement is not
9 proportional. It's much higher on a percentage and pro rata
10 basis for a smaller company.

11 So to the extent we can benefit all registrants,
12 our view was we'd probably benefit small public companies
13 more than larger, so I just wanted to point that out.

14 CHAIRMAN WANDER: Thank you very much.

15 Any other questions, comments? Drew?

16 MR. CONNOLLY: This is Drew Connolly.

17 Leroy, I'm only struck by the fact that Number 10
18 of your recommendations is the one that was not on the
19 record, and I'd like very much to put some serious candle
20 power behind this one, because it not only mimics but expands
21 on Mark's prior strong recommendation, and if I may, I'd like
22 to read your Recommendation Number 10 into the record.

23 "The SEC should commit more resources and
24 professional staff to an office of ombudsman or a help desk
25 to provide assistance to smaller public companies.

1 "The SEC should also public guidance on reporting
2 and legal requirements and assisting smaller public
3 companies."

4 There is no question that the thousands of
5 companies at the lowest tier, the entry level public
6 companies, the folks who we are hoping to nurture into the
7 smaller public company space, and then ultimately the WICSI
8 space if they're good enough, could benefit from a -- and I'm
9 certain that if Jerry could speak in a budget meeting within
10 the organization, I doubt that he'd dispute any of this.

11 But given the resources and given the focus and
12 given the opportunity, I would think that his office could
13 and would meet the challenge.

14 So I'd like to make sure that Number 10 is
15 spotlighted in your recommendations strongly.

16 CHAIRMAN WANDER: Thank you. Other questions?
17 Rick?

18 MR. BROUNSTEIN: Yeah, two, I don't know if these
19 are small points or not, but on the recommendation that I
20 think is Number 3, where you're talking about materiality
21 versus meaningfulness, I think we all know it, but the whole
22 issue of restatement because it's in error versus restatement
23 because it's intentional, the perception out there today, and
24 so I guess what I'm suggesting is we go into the drafting.
25 Maybe there's other exceptions.

1 Because the -- you know, I just came off of two
2 fairly large accounting conferences in the last few weeks,
3 one with CPE, Inc. and one that FEI hosted, and various, you
4 know, presenters, and one guy yesterday, Jim Milliken, and I
5 forget the organization, but it's an ISS type organization
6 that a lot of the institutions look for the voting, and his
7 comment was when you see a restatement, you know, his comment
8 for a restatement is it's the Wall Street walk.

9 So any time there's a restatement, all the
10 institutions, their direction is. just sell. You know, don't
11 wait around to figure it out.

12 So as we look at this, I think it's a lot -- you
13 know, it's actually a fairly large issue where you talk about
14 maybe watering these things down, but at this point in time,
15 you know, Refco talks about material weaknesses, and everyone
16 buys their stock, and there was only upset afterwards when
17 they find out that there was some meat behind them.

18 But a restatement, innocent or not, is treated as
19 something terrible and is a huge hit to the market cap, and
20 as I look at restatements, not all restatements are created
21 the same. You give a couple examples.

22 Maybe, I don't know how broad we can go, but maybe
23 there are other ones we can at least consider, and maybe
24 Number 6 that you talk about with the safe harbor is a little
25 bit like that.

1 I have my own, and that's my other comment, I have
2 my own sort of opinion on fair value.

3 Yeah, theoretically, it's great, but I can take
4 five experts and sit down with, whether it's 123-R or, you
5 know, convertible stock with debt or any one of a number that
6 are coming out, and get five very different answers and it's
7 a very easy way to manipulate earnings without the auditor
8 being able to make a good judgment.

9 I mean, a slight move in an industry can have a
10 huge move.

11 I know it's very big at the international
12 accounting standards level and so it's probably way out of
13 our realm, but, you know, it is clearly, you know, something
14 that I think down the road we're going to all be looking back
15 at and say why did we do it, and most companies that I deal
16 with, every time there's one more like that, they could care
17 less whether I get it right or not. They don't want a
18 restatement.

19 And ultimately, they want to know what really is
20 the underlying income statement when you pull out all this
21 subjective theoretical.

22 But anyway, that's --

23 CHAIRMAN WANDER: Well, you should really
24 communicate with Leroy to see if there are other examples to
25 be added.

1 MR. DENNIS: Herb, if I can just -- I mean, the two
2 examples we put in materiality are not intended to be the
3 only ones.

4 I mean, they are examples that maybe are the most
5 problematic at this point that we see.

6 And I agree with you completely on fair value.
7 That is a very, very difficult standard with a lot of
8 judgment and the more we move to that, the more judgment and
9 less preciseness is involved in the accounting that companies
10 have to do. It's not an audit issue, it's an accounting
11 issue.

12 CHAIRMAN WANDER: Steve?

13 MR. BOCHNER: I guess to just add color to Leroy's
14 suggestion on materiality -- by the way, I'm glad I'm not the
15 material water carrier anymore, Leroy, thanks for taking that
16 on.

17 But the question is can -- you know, is there a way
18 short of amending a 10-Q or a 10-K that one could, so we
19 have, so issuers have an objective test -- you know, I don't
20 know whether percentage of revenue or some other test -- but
21 that doesn't go to disclosure, so it still might be something
22 that in MD&A or perhaps in an 8-K, either under 10b-5 or
23 maybe mandated, maybe in MD&A there could be a requirement to
24 disclose any changes that are, you know, that the issuers
25 conclude are not material to the previous financial

1 statement.

2 So you don't have an actual restatement and all of
3 the effort and cost associated with that, but that might be
4 divorced from disclosure.

5 If it's under 5 percent, the issuer may -- perhaps
6 we should look at whether it's required disclosure or
7 self-disclosure from a 10b-5 point of view.

8 I think the point is that these restatements, I
9 think people are erring on the side of conservatism, so when
10 in doubt, restate, causes market dislocation, causes
11 securities class action lawsuits, and costs companies a lot
12 of money.

13 So I'm hoping what we're saying is we're divorcing
14 sort of the investor disclosure side of things from sort of
15 the technical restatement and all the costs and other
16 implications that that has.

17 We're not saying that, you know there shouldn't be
18 some disclosure necessarily if there's been a change.

19 MR. DENNIS: Yeah, I agree with that.

20 I think it's very difficult to come up with an
21 objective standard of materiality, because the facts and
22 circumstances are different.

23 I think there may be a situation where something is
24 immaterial in a quarter, or material in a quarter but maybe
25 immaterial in an annual financial statement, and whether or

1 not you go back and correct that is one of the things we've
2 addressed here.

3 I think one of the things you got to -- you also
4 got to deal with, though, is as you go forward, how do you
5 make sure that you have comparative data that's accurate, so
6 that you're comparing apples and apples?

7 And it may be -- and this is something we've tossed
8 around a little bit -- it may be that changing that Q on a
9 comparative basis doesn't necessarily mean you've restated
10 the prior year as long as it meets certain materiality
11 standards and is under a certain level of materiality.

12 I think all of us were in agreement that if it's
13 material on an annual basis, if your 10-K is materially
14 incorrect, you just probably should go back and fix that, and
15 that's a restatement and I don't think any of us proposed
16 that that be treated on a prospective basis or anything like
17 that, that we do have to get the numbers right on an annual
18 basis.

19 John, do you have anything you want to add to that?

20 MR. VEIHMEYER: I would just add, without getting
21 into the specifics, I think the broad -- the underlying
22 principle in this recommendation is a weakening of confidence
23 in the financial reporting system in general increases the
24 cost for everybody, and if there are restatement occurring
25 that are occurring so frequently because maybe we're taking

1 collectively a much too narrow view of what's really relevant
2 in some cases.

3 We're not talking about clearly immaterial errors
4 that are discovered.

5 We're talking about things that are on the margin
6 at this point and I think, Steve, to your point, maybe we are
7 pretty consistently erring on the side of conservatism, and
8 could we give some clear guidance that without adversely
9 impacting the quality of financial reporting might strengthen
10 confidence in the financial reporting by not having
11 restatements be a pretty regular occurrence.

12 CHAIRMAN WANDER: Alec?

13 MR. DAVERN: It's Alec Davern. One very quick
14 comment, Leroy, and then I just wanted to express my very
15 strong support for Recommendation Number 3.

16 I think you guys in the two examples, not
17 precluding there might be other examples, but the two
18 examples you've laid out are very well articulated, and I
19 strongly, strongly support that we adopt that recommendation.

20 Thank you.

21 CHAIRMAN WANDER: Jim.

22 CHAIRMAN THYEN: Leroy, real quickly, maybe you
23 could explain how you set your order of importance?

24 MR. DENNIS: You know, Jim, it's been a while since
25 we set that order, so it's kind of ancient history to me.

1 We started off with what we thought affected
2 probably the most companies and where we thought the most
3 pain was at, and kind of worked down from there.

4 And we probably set this order two months ago,
5 three months ago, and, you know, it's tweaked a little bit in
6 the last 30 days, but not much.

7 And I would guess, you know, that's how we came up
8 with that.

9 We probably also looked at what was the easiest to
10 implement, and, you know, for example, the simplicity in the
11 accounting standards I would put at number one if we could
12 figure out how to do that.

13 I think that's a lofty goal. By the time I retire
14 from this career, from my career here, if we make progress
15 toward that, I'd feel really good.

16 You know, I think there's a lot of complexities
17 that cause that to be very, very difficult to implement.

18 So that's my input --

19 MR. VEIHMEYER: I would just say it's fair to say,
20 with the guidance that Herb started us with this morning, I
21 think we probably collectively need to go back, take a look
22 at that, and make sure that if in fact there's some desire --
23 we viewed all of them as important. I think we did try and
24 scale them the way Leroy said.

25 But I think we'll take a closer look at that, Jim,

1 and make sure that when we finalize these, they are in some
2 order of priority.

3 CHAIRMAN WANDER: Great. That would be terrific.

4 Other questions or comments?

5 (No response.)

6 CHAIRMAN WANDER: Good. We're now to David.

7 Everybody has been very patient. Thanks for all
8 your patience. And we will have the report of the Capital
9 Formation Subcommittee.

10 MR. COOLIDGE: Thank you, Herb. David Coolidge.

11 Seeing as how I'm the only thing standing between
12 you and lunch, you-all and lunch, I will try and remove that
13 obstacle quickly.

14 But let me first thank my fellow subcommittee
15 members for their work, and our thanks to the SEC for their
16 assistance in facilitating our work.

17 Our recommendations, which you've all seen and
18 really heard before in some respects, not the detail that
19 we've got it in the report, but we've done this in a couple
20 other committee sessions, but these recommendations are
21 designed to facilitate the capital raising process, ease
22 burdens on smaller public companies which have seen an
23 increase in regulatory requirements, and hopefully improve in
24 some fashion the trading markets for smaller public
25 companies.

1 We have eight recommendations for consideration.
2 They are listed in the order of priority, and I think our
3 listing is based on what we think is the hardest one to get
4 through, so we focus everybody on the hard ones first and
5 leave the easy ones at the end.

6 They are, and I will go through them quickly:

7 Number 1. Adopt a new private offering exemption
8 that does not prohibit general solicitation and advertising
9 for transactions with certain purchasers.

10 This is a little bit of a paradigm shift, I guess,
11 in that our feeling was that it's the -- if you're interested
12 in investor protection, what you need to be worried about in
13 these private offerings is who the investors are, not how
14 many people know about the offering.

15 And so that's kind of the basis for this
16 recommendation, but it obviously would allow private
17 offerings to go forward on a different basis than they have
18 in the past. There's a number of changes in the existing
19 construction that this particular recommendation refers to.

20 Number 2. SEC should spearhead a multi-agency
21 effort to create a streamlined NASD registration process for
22 finders, M&A advisors, and institutional private placement
23 practitioners.

24 There is a report out there by the ABA making this
25 recommendation.

1 What is the case is there are lots of people
2 engaged in these practices that are not NASD members and it
3 seems that we would like to, I don't want to call it have an
4 amnesty program here, but in effect create a different
5 registration process that would allow lots of people to come
6 forward and get an NASD registration affected.

7 Obviously, if this is an NASD registration light,
8 our view is that these types of advisors would not hold
9 customer funds, and we're really in the business of assisting
10 companies to raise money and should be allowed to do so
11 because it does again assist in the capital formation
12 process.

13 Recommendation Number 3 is to -- is really not
14 dissimilar than Recommendation Number 1 with respect to other
15 private placement exemption adjustments.

16 I won't bother to go through the details of that,
17 but they are changing of certain rules.

18 Number 4. Come up with a new way for companies to
19 go private.

20 It's, for small companies, microcap companies in
21 particular, it's a very burdensome regime requiring all sorts
22 of filings and things to happen before that can go forward.

23 So we don't have a lot of detail on this particular
24 recommendation at this point in time because we didn't have
25 the opportunity to work it all out, but we think that that's

1 a logical place to go, given the increased burden of
2 regulation.

3 If people want to opt out of the system, it
4 shouldn't be a horrendous regulatory burden to opt out of the
5 system.

6 Number 5. Trading markets.

7 One of our concerns is that with the changes at
8 NASDAQ becoming an exchange and the NASD taking back the OTC
9 bulletin board market with the NASDAQ running it on a
10 contractual basis, that this very important trading market
11 for microcap and smaller public companies be a viable one
12 and, hopefully, that things can be done at the SEC level and
13 the NASD level to make sure that it remains viable.

14 And there is one item in this recommendation that I
15 would like to delete -- this was a typo, I guess -- which is
16 5(b) trading markets, where it talked about compensation being
17 allowed to be paid to market-making dealers by the companies.

18 That was not meant to be. That was a suggestion
19 that had been made at an earlier session, and we decided not
20 to go forward with that one.

21 So 5(b) is out of our recommendation.

22 Number 6. Research.

23 The SEC should adopt policies that encourage and
24 promote the dissemination of research in smaller public
25 companies.

1 As we all know, the amount of research published in
2 smaller public companies has been declining. This is due to
3 regulatory issues. It's also due to marketplace pressures.
4 But we think that the more research, the better.

5 We're suggesting that company sponsored research be
6 okayed with full disclosure and that soft dollar payments for
7 research under current safe harbor provisions of Rule 28(e) --
8 that was also a typo that was left out under 6(b), just write
9 28(e) after a rule -- ought to be allowed to continue.

10 The only reason we're recommending a continuation
11 is because that subject has been discussed in various venues
12 and we think we would like to come out in favor of continuing
13 with Rule 28(e).

14 And then Number 7. Rule 701.

15 Basically an amendment to the dollar amounts that
16 are allowed in that rule to kind of catch up for inflation.
17 It's not a huge change, but something we thought we ought to
18 mention.

19 And then Number 8. Securities class legislation
20 Relief for employee stock options has occurred in a few
21 cases.

22 Employee stock options have been traded, the same
23 as voting securities, and we don't think that's correct, so
24 we've got a recommendation on that subject.

25 As I said, most of these you've seen before, with

1 some changes in the final report that we have here, but
2 essentially, those are our eight recommendations.

3 We do have a note here on PIPE relief, but it's a
4 note, it's not a recommendation at this point in time.

5 And I want to especially acknowledge Richie
6 Leisner, who helped me considerably in this whole process,
7 and I'm sure he's got a few things he would like to say.

8 MR. LEISNER: Actually, I don't have anything to
9 add to that except that I think we should, and I know we
10 should mention that, although not a voting member, Jack
11 Herstein to our right provided us with valuable input from
12 the regulatory standpoint.

13 And I'm sure Jack will speak for himself in a
14 little bit, but Jack pointed out to us that he had a lot of
15 concerns about our number one proposal.

16 And we're happy to talk about people will have
17 concerns about it.

18 The one thing I would say is, having the
19 perspective of been a securities practitioner for a number of
20 years, I have seen changes in the requirements for private
21 placements and at several instances when there have been
22 incremental changes in what the standards were, people who
23 were involved in the process threw up their hands and said,
24 "Oh, my goodness, you're opening the floodgates to fraud,"
25 and that did not prove to be true in the past.

1 Most recently, the largest change was when
2 Regulation D was adopted in the early 1980s or late 1970s.

3 Prior to that time, the SEC staff position was that
4 to have an effective private placement, every offeree had to
5 meet the investor suitability requirements that today apply
6 under Regulation D only to purchasers.

7 And the thought was that it would be inappropriate
8 to offer investments to people who couldn't qualify to buy
9 them, and so that was the logic for offeree suitability, but
10 it worked out in a number of instances, for example, if an
11 issuer didn't have records to show that every offeree was
12 suitable or even who all the offerees were, everyone could
13 get their money back. That was perhaps an unintended result.

14 More recently, in the last decade or so with the
15 growth of the Internet and other types of communication, the
16 staff has provided arrangements by which non-issuers have
17 been allowed to engage in very broad solicitations of
18 prospective clients without offending the private placement
19 rules.

20 And on top of that, on an experimental basis, in
21 1992, the Commission approved testing the waters in
22 Regulation A offerings, which has not been embraced, for two
23 reasons, the first of which is hardly anybody does Regulation
24 A, and the second of which was this was a proposal that was
25 not embraced by the states, which sort of brings me to the

1 end of this discussion, which is that our proposal is to make
2 this exemption under NISMEA, which means it would be a
3 covered security, and that would mean that it would not -- it
4 would -- the states could collect fees, but the states could
5 not impose duplicative or different standards if this were
6 adopted.

7 Finally, from a technical standpoint, I don't think
8 it would make much difference to the subcommittee where this
9 exemption got stuck, although Jack might have a suggestion
10 where we should stick it.

11 But we'll talk, Jack and I will talk about that at
12 lunch.

13 So you could put it as part of Regulation D, you
14 could -- we're really talking at a conceptual level, and we
15 hope that this is responsive to what Jim and Herb asked us
16 for back in April, which was to be bold.

17 CHAIRMAN WANDER: Thank you Richie, David.

18 Anybody else on your subcommittee have comments?

19 I'll start with Drew and then Jack.

20 MR. CONNOLLY: I'm going to be brief, which will be
21 refreshing, I'm sure, Herb.

22 David, I think this, and maybe we'll talk about
23 this off-line, but in terms of 5(d), the part that I thought
24 we agreed on, this is not for continuous market-making, but
25 rather for the submission of the 211 form, which was

1 previously allowed, and the rule changed by the NASD to
2 preclude a broker-dealer from collecting compensation, due
3 diligence fees as it were, for filing and comment period, not
4 for making the market, but rather for going through the
5 effort, professional effort to get a market initiated,
6 recapturing due diligence expenses, et cetera.

7 I think that --

8 MR. COOLIDGE: We can revisit that.

9 MR. CONNOLLY: Okay.

10 CHAIRMAN WANDER: Jack?

11 MR. HERSTEIN: Richie, I tried to be bold.

12 The past morning, this morning, I've heard investor
13 protection used a lot by various subcommittees.

14 From my standpoint as a state regulator, investor
15 protection has a different meaning.

16 Basically, we are on the front line, we're the
17 grassroots effort, and basically it's our primary function as
18 state regulators for investor protection, not once the
19 individual gets inside the company, but before the individual
20 gets inside the company.

21 I just have a couple comments to make a on a couple
22 of the recommendations.

23 The first one is the new private offering exemption
24 regarding the general solicitation and advertising for
25 transactions with certain purchasers.

1 I might refer to them as, you know, maybe super
2 purchasers, because we're talking about accredited investor.

3 Okay.

4 Accredited investor is defined, I think, in
5 Footnote Number 2 as somebody who has a net worth of \$1
6 million or has a \$200,000 annual income and/or \$300,000 in
7 joint annual income with husband and wife.

8 Now, it's suggested in number one that the -- not
9 the term accredited investor, but basically a super investor
10 have a \$2 million joint net worth or \$300,000 annual income
11 or \$400,000 in joint annual income.

12 A little history of Regulation D and the accredited
13 investor.

14 In 1982, that's when the SEC I believe introduced
15 Regulation D and also the definition of accredited investor.

16 In 1988, Reg D and the accredited investor was
17 amended and only was amended that \$1 million net worth still
18 was the same as in 1982, except that they did add in 1988,
19 they added a \$200,000 individual annual income and the
20 \$300,000 joint annual income.

21 So since 1982, the definition of accredited
22 investor has not been changed.

23 We all know basically in the last 10 or 15 years
24 how the wealth of this nation has increased greatly, how many
25 millionaires and multi-millionaires we have out there.

1 On the rate of inflation, under consumer price
2 index, CPI, which is a widely used measure of inflation,
3 based on that definition and their formula, since 1982, the
4 \$1 million net worth should have basically been moved, bumped
5 up gradually 'til about \$1.8 million, the \$200,000 individual
6 annual income about \$340,000, and the \$300,000 joint annual
7 income approximately about \$510,000.

8 Now, I'm not saying change the definition of
9 accredited investor. I'd like to see it, but I'm not
10 suggesting that.

11 However, I would like to see for this proposal that
12 the suggested net worth of \$2 million be increased to \$5
13 million and have it be \$1 million in annual income for
14 natural persons or \$1 million for joint annual incomes.

15 I think that basically would be approximately twice
16 what accredited definition should be as of now.

17 The other problem that I would like to see a little
18 more worked on in this Recommendation Number 1 is that,
19 Richie, last time in October you talked about selling this to
20 rich people and to smart people without money, and I believe
21 your smart people -- and your smart people without money
22 would be in the investment sophistication, which I think
23 probably needs to be defined more. I think there's a void
24 there.

25 MR. LEISNER: You think I wasn't smart enough to

1 define it?

2 MR. HERSTEIN: I think that might need to be a
3 little worked on.

4 Recommendation Number 3 --

5 MR. LEISNER: Jack, this is Richie.

6 Would you review the bidding on the financial
7 wherewithal, just the ones that you want?

8 MR. HERSTEIN: Well, I think you suggested -- I'm
9 suggesting \$5 million, \$1 million annual income, \$1 million
10 joint annual income. I know my letter was higher than that.
11 I rethought the issue. All right?

12 Okay.

13 The other recommendation that we proposed is Number
14 5(d), as in dog. Drew had a problem with 5(d). I have a
15 problem with 5(d) as in dog, trading markets.

16 If we recall, again going back to our meeting here
17 on October 25th, Steve Bochner brought up the suggestion that
18 earlier the day before our subcommittee meeting about how
19 NASDAQ small cap companies should be covered securities. I
20 expressed some concern at that time.

21 Since that time, I believe on November 17th, Steve
22 called me and also e-mailed me some thoughts and suggestions
23 and proposal regarding the small cap be included either as to
24 cover securities or I believe the SEC could just change the
25 definition and make them exempt securities very similar to

1 the NMS securities.

2 Backtracking real quick, there's approximately
3 2,650 securities that are on the NMS market, which are now
4 exempt, and there's 578 companies that are listed on the
5 small cap.

6 After Steve's letter, he also suggested or he made
7 mention in his phone call that there was a meeting with
8 NASDAQ and I'm not sure if Steve was at that meeting, but
9 there was a couple state securities people at that meeting.

10 NASDAQ expressed their proposal to them, and the
11 state people basically more or less bought into that may be
12 small caps with the change that is taking place on the NMS
13 and NASDAQ, that the small cap companies possibly should be
14 treated the same as the NMS

15 A couple of the states presented this in a phone
16 call to the NASAA board of directors. They took it under
17 advisement. They had no objections. And that will probably
18 be discussed sometime later on.

19 When I opened the document on our committee meeting
20 on December 7th, I noticed that, under 5(d), next to the
21 NASDAQ small cap stocks were the OTC bulletin board stocks
22 listed. That is my concern.

23 There are basically over 3,300 over-the-counter
24 bulletin board stocks. Some of those companies are very fine
25 companies, some are not.

1 OTC bulletin boards are only a quotation medium for
2 subscribing members only.

3 There are no listing standards or requirements, and
4 there are no corporate governance standards available, so
5 basically they're companies that buy their way onto this
6 market, and that is it, and I do not believe that they should
7 be given the same treatment as the NASDAQ small cap markets.

8 So my proposal is, if we're going to vote on this
9 when we come to 5(d), I would either recommend that we
10 eliminate the second half on the OTC bulletin board or vote
11 on them as separate issues.

12 CHAIRMAN WANDER: Thank you Jack

13 MR. HERSTEIN: And one other item here.

14 CHAIRMAN WANDER: Oh, sure.

15 MR. HERSTEIN: Yeah. Something that didn't make
16 the list, under capital formation issues.

17 I would like to recommend and this is under the
18 chairman's or the subcommittee's advisement, I would
19 recommend that both Rule 505 under Reg D, Regulation D, and
20 Regulation A, both be the amount of money that can be raised
21 in a 12-month period now set at \$5 million.

22 I know Richie has mentioned before that nobody uses
23 Reg A for various reasons, so I would suggest that we raise
24 that issue, that total dollar amount, and also 505 at the
25 same time, bump it up from \$5 million to \$10 million in a

1 12-month period.

2 CHAIRMAN WANDER: Anything else, Jack? Thank you
3 very much.

4 Rick?

5 MR. BROUNSTEIN: I didn't have a comment until the
6 last one.

7 My comment would be on the recommendation that I
8 agree with on the OTCBB, you need to tie it into everything
9 else going on.

10 So in other words if we pass the entirety of what
11 we're talking about here, then there are going to be
12 corporate governance standards for the OTCBB.

13 MR. HERSTEIN: Right, but it has to be tied in with
14 everything else.

15 I mean, there can't be a stand-alone over here and
16 the other subcommittees do nothing.

17 So basically I see the format, all the other
18 subcommittees, OTCBB would have to have the corporate
19 governance standards, would have to basically be different
20 now than on NASDAQ, and the last thing that would happen,
21 they would get covered securities treatment.

22 Am I correct? You don't put the chicken before the
23 egg.

24 MR. BROUNSTEIN: I guess I think it's all going to
25 be part of the same drafting process, but, you know, it's a

1 good point. If we decided to not do one, then it impacts
2 looking at the exemption for the other.

3 MR. CONNOLLY: There's got to be a blended
4 recommendation.

5 CHAIRMAN WANDER: I understand both Jack and Rick's
6 response, and I think probably we will have to make sure that
7 we follow that to make sure that it works out in the
8 drafting.

9 And unfortunately for you, Jack, you don't have a
10 vote. You're an observer. But we will make sure that we
11 follow that, because I think it was a good point, and I think
12 there is support for that.

13 Richie?

14 MR. LEISNER: Just speaking individually, I don't
15 have any objection to splitting that proposal into two
16 pieces. I think that that's for voting purposes.

17 But I would just want to point out to everybody
18 that when the concept of a covered security was adopted, the
19 bulletin board did not have the regulation on it that it has
20 today.

21 The bulletin board at that time did not require the
22 companies to be 34 Act registered, which they are now, and
23 have for a number of years since 1999, have been required to
24 do, so that's a pretty dramatic change in the quality of
25 information that is provided.

1 CHAIRMAN WANDER: So you're all aware of this, the
2 OTCBB, you have to be 34 Act registered, which means you
3 supply people with 10-Ks, 10-Qs, proxy statements, Section
4 16, current reports on form 8-K.

5 However, there are no listing standards, such as
6 the majority of independent directors, et cetera, which is --
7 and market cap -- and all of the independence rules, the
8 voting on stock options, for example, all of those things.

9 So that's the difference we're talking about.

10 MR. LEISNER: I guess the point I really was making
11 is that in 1996, when the law was passed, the NASDAQ didn't
12 have those rules, either.

13 CHAIRMAN WANDER: No, that's true. That's 1996,
14 and today is almost 10 years later.

15 Janet.

16 MS. DOLAN: For those of us that don't work in this
17 every day, I just want to know, I mean, is removing this bar
18 to decide if, you know only Bill Gates and Donald Trump get
19 to have access to these great investments?

20 I mean, is there some framework? I mean, is there
21 some framework you would link this to, like, you know
22 X percentage of the population, I mean, or do you just try to
23 move it way up and then say we'll grow into it and 10 years
24 from now we'll change it again?

25 I mean, for the rest of us, what's a framework that

1 we could decide whether it should be here or farther up?

2 MR. CONNOLLY: Janet, thank you for colorfully
3 posing my concern, as well.

4 The issue is very simply, from a regulator,
5 investor protection standpoint, they are the folks who have
6 the stop sign saying, you know, not only should you stop,
7 look, and listen, but you are not allowed to be here.

8 So my concern as someone who has done capital
9 formation professionally most of my life and someone who is
10 hoping to stay in that arena competitively is that the only
11 way that I would embrace some part of Jack's recommendation,
12 and I doubt it would be \$1 million annual income, because,
13 you know, there may be a couple guys in the room, but it's
14 not me, would be that if we tripled the non-accredited
15 investor exemption -- typically, you can do it for 35 or
16 fewer offerees -- I know that if -- I'm in the middle of
17 trying to do a \$5 million private placement raise right now
18 with an underwriter, private placement agent.

19 And I know that if I can only show and enroll
20 accredited investors under the current definition, I am
21 precluding doing that offering quickly and I'm precluding
22 allowing folks who are neither wealthy private equity funds,
23 hedge funds, well-endowed super purchasers to have access to
24 what I consider to be one of the finest early stage
25 investments out there. And I'm certain that they're across

1 the board.

2 If we don't let people into the game for the best
3 deals at the earliest stages because we're afraid that they
4 could lose money, all of the anti-fraud provisions still
5 exist, there are no other reasons, other than some
6 perception, and I'm not in any way assaulting this, because,
7 you know what? Jack is a cop.

8 Jack is -- and police and law enforcement people
9 every day see the bad. There is no I don't think recognition
10 that of every public company that Jack, or investment
11 prosecution that his division happens to engage in, they're
12 not seeing the 20, 30, 50, or 80 proportionately that are
13 going about their business and returning investor returns.

14 So it is right and proper for him to focus on the
15 concern, but I think that the Bill Gates outsized opportunity
16 keeps far too many people out of the market.

17 CHAIRMAN WANDER: Let me try just a slightly way.

18 What we're talking about is the registration
19 requirements under the 33 Act. In other words --

20 MS. DOLAN: I understand that. I just want to know
21 what rational --

22 CHAIRMAN WANDER: Let me -- the Supreme Court has
23 held that the private offering exemption from the
24 registration requirements shouldn't apply to those people who
25 don't need the protection that registration would provide.

1 And so when the SEC adopted Regulation D, there was
2 a forerunner to it prior to that time. This was a surrogate.

3 There are eight categories of buyers that sort of
4 by definition are able to fend for themselves under the
5 Supreme Court's definition.

6 And Jack is absolutely correct that the amount of
7 money, the income, 200,000, 300,000 joint income were
8 selected 10, 15 years ago, and as we see with the SEC
9 regulations, they don't tend to get updated to reflect what's
10 happening in the economy.

11 There are a couple of other places in the
12 securities laws where numbers like that appear.

13 One is, can you invest in, in effect, an investment
14 company and not become a registered investment company, which
15 is a much higher amount that you would have to invest in, and
16 I suspect that the selection here was done based on some
17 analysis of what an appropriate level would be, and as you
18 hear, Jack thinks it's too low, and Drew thinks it's too
19 high.

20 MR. CONNOLLY: But Herb, I must just quickly say it
21 is not necessarily true that Jack and his 49 compatriots
22 don't have a vote, because were these recommendations to be
23 embraced by the commission, clearly as they're implemented
24 state by state, they're going to have an outside --

25 CHAIRMAN WANDER: Absolutely, and that's why I said

1 we're going to keep that on the agenda, because I think it is
2 important.

3 Rick.

4 MR. BROUNSTEIN: Rick Brounstein.

5 Just I think maybe this can all be a subject as we
6 get into drafting, but to me, we got to look at the intended
7 consequences of our proposals in their entirety.

8 I mean, I look at the PIPE discussion and it needs
9 more broadening. When you look at a PIPE and you say it's
10 unregistered, it's unregistered for a very short time.

11 If you look at the OTC argument we're having, to me
12 we should have the pink sheets in there.

13 We're turning around and we're going to say, you
14 know, everybody who is in our reporting system, so you don't
15 have enough -- if you have too many shareholders, you're
16 going to report.

17 You're going to have Ks, you're going to have Qs,
18 you're going to have independent audit committees.

19 We've raised the standards so that there's a lot of
20 transparency out there. We need to look at some of these
21 areas here that you're discussing and make sure that that
22 transparency, you know, gets with it the benefits that it
23 deserves.

24 CHAIRMAN WANDER: Okay.

25 MR. HERSTEIN: If I can answer Janet's question

1 very quickly about the bar high.

2 I mean, it's arbitrary numbers, but I would like to
3 see the bar raised higher just because once it's basically
4 into law, very seldom do they get raised after that.

5 CHAIRMAN WANDER: Leroy?

6 MR. DENNIS: I'd just like to ask the committee,
7 based on Jack's comments, did you look at -- explore the
8 definition of accredited investor and what discussions did
9 you have around that?

10 MR. COOLIDGE: Not really.

11 The levels that were set in Recommendation Number 1
12 were clearly keyed off of the accredited investor.

13 It was trying to make it a higher bar, higher
14 standard, but we didn't talk about adjusting the accredited
15 investor standards.

16 CHAIRMAN WANDER: I think to be fair, there hasn't
17 been a lot of difficulty in applying Regulation D, at least
18 that I'm aware of. I don't know if any of the other lawyers
19 or professionals have had that problem.

20 What I'd like to do now is break for lunch. When
21 we come back, let me give you my suggestion, which we can
22 discuss when we get back.

23 We're going to reverse the order of the voting on
24 the recommendations, and accept for Janet's recommendations,
25 which I think we probably should vote recommendation by

1 recommendation on, I think that would be the fairest.

2 The other subcommittees we could vote on either as
3 a package or if someone wants to discuss or debate one point
4 or vote on it so that they could actually have a negative
5 vote or an abstention on an issue we will accommodate them.

6 So what we'll do is say, for example, all of your
7 subcommittee recommendations will be there unless some are
8 voted on as one by the whole committee, unless someone likes
9 to separate one of the issues which we would then vote on
10 separately.

11 Steve?

12 MR. BOCHNER: Can I just ask? And when we vote to
13 approve a preliminary recommendation, we're voting to
14 authorize the subcommittee to move forward in taking that and
15 turning it into a final recommendation, so we're not
16 really -- I'm interested in what your view is of the import
17 of a vote.

18 CHAIRMAN WANDER: That's a good point.

19 For example, I would suggest on the question of how
20 you're going to scale the number of shareholders and the
21 dollar amount that we frankly leave that blank because you've
22 asked that, and so we should leave that blank.

23 And then what we're going to do is vote on it. If
24 it's passed, you will, working with the staff, start
25 preparing the formal recommendations in a report, and we have

1 a couple of reports around the room, so people can look at
2 what these reports look like.

3 And then we will bring the whole report with the
4 recommendations back to the subcommittee at our next -- I
5 mean to the whole committee at our next meeting at which time
6 we can debate any one of those issues again and approve them
7 finally and then they'll be out for public exposure.

8 MR. BOCHNER: Kind of directional concurrence, as
9 opposed to --

10 CHAIRMAN WANDER: Yes. I am sure we're going to
11 make changes from here on.

12 I think the areas are complex enough and we're
13 still learning that that would be appropriate.

14 So it's now 10 to 1:00.

15 Two o'clock, and we'll meet from 2:00 to 4:00 and I
16 thank all of you for your patience. We didn't have a break,
17 but I think we worked through this in a very efficient
18 manner.

19 (Whereupon, at 12:55 p.m., a lunch
20 recess was taken until 2:09 p.m.)

21 CHAIRMAN WANDER: Let's see. We are missing Dave,
22 Richie, Ted.

23 Before we go to the voting, let me reconvene the
24 meeting.

25 And I think we should discuss our next meeting

1 date, which, Gerry, is now scheduled for -- the master
2 schedule before amended is down as January 9th, the sixth
3 meeting, to consider the draft final report.

4 We think that's pushing too much, and so the date
5 that we penciled in is January 23rd, if I'm correct, and
6 gives us an extra 12, 13 days to get the report in shape for
7 everybody to review before we meet.

8 Is that agreeable for everybody, or as many of you
9 as possible? Yeah, it would be in D.C. again. The 23rd?

10 MR. DENNIS: Herb, the 9th is then canceled, then?

11 CHAIRMAN WANDER: Yes.

12 MR. SCHACHT: I can't be here on the 23rd. What
13 will happen on the 23rd?

14 CHAIRMAN WANDER: We'll approve the report in its
15 form to be submitted as a public exposure document.

16 MR. CONNOLLY: I don't recall, are there proxies
17 for things like that?

18 CHAIRMAN WANDER: No, but you could be on the
19 phone. Is that helpful to you, Kurt?

20 I'm sorry we had to change the schedule, but there
21 was just no other way of doing it.

22 MR. SCHACHT: So there will be voting by phone?

23 CHAIRMAN WANDER: Yes.

24 Is that the date we selected? Is that Martin
25 Luther King Day? Okay. Because that's a national holiday.

1 Okay, so for those who just joined us, we are
2 canceling the January 9th meeting and our next meeting will
3 be January 23rd, here in Washington.

4 We will then at that time have a draft of the
5 recommendations and report, will review that, vote on it
6 again, make any last-minute changes, and then that will go
7 out for public exposure, so that we can again continue our
8 fact-finding, and then meet again to finalize the report.

9 So is that clear with everyone?

10 Okay.

11 Anything else on the dates, time, schedule?

12 MR. BROUNSTEIN: The same preliminary redo of the
13 master had a new date in March. Should we look at that, as
14 well, right now?

15 CHAIRMAN WANDER: Yeah. What's the date?

16 MR. BROUNSTEIN: I think it's the 31st and I think
17 it was the 20th.

18 MR. LAPORTE: Yea, March 20th, and I think it's
19 been changed to the -- suggested changed to the 31st.

20 MR. BROUNSTEIN: Yeah. I mean, I have -- your
21 revised master had it on the 31st, and my old book has the
22 20th. The 31st is a Friday.

23 CHAIRMAN WANDER: Is a Friday?

24 Yes, okay. So January 23rd and March 31st.

25 MR. LAPORTE: Subject to the fact of whether we can

1 get this room.

2 CHAIRMAN WANDER: I'm sorry. What are the dates?
3 January 23rd?

4 MR. LAPORTE: Right, and we're tentatively
5 scheduling for March the 31st.

6 CHAIRMAN WANDER: March 31st.

7 MR. LAPORTE: Conditioned on our being able to get
8 this room.

9 CHAIRMAN WANDER: Well, can we get another room?

10 MR. LAPORTE: Or we can get another room, right.

11 CHAIRMAN WANDER: All right. Two other items
12 before we move on to vote.

13 One of those is that you all have at your places a
14 letter Senator Enzi sent to Chairman Cox on December 12th,
15 which the Chairman has suggested we distribute to everybody.

16 It's asking that the Commission give I guess due
17 consideration to our recommendations, and it's a very
18 favorable letter to the work of our advisory committee.

19 Secondly, you have at your place the final report
20 from the November meeting of the SEC's annual business --
21 government-business forum on small business capital
22 formation, so that you can look at that and indeed when we're
23 preparing our report, we will have that information available
24 to us.

25 MR. CONNOLLY: Will it be appended as part of our

1 report?

2 CHAIRMAN WANDER: I don't think so, but if you'd
3 like to do that, when we get the report, you can mention
4 that.

5 We're now going to vote and we're going to do it in
6 reverse order. Capital formation recommendations.

7 And the way I see this, we could vote on all of
8 them, but you have taken out 5(b), which you're going to talk
9 to Drew about for possibly putting it back in with
10 qualifications, and as I understand it, we're going to vote
11 on 5(c) as two items, one to make available -- no, I'm sorry,
12 5(d), yes, excuse me -- make NASDAQ small cap stocks as one,
13 as a covered security, and secondly, as a subset of that, a
14 separate item, make OTCBB listed stocks covered securities.

15 Yes.

16 MR. DENNIS: Herb, just on 5(d), the second
17 amendment with the OTCBB, I think that was also contingent
18 upon the corporate governance standards passing?

19 CHAIRMAN WANDER: Yes. Yes.

20 We'll all get to look at that one again, because
21 we're going to have to make sure they do actually dovetail.

22 Is there anyone who wants to separate any of these
23 issues, or can we vote on them as one item?

24 (No response.)

25 CHAIRMAN WANDER: Okay. Is there a motion to

1 approve the capital formation subcommittee recommendations?

2 M O T I O N

3 MR. DAVERN: I'll move it.

4 MR. LAMBERT: Second.

5 CHAIRMAN WANDER: Second.

6 Any further discussion?

7 (No response.)

8 CHAIRMAN WANDER: All in favor, raise hands, I
9 guess.

10 (A show of hands.)

11 CHAIRMAN WANDER: Any against or any abstentions?

12 (No response.)

13 CHAIRMAN WANDER: Okay, terrific. We might get out
14 of here early, beat the snow in Chicago.

15 MR. BOCHNER: Herb, do you think the -- I just want
16 to say to Leroy's comment, the work we're doing with respect
17 to certain governance requirements that we would, that's the
18 same type of governance listing standards that was, or should
19 not -- may not necessarily be the same type of standards that
20 one would want to get the kind of relief that we're talking
21 about in this other context for covered securities.

22 So I guess I would suggest maybe some more work and
23 thinking ought to be done about because I don't believe the
24 SEC actually has the authority, unless they're listing
25 standards, for the OTCBB to make them covered securities.

1 I mean, Gerry and Kevin can check on that for us,
2 but I think there's a problem in making those covered
3 securities without listing standards, and I don't think what
4 we're doing would be listing standards.

5 So I just think somebody needs to do some more
6 thinking about that.

7 CHAIRMAN WANDER: Okay. I think that's a good
8 point.

9 We don't have the handle of getting the relief
10 under 404.

11 All right, good. We're off to a good start.

12 The next one is Leroy's accounting standards
13 recommendations.

14 Is there anyone here who would like to separate out
15 and vote separately on any one of the issues?

16 (No response.)

17 CHAIRMAN WANDER: If not, is there a motion to
18 approve those?

19 M O T I O N

20 MR. CONNOLLY: So moved.

21 CHAIRMAN WANDER: Second?

22 MR. DAVERN: Second.

23 CHAIRMAN WANDER: Further discussion?

24 (No response.)

25 CHAIRMAN WANDER: If not, all in favor raise your

1 hand.

2 (A show of hands.)

3 CHAIRMAN WANDER: Any no votes or any abstentions?

4 (No response.)

5 CHAIRMAN WANDER: None. Oh, I'm sorry. Oh, they
6 just left their hands up.

7 The next item is corporate governance disclosure
8 recommendations.

9 Is there anyone who wants to separate any one of
10 the items?

11 Yes, Leroy.

12 MR. DENNIS: This is Leroy.

13 Herb, I'd like to separate the considerations
14 around the stock options, and then as far as the -- I don't
15 know how you're going to word the recommendation, Steve, on
16 the 300, 750 shareholders of record in there recommendation.

17 MR. BOCHNER: Maybe as Herb said earlier that we'd
18 put a number of security holders to be determined as
19 additional data is obtained, if that --

20 CHAIRMAN WANDER: Well all have a chance to vote on
21 it again at the next meeting.

22 MR. CONNOLLY: Before the vote, Herb, one other
23 question.

24 In terms of the potential collapsing of the S-B
25 regimen into, you know, S-K, is that -- the wording of the

1 recommendation says that we're going to ask the Commission to
2 evaluate.

3 Is there any way that prior to a final drafting of
4 this recommendation we can request feedback from Corporate
5 Finance or somebody within the organization to see whether or
6 not this is feasible?

7 I mean, we know loosely the number of S-B filers,
8 but we don't know the position of the Commission on this.
9 There's some controversy out there, that's all.

10 CHAIRMAN WANDER: I think we can, but I think we
11 could also, between now and when the report is written up,
12 also get a better fix ourselves on which of the existing S-B
13 regulations we would like to include in S-K to be applicable
14 to microcap companies. Okay?

15 So that we don't just throw the ball against the
16 wall for the SEC, we give them a little more direction.

17 Yeah, Kurt.

18 MR. SCHACHT: I have one question, Herb. Kurt
19 Schacht.

20 On your second dot point, that's the one that's
21 dealing with the corporate governance enhancements, and what
22 happens if exemption doesn't fly for smaller companies? Are
23 you still recommending -- so instead we go with a better
24 implementation of Section 404 as the alternative
25 recommendation. Would we still be requiring the corporate

1 governance enhancements?

2 MR. BOCHNER: You mean if the SEC, if we either
3 don't recommend the 404 exemption or the SEC doesn't accept
4 that recommendation would we be imposing these? We have not
5 talked about doing that. We've talked about it as something
6 that would be imposed if the 404 exemption relief is
7 provided.

8 But it does dovetail with this concept of the
9 listing standards that was previously discussed.

10 CHAIRMAN WANDER: Any other questions? We're going
11 to vote on everything but the stock option issue.

12 (No response.)

13 CHAIRMAN WANDER: Is there a motion?

14 MR. DENNIS: Move it.

15 CHAIRMAN WANDER: Second?

16 MS. CAFFERTY: I second it.

17 CHAIRMAN WANDER: Second.

18 Any further discussion?

19 (No response.)

20 CHAIRMAN WANDER: If not, all in favor say aye, or
21 raise your hands.

22 (A show of hands.)

23 CHAIRMAN WANDER: Any negative votes?

24 (No response.)

25 CHAIRMAN WANDER: Any abstentions?

1 (No response.)

2 CHAIRMAN WANDER: Now, we'll vote on the stock
3 options. Does someone want to move that aspect of the
4 report?

5 MR. DENNIS: Could somebody just recap the issue
6 again, please?

7 CHAIRMAN WANDER: It's that, as I understand it,
8 that holders of options, whether vested or unvested, are not
9 counted as shareholders for determination of whether you have
10 to register under the 34 Act.

11 Did I say it right, Steve?

12 MR. BOCHNER: Yes.

13 CHAIRMAN WANDER: And Leroy has raised an issue
14 that he believes that anyone who does have a vested option
15 really is always making an investment decision and therefore
16 he would count them.

17 MR. DENNIS: Yeah.

18 MR. BOCHNER: Do you want me to respond to that, or
19 should we just go to the vote?

20 CHAIRMAN WANDER: I'd go to the vote, but John, you
21 hadn't said anything.

22 MR. VEIHMEYER: Actually, I was just going to ask,
23 Steve, I think when Leroy asked that question, he asked two
24 questions, and you got to the first one, and I'd be
25 interested actually in how the committee evaluated the issue

1 that Leroy asked about to help me before I voted, because I
2 think it is a legitimate question, and I'd like to understand
3 just the rationale of the committee.

4 MR. BOCHNER: Sure, be happy to, and then I'll ask
5 my subcommittee members to jump in.

6 So we -- my thinking on the topic and my bringing
7 it before the subcommittee, and I think their thinking on the
8 topic was helped along by Rule 701, which is an area where
9 the SEC has said in a rule that, as long as options are
10 issued in a compensatory transaction subject to certain
11 limits that we're actually proposing to raise here, the
12 capital formation subcommittee is proposing to raise, that
13 there's an exemption from registration provided under the 33
14 Act because in that compensatory context the protections of
15 the 33 Act aren't necessary, or may be outweighed by the need
16 to grant those exemptions.

17 And indeed, you know, in the pre-701 era, companies
18 had a hard time granting options under the private placement
19 exemption.

20 It was a real problem, because you had to give
21 options, but you couldn't, because you didn't meet the
22 private placement exemption, so your alternatives were to,
23 you know, not hire employees or start filing, so it just was
24 not a tenable situation.

25 701 solved that, and I feel like we're dealing with

1 a little bit of the same problem again.

2 And so I think what Leroy says has merit. In other
3 words, would it be better for an optionee to have more
4 information than less in deciding when the whether to
5 exercise yes.

6 The problem we're trying to deal with is where a
7 small company is growing, gets to, you know, 300, 400, 500
8 employees, grants options to those employees, maybe has done
9 three rounds of financing, and now all of a sudden, if you
10 include the optionees, guess what? We got to either stop
11 granting options or go public.

12 And it seemed to us that in weighing those
13 competing interests, that if you specified that they must be
14 in a compensatory transaction, they must be unexercised, and
15 we could also add, and I just thought of this today when I
16 read the capital formation subcommittee's recommendation, but
17 we could throw in a net exercise requirement to not be
18 counted, meaning that the optionee wouldn't -- could have
19 the -- I won't use the word option -- the alternative to pay,
20 instead of paying cash, to use the appreciated value of the
21 stock to exercise so they're not actually out of pocket.

22 So that could be something we could also consider.

23 But that's the -- that was our rationale.

24 MR. SCHACHT: Just one quick question. This is
25 Kurt.

1 When do they go into the calculation for
2 compensation expense, upon grant or upon vesting?

3 MR. BOCHNER: On grant.

4 MR. SCHACHT: Grant.

5 MR. DENNIS: And Herb, I'd like to maybe hear from
6 also Rick and Alex and Pat, who maybe are more in the field
7 with some of this stuff than I am, as to what their opinions
8 are on this.

9 MR. BOCHNER: I think Ted might, you know, because
10 a venture capitalist, I think he sees a lot of these things,
11 too.

12 MR. SCHLEIN: Ted Schlein.

13 Steve's definition and the way he's looking at it
14 is very similar to how in the venture world we would look at
15 this and determine who is really a holder and who's not a
16 holder.

17 But I also would jump back. If somebody wants to
18 remove the stock option expensing from comp, I'm ready to --
19 you opened the door, but I'm right there behind you.

20 MR. DAVERN: Alex Davern here.

21 I would strongly support this provision.

22 Having worked at a company where we stopped issuing
23 options specifically because of this exact rule, which was
24 not a good thing for our business or our shareholders, I
25 would strongly support this provision personally.

1 CHAIRMAN WANDER: Anybody else? Pat?

2 Pat said he had the same comment.

3 Leroy, anything further?

4 MR. DENNIS: No.

5 CHAIRMAN WANDER: Okay. Now, we're going to vote
6 on whether to accept this recommendation from the corporate
7 governance and disclosure subcommittee dealing with stock
8 options.

9 Is there a motion to approve that?

10 M O T I O N

11 MR. JAFFEE: I'll move it.

12 CHAIRMAN WANDER: A second?

13 MR. LEISNER: Second.

14 CHAIRMAN WANDER: Yes, Richie.

15 All in favor, raise your hands.

16 (A show of hands.)

17 CHAIRMAN WANDER: Opposed?

18 (A show of hands.)

19 CHAIRMAN WANDER: Two.

20 Any abstentions?

21 (No response.)

22 CHAIRMAN WANDER: For the record, Kurt and Leroy
23 were the negative votes. Okay.

24 MR. ROBOTTI: Herb, on that vote, the capital
25 formation subcommittee had eight recommendations. The eight

1 recommendation deals with the same topic, doesn't it?

2 CHAIRMAN WANDER: But it's slightly different.

3 MR. ROBOTTI: Okay. But we've kind of authorized
4 another subcommittee's report that kind of endorses a similar
5 concept to approach the same issue, though.

6 CHAIRMAN WANDER: Yeah, but I think their approach
7 was not dealing with the 34 Act registration, if I recall.
8 It dealt with the amount of --

9 MR. ROBOTTI: No, they snuck it in there, Herb. It
10 is in there. So Leroy already voted for it.

11 MR. BOCHNER: I think it also --

12 MR. DENNIS: You're right, Bob, and I wouldn't be
13 opposed to, you know, increasing the limit of the number of
14 shareholders.

15 I just personally believe they're shareholders,
16 and, you know, do I exempt a penny stock shareholder or
17 somebody that buys it for a buck a share? No, I think
18 they're the same.

19 CHAIRMAN WANDER: Okay, let's move on.

20 We are now to --

21 MR. CONNOLLY: Do we give the right to object if --

22 CHAIRMAN WANDER: No, no. We voted.

23 If this was a really important issue, I might
24 consider it.

25 We're now down to internal control over financial

1 reporting recommendations, and there are five
2 recommendations, correct, Janet?

3 MS. DOLAN: Yes.

4 CHAIRMAN WANDER: And I think the best approach
5 here, since I know we will have some negative votes, is to
6 vote on each item separately and in order.

7 So the first item is obviously Recommendation
8 Number 1.

9 M O T I O N

10 MR. LAMBERT: I move.

11 CHAIRMAN WANDER: Is there a second?

12 MR. VEIHMEYER: Second.

13 CHAIRMAN WANDER: There is a second.

14 Any further comment, discussion, questions?

15 (No response.)

16 CHAIRMAN WANDER: If not, all in favor of
17 Recommendation 1 raise your hands.

18 (A show of hands.)

19 CHAIRMAN WANDER: All right, opposed is Kurt.

20 (A show of hands.)

21 CHAIRMAN WANDER: Okay. One opposed.

22 Any abstentions?

23 (No response.)

24 CHAIRMAN WANDER: All right.

25 So Recommendation 2 is the exemption for smaller

1 public companies.

2 Is there a motion to approve that?

3 M O T I O N

4 MR. DAVERN: Move.

5 CHAIRMAN WANDER: Alec. Second?

6 MR. LEISNER: Second.

7 CHAIRMAN WANDER: Ted.

8 Any further discussion?

9 (No response.)

10 CHAIRMAN WANDER: If not, all in favor raise your
11 hands.

12 (A show of hands.)

13 CHAIRMAN WANDER: Okay. It's everyone. And
14 negative votes, Kurt.

15 (A show of hands.)

16 CHAIRMAN WANDER: Any abstentions?

17 (No response.)

18 CHAIRMAN WANDER: Recommendation Number 3 dealing
19 with if 1 and 2 fail or if 2 fails, essentially, what the
20 committee is recommending.

21 Motion to approve that?

22 M O T I O N

23 MR. BOCHNER: Move.

24 CHAIRMAN WANDER: Alex.

25 MS. DOLAN: Second.

1 CHAIRMAN WANDER: Janet, you can second it.

2 Yes?

3 Actually, you should get the motion on the floor so
4 that you can --

5 MR. JENSEN: The motion is on the floor, so now we
6 can talk about it.

7 The -- and I had previously signaled this to the
8 group here.

9 A concern I've got is there is debate in the
10 accounting profession right now as to the merit of another
11 standard, and I think that that debate needs to occur, so I'm
12 not trying to stop the debate.

13 On the other hand, being a member of that
14 profession, although I voted previously for this, at this
15 point I'm going to abstain from voting on it, and I just kind
16 of wanted everybody to understand why.

17 And that is I think that the debate in the public
18 accounting firms and in the profession needs to take place as
19 to the merit of having yet another standard out there. I
20 think there are a lot of things to consider.

21 My concern with AS2, as it was -- as we went
22 through the process originally was that a lot of the comments
23 from the profession, the people who had to deliver those
24 reports, certainly everybody had an opportunity to comment on
25 them, but I think it was pushed through so quickly and so

1 rapidly, I think that the providers of these kinds of reports
2 need an opportunity to let the technical aspects of this be
3 ironed out as well as the practical aspects in terms of their
4 own risk, what they're willing to take on and what they're
5 not willing to take on.

6 So for that reason, at this point, I'm neither
7 going to vote no or yes, but abstain from the vote, and I
8 just wanted everybody to know why.

9 MR. JAFFEE: Herb, can I ask a question?

10 These recommendations that we make, the commission
11 will what? What will they do with them? They will accept
12 them, they will modify them, or they will do nothing, or do
13 we know?

14 CHAIRMAN WANDER: They will take them under
15 consideration, and hopefully someday there will be a release
16 out proposing what we recommend, or to a large extent what we
17 recommend.

18 But they do not do anything formal with them unless
19 they decide to propose some rules.

20 MR. JAFFEE: Because what I was going to suggest is
21 that this Number 3 sort of says we recommend 2, but if you
22 don't like 2, here we got 3, and what I was going to ask is,
23 could we set up some kind of a process or format where after
24 a certain period of time if nothing has happened, we have the
25 opportunity of coming back with a fallback on anything?

1 CHAIRMAN WANDER: I'd like that, but we sunset,
2 unfortunately, next April.

3 MR. CONNOLLY: Actually, as a followup to that, but
4 different -- a followup to that, but different is, is there
5 any way we could go on, formally go on record as suggesting
6 that anybody within the SEC who would have the ear of one or
7 more of the commissioners seeing the work product that we
8 draft today and vote today to adopt and it likely will end up
9 through the final work product could jump the gun, to borrow
10 an SEC expression, gun jumping, and adopt and vote on and
11 implement some of these recommendations prior to being
12 finally delivered the work product?

13 CHAIRMAN WANDER: Well, I think that's already in
14 motion, and for example, the SEC put out a release last week
15 or two weeks ago really taking one of Steve's recommendations
16 dealing with the dissemination of proxy statements.

17 So I don't think we need any formal statement.

18 Janet?

19 MS. DOLAN: I just wanted to respond to Dick,
20 because I thought your question might be going down just a
21 slightly different bent, which is that, do we dilute the
22 power of, you know, of 1 and 2, particularly 2, by having an
23 alternative?

24 And we debated this. We said, well, maybe we
25 should put what came to be Recommendation 3, maybe it should

1 be in a footnote or maybe it should be an appendix.

2 And we actually came down on the other side, which
3 is we are so committed to providing relief for those that we
4 think really desperately need relief that we put them both in
5 to say, if you don't do 1, if you're just not willing, for
6 whatever reasons, to exempt, then we urge you to do
7 Recommendation 3, so we don't run into the situation where
8 they just don't want to exempt and then nothing gets done.

9 So we took the other side of it, which is to say
10 just how strongly we feel about this was to put both
11 alternatives and say you have to do something.

12 We think there certainly should be the political
13 will and everything else to do an exemption, but if not, you
14 just can't walk away. Then you have to address the other
15 alternative.

16 So that's why we did it that way.

17 CHAIRMAN WANDER: And also partly to really take
18 care of your situation when we're no longer in existence --

19 MR. JAFFEE: No, that makes good sense. Yeah.

20 CHAIRMAN WANDER: All right. I think we can go to
21 a vote.

22 All in favor of Recommendation 3, raise your hands.

23 (A show of hands.)

24 CHAIRMAN WANDER: Okay. Abstentions?

25 (A show of hands.)

1 CHAIRMAN WANDER: There's one, two.

2 Okay.

3 Any against?

4 (A show of hands.)

5 CHAIRMAN WANDER: Two. Ted -- I'm sorry, you're
6 right.

7 Against are Ted and John and abstentions were Pat
8 and Mark. I got that correct?

9 Okay.

10 Recommendation Number 4, which -- additional
11 guidance from COSO, the SEC, and the PCAOB.

12 Is there a motion to approve that recommendation?

13 M O T I O N

14 MR. DAVERN: So moved.

15 MS. CAFFERTY: Second.

16 CHAIRMAN WANDER: Second. All right.

17 It's open for discussion.

18 Yes, John.

19 MR. VEIHMEYER: John Veihmeyer.

20 This gets back to one of the items I commented on
21 this morning when we were discussing it.

22 I'm comfortable with everything in Recommendation 4
23 except I'm not sure how to deal with the last bullet, which
24 is not really framed as a recommendation.

25 We have a number of recommendations about different

1 bodies that we want to provide different guidance.

2 If 4 was written, for example, I mean if the last
3 bullet in 4 was written to state as a recommendation that we
4 want AS2 to be reopened and reevaluated, I think I would
5 vote no.

6 So I'm just -- I'm unclear how to vote on this
7 recommendation with the last bullet as it is, because I just
8 don't know what we're recommending with that included, to be
9 honest.

10 MS. DOLAN: Well, I want to be very precise,
11 because obviously this is getting right to the heart of a lot
12 of some very emotional issues in this effort.

13 We did not make a recommendation that AS2 be
14 amended or changed, but we felt that we could not, or we felt
15 we would be doing a disservice to the SEC if we didn't make a
16 statement that said we're not recommending a change, but we,
17 in all that we've heard, ask you to at least look at whether
18 we're going through a lot of these efforts to remediate the
19 fallout from the implementation of AS2, when in fact perhaps
20 if you look at it, you may decide there is more benefit to
21 looking at AS2 and considering whether it itself needs some
22 work as opposed to just ignoring it.

23 So we didn't have -- we did not make a
24 recommendation that yes it should be done, but we didn't want
25 to ignore what a lot of us would call the elephant in the

1 middle of the room, in terms of the whole effort that we're
2 all about here.

3 So that's as clear as I can be about why we put
4 that statement in.

5 You're not voting for a recommendation to ask that
6 AS-2 be amended, but it is a statement from our subcommittee
7 that this entire advisory committee would also be endorsing,
8 which is at least putting in front of the SEC that this is a
9 question they ought to look at.

10 MS. DOLAN: That's as clear as I can be.

11 CHAIRMAN WANDER: Okay.

12 CHAIRMAN WANDER: I would invite any other members
13 of the subcommittee who want to say anything.

14 MR. JENSEN: Let me see if it makes any sense.

15 We've -- we started down a path. We have been down
16 every, I guess to use the expression, every rathole you can
17 think of as it looked to how you might approach AS2 in a
18 smaller company environment, and I think it's important that
19 we keep this conversation framed in the smaller company
20 environment.

21 This is not an indictment of AS2 and its
22 implementation. It's not a commentary by this committee
23 about how we believe anybody has implemented it or any other
24 thing. And I think sometimes in the debate we all forget
25 that.

1 What we're really talking about are the smallest of
2 the small.

3 We're talking about companies who are having
4 difficulties financially affording the implementation of 404,
5 having difficulties obtaining resources to comply with AS2.

6 You know, we've tried to lay out some logical
7 patterns of what we thought could be a solution here that
8 would allow companies to thoughtfully and affordably comply
9 with the law.

10 If you really walk down the logic trail, ultimately
11 it gets to the point where at some point, if there is no new
12 standard that comes out, if there is no relief or exemption
13 given to those companies, then I think someone really does
14 need to sit down and take a look at the applicability of the
15 standard as it relates to smaller companies.

16 And I think that that is something we've emphasized
17 all along, and that's our charter, and sometimes gets
18 forgotten.

19 As it relates to that population of companies only,
20 then maybe something should be looked at.

21 If, in fact, it was determined that there are
22 things in AS-2 that are driving behaviors of both companies
23 and auditors too, an ineffective approach and an overly
24 cautious or overly expensive approach. I think that's what
25 this recommendation is trying to get to.

1 It might need some more words around that, too,
2 because I do worry, you know, when you say it like this, it
3 basically says AS2. It doesn't say for smaller companies,
4 although that's incumbent in the recommendation.

5 But I think people can start to take this argument
6 to an illogical conclusion. We're not -- it's not a
7 commentary, not meant to be one, on the entire adoption of
8 that standard.

9 CHAIRMAN WANDER: Yes, John.

10 MR. VEIHMEYER: I appreciate that.

11 Janet and Mark, I'm just being real honest with
12 you. I'm struggling with -- I want to support this
13 recommendation. I'm struggling with the way this is drafted
14 right now.

15 It's not in the form of a recommendation that you
16 could either say yea or nay for, and yet it seems to imply
17 that maybe there's -- it's not drafted as a recommendation,
18 but I think if you wanted to come back afterwards and look at
19 it, I think you could interpret that, and the subcommittee
20 was recommending that the SEC go down this path of reopening.

21 So I'm just trying to really clarify as much as I
22 can what the intent of the subcommittee is.

23 I would hate to vote in favor of this
24 recommendation and have a subsequent interpretation of what
25 we were voting for be that the SEC should -- and the thing

1 I'm struggling with, as I tried to clarify to day, I don't
2 think this means God handed this down and we should never
3 revisit, but the wording here that it is now time -- if -- is
4 it now time to reevaluate or amend the standard, my view is
5 now is not the time to do that, and I just want to make sure
6 I'm voting for what -- either for or against what the
7 subcommittee is intending, and I'm just asking if we could be
8 as clear as we can be in the wording of this recommendation
9 so that I can support what I think is an overall very good
10 recommendation in Number 4.

11 CHAIRMAN WANDER: Dan.

12 MR. GOELZER: Could I just make a clarifying point?

13 People might want to look at Slide 43, which
14 contains a list of what to me at least are the primary
15 problems that have been identified with respect to the
16 implementation of AS2 in the first year, and/or just directs
17 the PCAOB to correct those problems.

18 If you look at the top of Slide 44, it includes
19 possible amendments to AS2 as a way of implementing or
20 solving those problem areas.

21 I guess I'm not sure myself what the final bullet
22 on 44 adds to that discussion. I'll leave that to the voting
23 members of the committee.

24 But I think I would say that from my perspective,
25 with or without that final bullet, the PCAOB would already be

1 given some fairly specific instructions about the problems
2 that have occurred and what to do about them.

3 CHAIRMAN WANDER: Kurt.

4 MR. SCHACHT: I appreciate -- this is Kurt Schacht.
5 I appreciate the chance to take a crack at this.

6 If the fix to Section 404 is decided to be an
7 implementation fix, there are essentially three ways to do
8 that.

9 You can leave AS2 alone. Hopefully, as you go
10 through it, some additional cycles that things settle in, the
11 new guidance that's out there, that that settles in, and that
12 there's better implementation through that method.

13 There is also thinking that you would possibly
14 refine AS2 as it currently stands, to tweak it, to enhance
15 implementation.

16 And thirdly, our thinking was that there could be a
17 separate standard, an ASX, a small, tailored AS2 standard
18 for small companies.

19 So if implementation as opposed to exemption is the
20 way to go, there are a number of ways that you could get the
21 better implementation, and I'm thinking that this group
22 thought that all of them should be on the table for
23 consideration.

24 CHAIRMAN WANDER: Okay.

25 Any other questions?

1 Janet, did you --

2 MS. DOLAN: Just in the interest of trying to
3 create a process here whereby we might perhaps move forward
4 and yet let everybody vote on exactly what they feel they can
5 in good conscience vote on, we might parse this portion of it
6 and separate that last bullet and make it a separate vote,
7 but it stands on its own, and people voting for it have the
8 opportunity to say, since we are advising the SEC, while we
9 have identified some ways to fix it, we are actually putting
10 in a separate vote that says we're not telling you to redo it
11 for a small company, but you might decide on your own that it
12 is the time to look at the whole thing.

13 Anyway, I'm just trying to find a way where we
14 don't sort of like in this town an omnibus spending bill,
15 throw things in where we get disingenuous votes, and that's
16 not what we're trying to do here. We're trying to really
17 provide clarity and a real roadmap for the SEC.

18 So I don't mind separating it and letting people
19 vote and see what people are willing to vote for.

20 CHAIRMAN WANDER: Leroy, did you have a comment?

21 MR. VEIHMEYER: That would solve my dilemma.

22 MR. DENNIS: I agree with that.

23 I just, I do share John's concern as I read that.
24 I think we ought to be clear. And I'd ask whether or not,
25 you know, whether you amend any of the wording here.

1 I mean, if you're recommending that the PCAOB and
2 the SEC consider whether AS2 is appropriate for smaller
3 business, I think that's fine as a recommendation, and we can
4 vote on that.

5 I'm not sure -- I agree with John on that. I'm not
6 sure what you mean by this recommendation, and there's what I
7 struggle with.

8 So I'd ask whether or not you propose any
9 clarification of this that we vote on separately if you take
10 it to that stage.

11 MR. DAVERN: I'd support Janet's move in the
12 interest of time at this point, that we separate them and
13 vote on them, and we'll be getting lots of public comment to
14 consider as we go forward between now and our next meeting at
15 the end of January.

16 CHAIRMAN WANDER: Okay, so it's been moved and
17 seconded that we take Recommendation 4 now.

18 There's a proposal to amend it to bifurcate it, to
19 have everything but the last bullet point voted on first and
20 then the last bullet point voted on second.

21 Is that agreeable to the motion makers?

22 MS. CAFFERTY: Yes.

23 CHAIRMAN WANDER: Okay. Mark?

24 MR. JENSEN: Can I comment? I just wanted to
25 comment on that.

1 I think when you do separate it, I think it goes
2 from being a softer recommendation to a pretty hard
3 recommendation, and I would have trouble supporting it as a
4 separate recommendation, because I think it does, when it's
5 out there by itself, it looks like it's a recommendation to
6 amend AS2, and I just, I think we're going beyond at least
7 where I think we wanted to be at that point.

8 But I'm not going to object to it, but I'm just
9 telling you, I'd have a hard time supporting it as a separate
10 recommendation.

11 CHAIRMAN WANDER: Janet.

12 MS. DOLAN: Well, I was not going to make it a
13 proposal.

14 I was going to make it to be the advisory committee
15 makes the following statement to the SEC, and leave it at
16 that.

17 It is just simply a statement endorsed, if it is,
18 by the advisory committee that says you may want to consider.
19 That was it.

20 I wasn't going to turn it into a proposal, say we
21 propose that -- anyway, that was all.

22 MR. JENSEN: Well, I think the importance of it is,
23 and it's somewhat lost, and, you know, I don't know who the
24 guy was that put this power point together, but, you know, I
25 think it is in the way, you know, "You're fired," or "You're

1 off the island," or whatever.

2 But, you know, it should be under the heading of
3 ask the PCAOB to provide greater clarity and to encourage
4 greater cost effectiveness in the application of AS2.
5 That's the heading that it really is under.

6 It's not in my mind, and never was a separate
7 bullet.

8 Now, maybe it intentionally was a separate bullet
9 and I'm missing the point, but it seems to me that, because
10 it says at the heading there, you know, is to basically
11 consider all these things, you know, in implementing the
12 foregoing, and then I think the question then was when you
13 take a look at all of those things, is the only way to get to
14 those things is through an amendment to AS2 or not, which I
15 think the PCAOB has demonstrated they think there are other
16 ways to get to these kinds of amendments without actually
17 opening up AS2. Their guidance in November is an example,
18 their guidance in May.

19 And that's actually what the bullet in the middle
20 there says.

21 It says, you know -- because up above it says most
22 effectively accomplished by amendments to AS2 or other
23 things.

24 I mean, it's very open, saying, look, these are
25 things that need to be fixed, and if the only way to fix them

1 is by an amendment, then do that, but if there are other
2 ways, do that, and leaving it in their hands.

3 And I think keeping it in their hands is where it
4 rightfully belongs. They're the standard setter and they
5 should be able to do their job that way.

6 But, you know, I'm just saying if you break it out
7 separately, it looks to me like that is our recommendation,
8 and I might or might not be okay with that recommendation if
9 I knew what we were recommending would be amended, but I
10 think speaking for everybody, I think our fear is, if you
11 open this thing up, everything starts to get amended, and we
12 can't --

13 CHAIRMAN WANDER: Well, we have two divergent
14 views.

15 MS. DOLAN: And they're both from auditors.

16 CHAIRMAN WANDER: One is to vote on this as is and
17 one is to separate out the last bullet.

18 MR. DAVERN: I'd like to retract my earlier comment
19 about separating them out, and I agree with Mark, and I think
20 we should vote on them together. So I retract what I said
21 earlier.

22 MS. DOLAN: I'm on a subcommittee as well, and I
23 think we should vote on them separately.

24 CHAIRMAN WANDER: Well, why don't -- yes, John.

25 MR. VEIHMEYER: I just would again come back to,

1 typically when you have a situation like this, I think it's
2 because there's a more fundamental issue underlying it.

3 I think the fundamental issue that is highlighted
4 by the fact that we have reasonable people disagreeing on
5 this is that this, unlike everything else in the report, is
6 not really framed as a recommendation.

7 It is a comment, kind of a throwaway comment off to
8 the side, and I would just encourage -- so I don't know how
9 we do it at this point in the interest of time, but I guess
10 I'm questioning whether or not this is really like everything
11 else in your work product, is this really a recommendation
12 that anybody can actually vote yea or nay against.

13 CHAIRMAN WANDER: Well, we're going to have to
14 vote, because we have to get out. Mike Eisenberg's party is
15 going to be in this room a little later, his retirement
16 party.

17 Why don't we vote on whether we want the last
18 bullet point to be a separate point, and that's a procedural
19 vote, and then we'll vote on this substantively.

20 All right?

21 M O T I O N

22 MS. DOLAN: All right. And to accommodate John, I
23 will move it. I'm not necessarily supporting it, but I think
24 it's important to at least move it so we can -- so I'll move
25 it --

1 MR. CONNOLLY: I'll second it.

2 CHAIRMAN WANDER: So now we're voting on whether we
3 should separate the last bullet point.

4 All those in favor of separating the last bullet
5 point please raise your hand.

6 (A show of hands.)

7 CHAIRMAN WANDER: One -- one, two, three, four --
8 I'm sorry -- one, two, three, four, five, six, seven. Okay.

9 All those opposed -- I'm sorry.

10 Jim Thyen, Drew Connolly, Debbie, Janet, Rick,
11 Leroy, and John. Okay?

12 All those in favor of not separating it, please
13 raise your hands.

14 (A show of hands.)

15 CHAIRMAN WANDER: Ted, Richie, David, Alex, Mark,
16 Kurt, Pat, Bob, Steve, Pastora. How many is that? Ten.

17 So that -- I vote not to separate, but it doesn't
18 matter.

19 So now we'll vote on it as it's not going to be
20 separated.

21 We're voting on Recommendation Number 4 in its
22 totality.

23 Yes, Mark.

24 MR. JENSEN: But I do think, in the interest of
25 trying to get John over the line, is I do think this could be

1 drafted better, because in my mind, it was not intended to be
2 an amendment to AS2.

3 It was basically kind of a catch-all at the end
4 that in the foregoing, it -- if that was an approach that had
5 to be taken, that was an approach that would be taken. It's
6 not a recommendation to amend, and I think that needs to be
7 really clear.

8 But it would open it up, and frankly, what we're
9 trying to get to is the issue that was talked about earlier,
10 that when this stuff starts to get resolved, we're not going
11 to be here anymore.

12 And so it was basically trying to give somebody a
13 roadmap that said, here's what we think needs to happen, and
14 we kind of went down that path.

15 I think otherwise you strand these companies, that,
16 you know, there needs to be something that changes, and then
17 the work of the committee is done, we're not here anymore,
18 and there's no roadmap for anybody to follow.

19 That was the logic of that, and I think that bullet
20 could be better drafted to incorporate that and maybe as we
21 go through drafting it's something we could vote on again
22 later.

23 CHAIRMAN WANDER: We will vote on it and we could
24 try that. That's a good point. Leroy?
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M O T I O N

MR. DENNIS: That's what I was going to move, Herb,
and try this.

If I move that we put this recommendation on the
table with the instruction that the bullet point in question
be worked on in the next 30 days to provide better
clarification around that.

MR. CONNOLLY: Second.

CHAIRMAN WANDER: Well, that's really an amendment,
so we vote on all of 4 with the recommendation that the
language be examined and hopefully improved on in the next 30
days.

MR. DENNIS: Yeah, that's my move.

CHAIRMAN WANDER: Okay.

MR. CONNOLLY: I'll second that.

CHAIRMAN WANDER: All right. Any further
discussion?

(No response.)

CHAIRMAN WANDER: All in favor of that, please
raise your hands.

(A show of hands.)

CHAIRMAN WANDER: Any opposed?

(No response.)

CHAIRMAN WANDER: No opposition.

Any abstentions?

1 (No response.)

2 CHAIRMAN WANDER: No. Okay.

3 Recommendation Number 5.

4 Oh, Dick Jaffee was not here on the last three
5 votes.

6 Recommendation 5, special cases. Very important.
7 Needs a little more work, really. But we don't want to
8 forget it because it is important here.

9 Is there a motion in favor of Recommendation 5?

10 M O T I O N

11 MR. JENSEN: I would move that.

12 CHAIRMAN WANDER: Okay.

13 Second?

14 MR. CONNOLLY: Aye.

15 CHAIRMAN WANDER: Drew.

16 Further discussion?

17 (No response.)

18 CHAIRMAN WANDER: If not, all in favor raise your
19 hands.

20 (A show of hands.)

21 CHAIRMAN WANDER: Any opposed?

22 (No response.)

23 CHAIRMAN WANDER: Any abstentions?

24 (No response.)

25 CHAIRMAN WANDER: It's all in favor except Dick

1 Jaffee, who is not here right now.

2 Janet, thank you. Thank you to all the other
3 subcommittee chairs. I think we've had a very productive
4 day.

5 Now, the work is not done yet, and we're not at the
6 finish line.

7 We will be in touch with you about the drafting of
8 the recommendations in a report form, and remind me, please
9 to give me back my report, the earlier one, so I don't lose
10 it -- the book, yeah.

11 Any other comments and suggestions?

12 MS. DOLAN: Herb, I don't have a comment or
13 suggestion, but I was out of the room for the first two group
14 votes, and I wanted to vote in favor of them.

15 I just want to know the process whereby I do that,
16 or if maybe I just have.

17 CHAIRMAN WANDER: You just have.

18 MS. DOLAN: All right. I just want the record to
19 reflect that. Thank you.

20 CHAIRMAN WANDER: I really do think we've had a
21 very productive meeting, and one of the reasons is that I
22 think all of you have done such hard work prior to the
23 meeting.

24 There's really been a considerable amount of effort
25 and good thought and dedication to this, and that's why I

1 think we were able to get through this in I won't say record
2 time, I don't know what the record is, but with, I think with
3 thorough consideration. Everybody's views have been stated.

4 And so now we're on to the next step.

5 Any other comments? Jim?

6 (No response.)

7 CHAIRMAN WANDER: Anybody else have any other good
8 and welfare, anything to bring before the committee?

9 (No response.)

10 CHAIRMAN WANDER: If not, we're adjourned.


11 (Whereupon, at 3:00 p.m., the meeting was
12 adjourned.)

13

* * * * *

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

1/26/06
Date

Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its meetings of October 25, 2005 and December 14, 2005 and the date of receipt.

Dec. 14, 2005 Robin Rousseau, CPA

Dec. 14, 2005 Kurt Schacht, CFA

Dec. 13, 2005 Sarah A. Miller, Director & Chief, Regulatory Counsel, Center for Securities, Trust and Investments, American Bankers Association

Dec. 13, 2005 Hamp Haucke, VP, IT and Properties/Facilities, TIMCO Aviation Services, Inc.

Dec. 12, 2005 Michael B. Enzi, Member of Congress

Dec. 12, 2005 Frank E. Williams, Jr.

Dec. 12, 2005 Gayle Essary, CEO, Investrend Communications, Inc.; Acting Executive Director, Shareholders Research Alliance; Executive Director, FIRST Research Consortium

Dec. 12, 2005 Robert B. Briscoe, Chief Financial Officer, The Savannah Bancorp, Inc.

Dec. 12, 2005 Robert F. Reisner, Vice Chairman, Shareholders Research Alliance

Dec. 8, 2005 James C. Greenwood, President and CEO, Biotechnology Industry Organization; Mark G. Heesen, President, National Venture Capital Association; Lezlee Westine, President and CEO, TechNet; Victoria D. Hadfield, President, SEMI North America; David L. Gollaher, Ph.D., President and CEO, California Healthcare Institute; Megan M. Ivory, Executive Vice President, Federal Government Relations, Advanced Medical Technology Association

Dec. 07, 2005 Geoffrey Grier, Sr. Vice President Marketing & Sales, Research Data Group, Inc.

Dec. 06, 2005 Anonymous

Dec. 06, 2005 Anonymous

Dec. 02, 2005 Dr. Jeffrey Haber, CPA, EQ Metrics, LLP

Dec. 01, 2005 DeAnn M. Duffield Vice President of Reporting and Administration and Secretary, Maxus Realty Trust, Inc.

Nov. 29, 2005 Frederick D. Lipman, Esq., Blank Rome LLP

Nov. 19, 2005 Gayle Essary, Managing Director, Investrend Research Syndicate / Investrend Research; Executive Director, FIRST Research Consortium; Interim Administrator, Shareholders Research Alliance; CEO, Investrend Communications, Inc.

ATTACHMENTS

Listed below and attached are the written reports submitted by the subcommittees of the Advisory Committee and referred to throughout these proceedings. Please consult the text of the proceedings to determine whether the recommendations contained in these reports were approved as submitted.

[Report of Subcommittee on Internal Control Over Financial Reporting](#)

[Report of Subcommittee on Corporate Governance and Disclosure](#)

[Report of Subcommittee on Accounting Standards](#)

[Report of Subcommittee on Capital Formation](#)