File 265-23

May 31, 2005

To Members of the SEC Advisory Committee on Smaller Public Companies:

I am responding to your "Request for Public Comments on Summary of Proposed Committee Agenda." I am happy to have the opportunity to comment on your agenda, as I believe that your topics are vital to the challenges facing small issuers in the current regulatory environment. As a compliance consultant to small business issuers (SBIs), I have a perspective on the costs and burden of Sarbanes-Oxley compliance, as well as the importance of the SBI program.

Small issuers have access to capital markets for a reason. Regulated, ordered, efficient capital markets streamline the capital formation of small businesses, introduce efficiency into the process of small company growth, and facilitate the capitalization of more good ideas and viable companies – companies that would otherwise be lost in the personal network-driven community of venture capital and private equity investments. The current SBI structure works – quite simply. The current market for SBIs effectively delivers capital to small companies that are hungry for growth, and the existing market facilitates the research activities necessary for an informed investment. I strongly urge this Committee to remain committed to the SBI program.

The SEC should remain committed to small businesses in the United States. The agenda provided for this meeting seems to read like a catalogue of problems with SBIs, but I know that there are many profound benefits that SBIs bring to the US economy. Small businesses are a large part of the US economy – there are over 3 million businesses with fewer than five employees – and I encourage this Committee to recognize that they should be at least a small part of the US capital markets structure.

Until six years ago, the OTCBB was characterized as an environment ripe for the commission of fraud and other impropriety. This perception persists in the media and public opinion despite proof to the contrary. SBIs, under new regulatory regimes and ordered markets, can be traded in an efficient and educated manner. In fact, the increased order and structure of the SBI space stands in marked contrast to the perceived decline of disclosure by larger public companies. We have developed numerous white papers on the prevention of fraud in SBIs, and my company and its strategic partners remain committed to the reduction of fraud in this space. We are always working to improve our educational materials to further mitigate the risk of fraud in SBIs. Let's not forget that Enron and WorldCom were not traded on the OTCBB; they were traded on larger exchanges. The requirements of such regulations as the Sarbanes-Oxley Act emerged from the improper activities of larger publicly traded companies, not their SBI counterparts.

Regulating SBI markets is not as easy as doing so for large company exchanges. Small issuers are fundamentally different from larger companies, and they cannot be regulated in broad strokes like large issuers. Despite the effort, a regulated small issuer market facilitates the capitalization of small businesses for the purpose of growth. Small issuers become large issuers over time. There is value creation occurring in the small issuer market. While major regulatory agencies remain focused on the larger company space, my company, and the network that participates in its mission, is committed to small business. We recognize the role they play in our economy, the challenges they face, and the potential value they represent. We love small businesses, and we want to keep helping them grow.

My company and strategic partners help in a variety of ways, but primarily through education and assistance with compliance. In fact, my company recently invested heavily in the development of a series of new white papers on compliance which we provide to clients both for a fee and in some cases with no charge in order to help them remain compliant. Recent white papers developed under this initiative include:

- SOX 404 and the Small Company: Planning for Compliance
- Sarbanes-Oxley and Antifraud: Does Section 404 Help Small Companies?
- SOX 404 and the Small Company: Working with the COSO Framework
- SOX and Technology: Transferring the Burden of Compliance
- SOX 301 and OTC Stocks: A Look at SOX for Small Businesses
- The Importance of Compliance for SBIs
- Making Your Company SOXable: High-Impact Opportunities for Small Cap Companies

Our primary purpose in developing these educational materials is to spread as much meaningful information about compliance to small businesses as possible. We continue to invest heavily in educational materials to support the small issuer community.

The focus of your agenda should be on the development of a small business division at the SEC with a staff and mission focused singularly on the real issues of small issuers. Instead of thinking in terms of sales thresholds before allowing a public offering (such as the $50 million in sales threshold), we need to think about the capitalization of viable companies for value creation, investor benefit, and job growth. Small businesses need efficient access to capital markets, and the OTCBB is the best vehicle for facilitating this access. The SEC, media, and self-regulatory organizations should encourage small businesses to become educated in public markets value, access, and compliance. This should be the focus of the Committee's mandate.

The SBI market is not broken, but there are many ways we can continue to improve the flow of capital to small businesses. Finding the resources to participate in small business commission with a genuine interest in improving small business capital markets while protecting shareholder interests would be the most stable and proactive process the commission could implement.

My firm and its team members all have contributed to the small business market by working with a number of companies that have gone public in what could be called the traditional manner, through the filing of registration statements on Form SB-2 or bringing them fully reporting under Form 10-SB. In addition, my firm works with a number of companies who are required to file annual and periodic reports under Section 12g of the 1934 Act.

PCMC's team has participated in the filings of 10-SB and SB-2 filings, and we have overseen the filings of many small and medium size business filings but we don't practice in the same markets as firms such as Morgan Stanley or Goldman Sachs. Our market niche consists of companies that represent the definition of the SBI under Rule 405. We bring our experience with these efforts to our clients, having seen a variety of challenges that different companies face.

Our team realizes that we cannot thrive in this space – and we cannot help our clients effectively – without remaining completely committed to compliance with all state and federal requirements. The emergence of the OTCBB and other small issuer capital markets as viable venues for small businesses to access capital makes compliance activities more important than ever. The small issuer markets have come a long way over the past six years, and a commitment to compliance is the only way to continue the growth of a regulated and ordered small business market.

Our team consists of attorneys with SEC enforcement experience, and our board of advisors consists of former NASD regulators. We bring the expertise necessary to facilitate small business compliance with the spirit and letter of Congressional, SEC, and SRO regulations.

In addition to compliance, our team conducts educational activities for small issuers. One of the most prominent barriers to efficient and consistent compliance is knowing everything that compliance entails. Small issuers do not have the resources to fund dedicated compliance teams. With the right education, they don't need to take that approach. Our team's educational efforts help small issuers keep track of upcoming compliance due dates, and we also provide reminders for filing forms 3, 4, and 5 for their beneficial ownership statements as needed on a continuing basis. In fact, our team has even implemented an intranet for each client so that each of our client companies can receive automated filing reminders for everything from their shareholders meeting due dates to their Qs and Ks, and we make sure every compliance team member of each company receives these reminders. For small issuers that are reporting material information either through contracts, press releases, or in other ways, we work with them to stay current with Regulation FD and 8-K filings.

Characteristics of SBIs

Small business issuers are not just smaller versions of large companies. They own a distinct place in capital markets; they require their own capital market structure to facilitate the flow of funds to companies that rely on capital infusions for growth. The methods used to analyze, value, and trade small caps are different from those used in regard to their larger counterparts. Small issuer operations are fundamentally different. The activities of small issuers are driven primarily by the force of executives' personalities and through employee volition.

Among the salient factors in determining how smaller issuers operate is "personality." In small issuer markets, the personalities of the individuals involved are much more powerful – especially at the executive level. As the drivers of corporate culture and the decision-makers that set the direction of an organization, a company's leaders set the tone for their employees to follow. From the CEO's lips to the employees' ears – this is a direct line. Executive decisions rapidly shape the appearance and operations. Small issuer operations are less bureaucratic, more nimble, and they can easily respond to market changes. Executive drivers are felt all the way down to the lowest rung of the corporate ladder.

A direct output of the force of executives' personalities is employee volition as the catalyst for operational change. In a company that is new, short operating histories mean that many potential scenarios have not been encountered. Essentially, everything that happens in a new company is new. The same reasoning extends to small companies, even with long operating histories. As they expand the scope of their operations into new areas, it is like starting a new company – in that less of the operating history is applicable to the new challenges they will face. In order to capitalize on new opportunities, these small issuers have to respond rapidly to changes in the market, and this often involves employee decisions pertaining to operations.

New processes arise from the decisions that employees make in their daily business lives. They respond to the new challenges that result from the emerging business environment in which they participate. Employee volition to create new operations as responses to emerging business problems is not an executive function. These decisions are made by individual contributors – the people who react to new problems every day. Middle managers and supervisors green light these decisions, facilitating the creation of new "business processes" by employees. When an employee makes a decision to handle a new operational challenge, the same steps are used as this challenge arises again in the future. This is how processes arise through employee volition.

Rule 405: What It Means to Be a Small Business Issuer

To define what a small business is, I rely on the definition stated in Rule 405 of 1933 Act Regulation C. Use of the SEC's regulatory definition eliminates doubt and provides for uniformity in all ensuing communication and discussion on the subject of small business issuers. The definition of "small business issuer" stated in Rule 405 entails an entity that:

- Has revenues of less than $25 million
- Is a U.S. or Canadian issuer
- Is not an investment company
- If a majority owned subsidiary, the parent corporation is also a small business issuer

The exception to the above criteria pertains to the issuer's public float. The entity in question is not a small business issuer, per Rule 405, if it has a public float of at least $25 million. Public float is characterized as the aggregate market value of outstanding voting and non-voting shares held by non-affiliates. Rule 405 and its definition of small business issuers are quite important in that it represents the cornerstone of all standards and activities in an orderly small issuer marketplace.

An orderly small issuer market is essential to the integrity of the small company capitalization process. For years, the OTCBB was characterized as the "wild west" of equity markets. OTCBB was synonymous with risk – even danger – in terms of capital investment, and few institutional investors, let alone individual investors, would venture into this space. Since 1999, the OTCBB has demonstrated that with clear, reasonable governance, an orderly small issuer market is not only possible but advantageous to investors of all types who want to recognize the significant returns enabled by investing in small or early stage ventures with the potential for rapid growth. A number of hedge fund managers with whom I have spoken on this subject agree that the only way to recognize the returns that their investors require on traditional long positions is in the small issuer market.

The implementation of standards for market activity in the OTCBB (and other SME capital markets) has reduced the "wild west" feel of the small issuer space. With clear criteria for reporting, trading, and capitalization, it is actually possible to participate in SME capital markets while experiencing only the risk characterized by any equity investment. While smaller stocks are more volatile and can be less liquid, market risk is market risk. The market risk inherent in

SME capital markets differs from the market risk in larger company capital markets more by degree and less qualitatively. An orderly market facilitates inquiry and research by non-issuer participants (such as investors and market makers) in SME capital markets, attracting the significant funds of institutional investors simply because they can research and understand the opportunities in these markets.

The commitment of the SEC and self-regulatory organizations (SROs) to orderly and governed SME capital markets through the use of reasonable governance standards is profound. SME capital markets facilitate the financing of small business endeavors. In fact, SME capital markets accelerate the small business capitalization process, allowing the market to determine the viability of these ventures, instead of a handful of institutional investment decision makers whose decisions are driven more by portfolio risk models than the potential performance of the small enterprises being examined. With orderly small issuer markets, these businesses can access capital more easily, fueling economic growth.

Acquiring the capital to start your business operations on a full-time basis is one of the first and most daunting challenges you will face. Typical avenues include financing from private equity funds, venture capital funds, and institutions (such as banks). Each of these audiences is demanding; they want to ensure that the money they invest in your idea will generate returns commensurate with the risk you are asking them to assume. Garnering the attention of potential investors (especially venture capital firms, private equity investors, and angel investors) is not easy. Venture capital firms and private equity funds screen countless proposals and business plans every day. Angels and private equity funds tend not to advertise, and heavy networking is really the only way to find them and get a meeting. If you successfully pitch these investors, the terms they offer tend toward the severe. You will have to accept high interest rates for loans or surrender control of your business (as well as equity) to investors.

As mentioned above, there are a myriad of traditional routes for financing new businesses. Venture capital firms, private equity funds, angel investors, and banks have financial instruments that small businesses can use to fund their operations. Many small businesses do not have access to funds from these traditional venues for early stage investments. There are limits to the effectiveness of such institutions in starting your business. Deal terms are typically draconian, especially as the risk of your endeavor increases. If your operating history is short, if you are still in product development, or if you have had personal financial problems, you may still be able to get funds from these investment venues – but you will have to pay. Financiers will charge high fees (in excess of 10% of the capital raised) in addition to taking a significant equity position in your company. Without a doubt, you will have to surrender control.

Deal terms are usually painful, but this only becomes a problem after you have successfully convinced these traditional financial venues to fund your endeavor. Finding investors willing to consider your proposal is challenging. While venture capital firms are easy to find, they are inundated with unsolicited proposals and business plans continually. Many get only a cursory read – at best. Private equity investors operate in more private networks, and to get a fund manager's time, you need to "know somebody who knows somebody." Simply finding private equity investors is a difficult process. Once found, you have to overcome the same barriers as you would with venture capitalists. Private equity funds review many proposals and accept only a few. Further, since private equity networks are more intimate, you really have to convince both the fund manager and the participating investors.

Institutional lenders, e.g. banks, tend to provide the most reasonable terms; your cost of capital will be lowest with banks. But, bank loans provide two problems. First, banks will scrutinize your personal finances if your business does not have a long track record. They assume that they are lending to you, not to your business. Also, bank loans require repayment, unlike equity investments. By financing your business through credit, you immediately accept another bill to pay, and these payments must occur even when your operations may not support such cash outflows. Banks do provide the best terms, but understand that you are being examined and that the loan must be repaid despite the success or failure of your business.

With the challenges inherent in raising funds through traditional means, small businesses need to consider alternative sources of funds. With a short track record (if any) and high risk, convincing other people to give you their money – forget the euphemisms, this is exactly what you are doing – is extremely difficult. Typically, you can assume that an investor will not accept your “offer” to invest. SME capital markets, such as the OTCBB, represent viable alternatives to traditional small business financing venues.

Through SME capital markets, the process by which small issuers attract capital is streamlined, resulting in access to capital through open markets instead of relationships and personal networking. In the absence of orderly marketplaces such as the OTCBB, small businesses would be able to attract investors only by seeking institutions such as venture capital firms and private equity funds. To attract capital from these sources, small business leaders would have to catch the attention of these investment firms, which is a difficult task. Venture capital firms and private equity funds review countless proposals and business plans, and only a few supplicants are granted meetings.

One private equity fund manager recently commented on the process that he used in reviewing projects. For every hundred deals about which he heard, only approximately ten received serious consideration, i.e. only these ten received the opportunity to present. Of the ten that presented, he usually would fund only one project. To get funding, therefore, a small business has a 1% chance of success. Many other venture capital firms and private equity funds mirror these statistics. These financiers readily admit that many good ideas are left on the shelf, and that these good ideas are unlikely to make it to the market. But, these firms need to allocate their funds judiciously, and decisions are governed as much by how the venture fits into its portfolio of investments as they are by the likelihood of the venture’s success on the market.

The barriers to institutional funding for small businesses are not trivial. Meanwhile, this same small issuer market represents the fuel that drives the US economy. There are nearly 3.4 million companies with four or fewer employees; add another million (approximately) to see that companies with fewer than ten employees are a force of over 4.4 million businesses. According to the US Small Business Administration (the source of these statistics), small businesses represent 99.7% of all employers, create 60 - 80% of net new jobs annually, and pay 44.5% of the total U.S. private payroll. The following chart illustrates this point.

Small Business Statistics by Employment Size of Firms	
Employment Size	**Number of Firms**
Firms with 0-4 Employees	3,396,732
Firms with 5-9 Employees	1,021,210
Firms with 10-19 Employees	617,087
Firms with 20-99 Employees	515,977
Firms with over 100 Employees	122,310

There is no doubt as to the impact of small businesses on the US economy. The goal of most small businesses is to grow – either into large businesses or even larger small businesses. SME capital markets enable this growth, which continues to drive the US economy. Small businesses that enter into publicly traded markets increase their chances of becoming successful. The result of this success is job creation and revenue generation through taxes for the local, state, and national economies. Further, moving into publicly traded markets preserves small businesses beyond the business lives of their founders, by enabling only minimally disruptive exit strategies and enhanced succession planning.

Removing the barriers to capital acquisition for small businesses is the whole point of SME capital markets. The OTCBB, for example, enables the flow of capital to promising small businesses that can generate significant growth for their investors, founders, and employees. Through SME capital markets, there is a formal marketplace where investors and great ideas are brought together to generate value and create revenue.

Without SME capital markets, there is an informal marketplace consisting of private businesses seeking investments from venture capital firms and private equity investors. As stated earlier, the odds are stacked against small businesses – with a 1% chance of receiving funds. Venture capital firms and private equity investors become “market makers” in these companies and transact through a series of private placement investments. This process is inefficient and restrictive to small business growth. SME capital markets, on the other hand are much more efficient and enabling.

April 2005	
Securities	3,319
Market Makers (MM)	226
Positions	47,155
MM per Security	14.21
Share Volume	29,333,741,660
Dollar Volume	$4,037,723,416

According to the OTCBB,[1] the average security has on average more than fourteen market makers, in contrast with only one market maker per hundred securities. As a result, the OTCBB represents a profound shift from the existing private investment marketplace, which really favors

[1] http://www.otcbb.com/dynamic/marketstats.htm

neither investors nor small businesses through the inefficiency with which it operates. The OTCBB, on the other hand, is quite efficient. The trade of more than 3,000 securities is facilitated by in excess of 200 market makers with a total investment volume of more than $4 billion! This exemplifies the efficiency and value creation activities of the OTCBB and SME capital markets in general.

As a result of small business trading, the capitalization of small businesses becomes possible, efficient, and regular. The OTCBB statistics, for example, are indicative of consistent trading activities, not ad hoc positions akin to slot machine plays. Taking over 40,000 positions is neither accidental nor trivial. The OTCBB, like other SME capital markets, is a viable platform for the delivery of capital to small issuers.

Reporting, Transparency, and Disclosure

Much has been mentioned above about the importance of SME capital markets in fueling economic growth in the US. The OTCBB has evolved through the implementation of standards in recent years to become a demonstrably viable venue for small business capitalization. Trading on the OTCBB used to be an uncertain endeavor. Now, with increased governance, the OTCBB is characterized by the same types of risk as other capital markets. Reasonable regulation is vital to the success of SME capital markets.

Transparency and reporting facilitate the creation of a regulated and orderly market. An orderly market helps put small companies in front of a larger investment pool – a pool that includes market makers, individual investors, and institutional investors such as hedge funds and wealth managers. Regulations that require adequate and reasonable disclosure result in an efficient market. But, this is only the first step in fueling small company growth through SME capital markets.

Central to the importance of regulation is the protection of investors and other SME capital markets stakeholders. The purpose of governed capital markets is not to remove risk – it is to remove unreasonable risk. To make capital markets fair and efficient, regulation must exist to facilitate the flow of information. Investors and market makers still have to take responsibility for their trades. A regulated market will enable market participants to conduct the due diligence necessary for informed investing.

Transparency is the best resolution to the challenge of control at small issuers. I strongly encourage this Committee to set standards for the tone at the top and to require the disclosure of salient points to investors. This will enable investors to vote with their dollars, and the result is that liquidity represents the incentive for companies to comply through disclosure.

Sarbanes-Oxley Section 404

One of the most disconcerting issues facing the SBI market is Sarbanes-Oxley compliance. We all know that there is a problem. We see it in the media on a daily basis, and we hear about it at industry events. We know the impact on SBIs will be profound. The cost of compliance will remain disproportionately high for small issuers that could create jobs and fuel economic growth by investing new ideas and enhancing operations. Despite everything we have seen with Sarbanes-Oxley to date, we are still trying to figure out how profound the impact of Sarbanes-

Oxley will be on the small issuer market. SBIs currently are complying with Sarbanes-Oxley, and my company is working actively to help small businesses prepare for compliance. While we would encourage the SEC to curtail this SBI compliance requirement until specific SBI guidelines for Sarbanes-Oxley compliance are developed, we remain committed to helping small issuers remain compliant.

What makes determining the impact of Sarbanes-Oxley compliance on the small issuer market difficult to gauge is the notion of scalability. Small issuers are unique; they are fundamentally different from medium and large cap issuers. The notion that the burden of compliance will scale by common metrics such as top line, bottom line, or headcount is **fundamentally flawed**, in that common metrics do not reflect the realities of daily business in the small issuer space. Small issuers operate differently, less formally, and drive business through the force of executives' personalities. As a result, the control needs of small issuers are fundamentally different.

With small issuers, it is still imperative that the SEC protect shareholder interests and shareholder value. We all agree that this laudable goal is the driver behind such legislation as Sarbanes-Oxley, as well as the entire regulatory regime at the SEC and self-regulatory organizations (SROs) such as the NASD, NYSE, and the various Tier II exchanges that facilitate the capitalization of small businesses. The small cap market can be quite volatile, and it does tend to be less liquid than the market for larger issuers. This does not in any way make the small cap market less valuable or important. In fact, the contrary is true. The market for small cap stocks provides a vital role in the capitalization of small companies – the companies that fuel the growth of our economy and create the vast majority of our new jobs.

Depressing small issuer stocks through the levying of large compliance obligations is not the solution that we need to protect shareholder value. While complex compliance regimes create the appearance of safety and reliability, the reality is that extensive regulatory regimes accomplish the contrary. They depress small and medium enterprise (SME) capital markets. In fact, we can preserve and create significant shareholder value through the fostering of the effective flow of capital through SME capital markets. The purpose of this letter is to encourage the Committee to contribute strongly to the effective management of SME capital markets to facilitate the growth of small issuers.

Ultimately, a company's "tone at the top" represents the personality driver that governs employee volition. Employees take their cues from executive leadership. The decisions that they make in response to new situations and market forces result from actual and perceived boundaries communicated implicitly and explicitly by those who set the company's direction. Reliance on the "tone at the top" – i.e. the personalities, attitudes, and corporate culture – has persisted as a major component of Sarbanes-Oxley remediation. The tone at the top manifests itself in the COSO framework as the "control environment." Where the force of personality reigns, the tone at the top is the driver of all activities in the company.

Given the importance of executive personality and employee responsiveness to market forces, affecting the tone at the top is the most effective way to implement controlling change in small issuers. Business processes rise and fall on the fly, and controlling business processes in a dynamic environment is only a temporary solution to an ongoing problem. Changing the culture results in real change, not temporary solutions to an operational environment that will continue to change.

Controls are restrictions, boundaries; they necessarily restrict action. There are three types of controls that can benefit an organization. In regards to the existing regulatory environment, firms normally think about formal process-driven controls. There are two additional types of controls as well: social controls and technology controls. Each of these control framework types contributes to a well-controlled business environment, supporting the COSO notion of a comprehensive controls environment.[2] The COSO framework accounts for all three types of controls in defining a comprehensive framework.

Some roles in your company are sensitive, requiring unfailing diligence and oversight. It is imperative that roles pertaining to control, oversight, and diligence be distributed so that no one individual represents a single point of failure in the control model. Without the appropriate segregation of responsibilities, the opportunity for an individual to commit fraud emerges, and your company becomes exposed to risk. The average instance of fraud costs small businesses $127,500[3], and a small investment in the segregation of duties could thus yield a significant return.

Too often, reorganizations turn into mere shell games. Assumed at the beginning of the reorganization exercise is that every individual on the organizational chart has a role in the future organization, with a title substantially similar the titles already in use. Bodies are just moved from one manager to another, and reporting lines are shifted. Occasionally, new positions are opened or existing positions removed – but rarely to an extent considered radical. Quite simply, companies are lazy about reorganizations, and their reorganizations typically yield suboptimal structure results.

In order to prepare your organization (and its constituent employees) for Sarbanes-Oxley compliance, changes to your organizational structure must come from the position of radical overhaul to facilitate compliance – not the preservation of management titles or employee jobs. This is especially important at a small company, where retaining headcount in a manner not directly advantageous to the company acts as a tax on revenues and prevents growth – and can even lead to decline. To prevent restrictions on growth and enable rapid Sarbanes-Oxley compliance, small companies endeavoring to make themselves SOXable should take a fresh look at their organizational structures. In making themselves SOXable, small companies that are not publicly traded should prepare themselves for Sarbanes-Oxley if they anticipate being acquired. Preparation for Sarbanes-Oxley makes the small business more attractive for acquisition and facilitates the post-acquisition integration process.

The first step in building a SOXable organizational chart is not the boxes and reporting lines on the PowerPoint slides, however. You need to start any organizational structure effort from the mission of the company. Ultimately, the structure of your company's workforce must support the

[2] *Key Elements of Antifraud Controls*. PricewaterhouseCoopers, p. 3
[3] "The cost of employee fraud – Up Front". *looksmart findarticles*. *http://www.findarticles.com/p/articles/mi_m0BJK/is_7_13/ai_87718851*

purpose for which the employees have been brought together. A consulting firm's organization, for example, is built to enable the fluid movement of employees from project to the next, without rigid hierarchical structures. Newspapers, on the other hand, adhere to the traditional command-and-control model, with clear reporting lines and departments that do not change.

The easiest way to prevent fraud and provide an auditable controls structure for small issuers is not procedural; it is organizational. Ultimately, the use of social controls through organizational and structural management is more effective in small caps than process or technology controls. In order to ensure that your approach to controls through organization is auditable, you can segregate oversight duties. Segregation of duties requires the separation of roles for specific tasks and business processes where a conflict of interest would arise from one individual handling multiple responsibilities. Oversight and approval exemplify this problem.

With the purpose for which the company exists (i.e. the mission) established the next step in determining the most effective organizational structure is to understand how your company pursues the fulfillment of its mission. How does the company *operate*? A company's operations consist of business processes and activities that lead to the fulfillment of its mission. While analyzing operations can be tedious, the analysis will yield information indicating what roles the company should have – and the levels of oversight and control necessary for different positions.

In order to segregate duties, roles and responsibilities need to be redefined across your company. To do so effectively, you should build your necessary organizational structure from scratch. You may find that almost all of your employees will retain a position in this new structure, and their jobs will remain substantially the same. But, you will encounter a few high-impact changes that will introduce control and diligence into your operating environment.

- Determine roles you need based on responsibilities associated with business processes identified in your operational analysis
- Build the organization based on roles defined and oversight requirements
- Segregation of duties results from an organization with clear roles and oversight and control based on operational needs
- Your organizational structure, based on controlled operations, will align with your company's strategy, because your operations are structured to support the purpose of your business

Through the process of defining strategy and operations to drive your organizational structure, your company takes a step toward becoming SOXable. In addition to having segregated duties and introducing oversight – both of which are essential to the success of controls and ultimately with Section 404 compliance – your business process analysis activities help affect the transition from ad hoc business processes based on employee volition to planned operations that are organized and consistent.

Other business advantages result from SOXifying your company. Even if you make strategic decisions in the future that take Sarbanes-Oxley off the table, you will recognize a return on your pre-SOX investment in organizational design. By pursuing the process described above, the segregation of duties that your effort will yield will reduce the risk of fraud significantly, potentially saving more than $100,000 (for only one instance of fraud). Additionally, the resulting operational efficiency will lead to a reduction in waste, allowing employees to focus their efforts on growth instead of maintenance. Finally, employees dislike ambiguity. With clear roles and responsibilities, employee satisfaction is likely to increase, which will reduce turnover and increase productivity.

Emergent v. Engineered Processes
Organizational structures evolve over time; they are rarely engineered. Between planned reorganizations, organizations resume the evolutionary process, based on decisions made by employees during the normal course of business. Company management and executives hire and organize headcount to meet the immediate needs of the company. They respond to tactical challenges that arise on a day-to-day basis. The constant reaction to tactical problems causes your company's organization to become misaligned from your company's strategy over time. To keep costs down, employees tend to wear many hats – especially at a small company. This often leads to employees assuming responsibilities for the sake of expediency, even if it is to the long-term detriment of your company's operations. To reinstate an element of control into your company, and lay the ground work for Sarbanes-Oxley compliance, some roles should be segregated, to allow for oversight and control.

Business processes characterize how a company operates. Essentially, business processes are the specific ways that a company creates value through the small tasks that add up to big products. In ascertaining the character of an organization, business processes are descriptive of what the company does. There are two types of business processes: engineered and emergent. Engineered business processes are planned in order to deliver some sort of incremental value. Emergent business processes result from employee volition, as mentioned above. These processes emerge from the decisions that employees make on a daily basis.

Engineered processes are intentional and planned. These engineered processes are intentional in that the company decides to change operations in order to derive some sort of specific advantage. They are planned in that a person or team examines the most effective way for the company to operate, and they determine the most effective way to conduct business. The purpose of engineered processes is to create some incremental value. Drivers for creating engineered business processes include efficiency and control.

Unlike engineered business processes, emergent processes are unplanned and unintentional; they simply happen. Operations in smaller and newer companies evolve over time, as employees face new situations and need to make decisions on the fly. These processes result from employee decisions when they face new scenarios; employees have to figure out how to respond to something they haven't seen before. This is the role of volition. Employees make choices, and these choices become processes. These decisions are repeated as the initial scenario is repeated. It worked once, so employees keep doing it. As a result, the decision becomes a generally accepted business process. It becomes a part of the small issuer's operations by default.

Large companies are more likely to have engineered processes than emergent processes. The bias toward engineered processes results from the resources available to large companies to invest in optimal business processes, instead of reacting to business situations and allowing the reactions to become habit. Further, large companies have many large-scale processes, so the impact of engineered processes is significant. There is a compelling return on investment case that can be made. Process redesign yields large and immediate results.

Small companies are more likely to have emergent processes. Small issuers – especially those experiencing rapid growth, need to respond to new conditions and situations without being able to invest heavily in operational planning. To respond to imminent and complex market forces, small companies succeed through the entrepreneurial spirit and pure drive of the individuals involved in the venture – i.e. through the tone at the top. As a result, small issuers operate in a dynamic environment; as a result, their control needs are different. Small issuer controls need to rely on culture for control instead of focusing on burdensome control solutions.

For large and medium issuers, controls are easier to build and implement, facilitating Sarbanes-Oxley compliance. These issuers are more likely to have engineered processes. These planned operations are more likely to remain static for the foreseeable future, as time and human resources were invested in optimizing business processes in relation to client relationships, the value chain, and the organization's overriding strategy. Emergent processes, contrarily, will continue to emerge. They evolve in the face of continued new opportunities and situations. As emergent processes, change, controls are unlikely to remain relevant. Small caps will outgrow their policy/processes and technology controls more quickly.

It is possible to develop controls for emergent processes – and as a result implement a reliable, auditable control framework for participants in the SME capital market. We just can't use the same mechanism as large issuers to ensure control and protect shareholder value. We can seize corporate culture in order to affect control. There is precedent for this approach in the COSO framework. Also, your agenda demonstrates a step in this direction with your appropriate focus on the "tone at the top." Managing the "tone at the top" of an organization is the key to successful controls in small issuers.

The tone at the top control effort necessarily entails a social controls initiative. Changing the tone at the top requires a corporate cultural effort to shape cultural norms and expectations. Executives set the tone for the organization; they need to set the right tone. Fortunately, executives can accomplish this through communication, by example (behavior), and change management projects.

What can the SEC do about the need for organizational controls instead of process controls in the SME capital market? Can you legislate corporate culture? Maybe. Can you measure the results? Not easily. As a result, this option seems less and less viable. With some innovation, though, encouraging and enforcing tone at the top changes is possible. Sarbanes-Oxley demonstrates two steps in this direction with Section 301 and Section 403. Section 301 requires ethical guidelines and codes of conduct, while Section 403 requires the certification of financial statements.

Trying to Fit SOX to Small Issuers

The current state of Sarbanes-Oxley compliance in the SME capital markets is unclear. As small issuers pursue Sarbanes-Oxley compliance, the "shoehorn" approach is prevalent. Small issuers are trying to make Sarbanes-Oxley "fit" the unique requirements of the SME capital market. The

COSO framework has emerged as the standard for Sarbanes-Oxley remediation and compliance. The COSO framework is particularly effective for large issuers, but it is not the most appropriate approach for small caps. The COSO framework represents the predominate approach to Sarbanes-Oxley remediation and compliance. The COSO framework requires a lot of heavy lifting for small companies, including an extensive fraud risk assessment, the development of controls, and creating an ongoing structure to facilitate information, communication, and ongoing oversight.

But, COSO framework is what we have, so it is what we will have to use to facilitate compliance in the SME capital market. No other standard is likely to emerge, since there exists an "industry leader." Any adaptation by COSO will be substantially similar to what exists already. It works, right? There is no reason to fix it, it would seem. Further, too much institutional knowledge has built up around the existing framework. We can't leverage the lessons from existing compliance work because small caps are fundamentally different from large caps.

So far, small companies have been trying to make Sarbanes-Oxley "fit." They have used the COSO framework in an attempt to control operations. Through the execution of a process redesign project in conjunction with Sarbanes-Oxley remediation efforts, small issuers can comply with the Act. With effective planning and execution, small issuers can even reduce the overall burden and cost of compliance. But, this approach represents nothing more than "treading water"; it is not forward-looking. As new processes emerge through employee volition, they remain uncontrolled until a new control initiative is commissioned. So, ongoing controls development becomes necessary, not just ongoing controls management.

Clearly, there is a gap. Small caps are preparing to comply in the traditional manner – in the same manner as large issuers. Unfortunately, this is insufficient for ongoing compliance with the Act. Small companies can't comply once and manage in perpetuity. With the continued emergence of new operations as new business situations arise, small companies would need an ongoing controls development project to keep up with new projects. Small issuers quickly outgrow existing controls. As a result, ongoing compliance can become extremely expensive.

Liquidity and Value Impact

Developing a Sarbanes-Oxley "version" for small issuers – based on organizational audits and a definition of materiality – would support the liquidity of small issuers, increase shareholder value, and rejuvenate SME capital markets. SME capital markets are a great source of growth for the small businesses that fuel our economy. A market of such importance warrants your close attention and zealous support.

When focusing on the benefits of being publicly traded and considering the cost of compliance, small issuers may overlook the fact that compliance requirements continue as they remain on the OTCBB. Clearly, there is a gap between issuer knowledge and the SEC's filing requirements. Complying with basic SEC rules can be overwhelming. Add the burden of Sarbanes-Oxley in its current state to the effort required to comply with SEC registration requirements and the result is staggering. We are taxing small businesses with registration and control requirements when we should fuel their growth and encourage the use of SME capital markets as a stepping stone to more resilient exchanges. We understand the importance of Sarbanes-Oxley in the small issuer space, as we strongly support the compliance controls enacted in 1999 – regarding quotation on the OTCBB. In fact, the quotation rule was one of the best rule changes for small issuer liquidity. Regulations, as this demonstrates, can have a profound and positive impact on SME capital markets. We do not want to see the current burden of Sarbanes-Oxley requirements unravel the positive developments from previous OTCBB regulation requirements.

The impact of non-compliance is profound. While many small issuers can operate with inconsistent compliance processes, problems eventually arise. There is not just a legal consequence involved in compliance; there is a real business impact as well. Compliance can impact liquidity, which can affect your ability to raise funds for growth. One of the basic reasons for issuing is to access capital in structured exchanges, and non-compliance can limit this access. Being compliant does not affect your ability to issue so much as the brokers' ability to trade; losing brokers restricts your access to brokers – and therefore your access to capital. This is why we need a reasonable approach to compliance.

Section 404 of Sarbanes-Oxley requires companies to develop and test internal controls for any operations or technology systems that feed the companies financial statements. Section 404 states that covered entities[4] must:

- "[S]tate the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting"[5]
- "[C]ontain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting"[6]

The public companies' responsibilities are encapsulated in two statements. Section 404 also addresses the independent accounting firm, as it relates to the publicly traded company, asserting that "each registered public accounting firm that prepares or issues the audit report . . . shall attest to, and report on, the assessment made by the management".[7] Independent auditors have to render an opinion on management's assessment of the controls framework. As a result, the management of a publicly traded company becomes beholden to the independent auditors, and the independent auditors provide the diligence necessary to protect shareholders.

To comply with Section 404, you will need to develop controls to ensure that the risk of fraud is reduced across your company. To build effective accounting controls, you need to analyze your operations to determine where your greatest fraud risks reside; the purpose of Section 404 is the reduction of your company's fraud risk. Auditors need to validate the effectiveness of the controls. Ultimately, controls need to be certified by the CEO and CFO, and the auditors are required to comment on their clients' controls for the publication of annual reports.

Liquidity constitutes the ability of an asset to be converted to cash easily and with minimal degradation of value. The notion of liquidity entails more than simply having an available market; that is only half the formula. The asset that is "liquid" can be converted to cash that is

[4] This consists of publicly traded companies, market cap over $75 million
[5] Section 404(a)(1)
[6] Sarbanes-Oxley Act of 2002, Section 404(a)(2)
[7] Sarbanes-Oxley Act of 2002, Section 404(b)

commensurate with its value. The second half of the formula is problematic for OTCBB-traded companies. Many have wide bid/ask spreads. There is an available market, but with significant disparity between bid and ask prices, the value of the asset will be eroded when traded in the available market. By attracting market participants, liquidity is enhanced. Market participants lead to the active trading of a security, resulting in converging bid/ask spreads.

Attracting market participants, especially institutions that trade actively in OTCBB stocks (such as hedge funds), is vital to preserving liquidity. Many of the aspects of remaining attractive to institutional investors are not related to compliance. Revenues, margins, and product pipeline, for example, receive the scrutiny of potential investors. Other factors that impact the liquidity of your company's stock, though, can be controlled through compliance activities. Complying with SEC rules, listing requirements, and legislation such as Sarbanes-Oxley indicate the diligence with which a company approaches its operations. In addition to showing gaps in the management of the company, overlooking compliance requirements can impact the opportunity for investors to purchase shares and the ability of broker-dealers to make markets. Even if you continue to trade OTC in a non-compliant fashion, inaccurate compliance can turn off institutional investors. That's where the money is.

Remaining compliant makes access to other types of capital easier – not just the largess of institutional investors trolling the bulletin boards for cheap buys. Venture capital firms, private equity funds, and institutional lenders look for companies that are liquid; liquid companies are better investments. Such companies have an easier time raising capital, making large investments from institutional sources safer. Lending funds to a liquid company, for example, is safer because the company can always issue stock to acquire funds to repay the debt. This ability to raise funds makes both debt and equity investments in your company a safer bet for institutions and high net worth individual investors.

The benefits of remaining compliant are evident, but maintaining compliance can be challenging. Despite the returns that regulatory compliance can generate, compliance still requires an up front investment. Maintaining compliance is facilitated by transferring the burden of compliance through outsourcing and the use of technology and effective project management. These measures are generally good for your business, in addition to providing regulatory and compliance advantages.

Small business issuers need every advantage to attract large investments from institutional investors (such as hedge funds). For companies traded over-the-counter or on Tier II exchanges, the preferred locations for deal-hunting traders, one of the salient barriers to liquidity is compliance. By complying with listing requirements and other applicable laws (such as Sarbanes-Oxley), small caps can finance their growth through the larger investments available in public markets. By not remaining compliant with state or federal laws, traders may not be able to deal in your stock, which reduces trading volumes expands bid/ask spreads, and your ability to raise capital.

Clearly, it is in the best interest of small companies to comply with all pertinent state and federal regulations. Compliance enhances small cap liquidity and makes their stock more attractive to investors of all types – especially institutional investors such as hedge funds. Through effective compliance, attracting capital becomes exponentially easier. Despite the advantages of compliance, small caps still struggle with how to fund and maintain the compliance process. Complying with listing standards and SEC regulations is hard enough, and other laws (such as Sarbanes-Oxley) simply make the job that much more costly.

Call to Action

SME capital markets fuel the growth of our economy. In addition to providing the highest growth opportunities, small issuers also create more new jobs than any other segment of the market. It is impossible to overstate the importance of SME capital markets – and the small issuers that participate in them – to the continued prosperity of the United States. Further, SME capital markets represent a preliminary step to the liquidity and value enhancement of higher tier markets, such as the AMEX and NASDAQ – even the NYSE. The preliminary step that such smaller capital markets as the OTCBB, Pink Sheets, and Tier II exchanges represent is a vital opportunity to establish the track record and solvency needed to graduate to bigger opportunities. Small companies are merely large companies waiting to happen. We should foster growth instead of taxing these ventures unnecessarily.

Sarbanes-Oxley can be described aptly as an unnecessary tax on small issuers – at least in its current state. Because of the ambiguity of the Act, the conflict of interest experienced by auditors in having to interpret the Act, and the singular focus of the audit industry on the plight of large issuers, small issuer compliance has been overlooked. As a result, we are now in a position to have to understand a mechanism for rapid and comprehensive compliance in a market where the current institutional knowledge is insufficient.

To facilitate compliance with Section 404, the SEC Small Business Division really does need to issue guidance to ensure accurate and efficient compliance activities. The need for a procedures manual or guideline that defines standards and recommends best practice is vital for turning Section 404 from an unnecessary tax on small issuers to a valuable control and shareholder protection mechanism. As it is, the SEC does not provide small business guidance for SB-2 filings. Instead of issuing a procedures manual, the SEC simply issues comments on an ongoing basis. While this does yield a body of knowledge, it is not in a manageable form. If the goal is orderly markets and shareholder protection, this represents an easy step for the SEC to take.

This Committee is uniquely positioned to recommend to the SEC the changes necessary to enable small issuers to thrive while protecting the interests of institutional and individual shareholders. Through the development of meaningful compliance measures that are attainable by small issuers, the SME capital markets can thrive, fueling rapid growth for the US economy. Specific measures that the Committee can recommend to the SEC include:

- The use of organizational controls for the mitigation of fraud risk in small issuers
- The development of a "lite" framework for use by small issuers in place of Section 404 and the COSO framework
- The encouragement of transparency to empower investors to make informed decisions before voting with their investable dollars
- Clearly defining materiality to enable auditors to set clear standards for the development, implementation, and maintenance of accounting controls

There are a variety of outcomes that can make compliance with Sarbanes-Oxley more realistic for small issuers. I hope this Committee has the courage to pursue them aggressively.

To question the value of the SME capital markets is not just. Since small businesses drive the growth of our economy, it is imperative that this Committee and the SEC support the proliferation of funds through SME capital markets and encourage the growth of small issuers into large issuers. While Sarbanes-Oxley certainly responds to a clear need in the industry, further work is essential in order to develop the right solution for small issuers. Sarbanes-Oxley is a solid foundation, but further construction is necessary in order to ensure the protection of shareholders without strangling small issuers with the potential to grow.

There should not be a discussion of eliminating the SBI market, and the agenda for this Committee's meetings should not reflect this consideration. NASDAQ has not communicated to the investment community (through their database of OTCBB companies) that there should be comments regarding this meeting. I personally have taken an interest in the success of the OTCBB, and I have tried to show NASDAQ how the OTCBB could be a significant profit center – especially in the wake of the attempt to launch BBX. The efforts around SBI education that surrounded the BBX effort represented one of the best examples of OTCBB outreach that I have seen. Such efforts to educate SBIs foster the growth of the small issuer market and lead to the development of small issuers into large cap companies.

Regards,
Stephen Brock
President

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