Gloves come off in Sox fight

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The rhetoric against the Sarbanes-Oxley Act is becoming more heated as the Securities and Exchange Commission gears up for a roundtable this month on the rules stemming from the 2002 law.

"We're the victims of friendly fire," said Gary Morgenthaler, general partner at Morgenthaler Ventures in Menlo Park. "This is a regressive tax on small business.

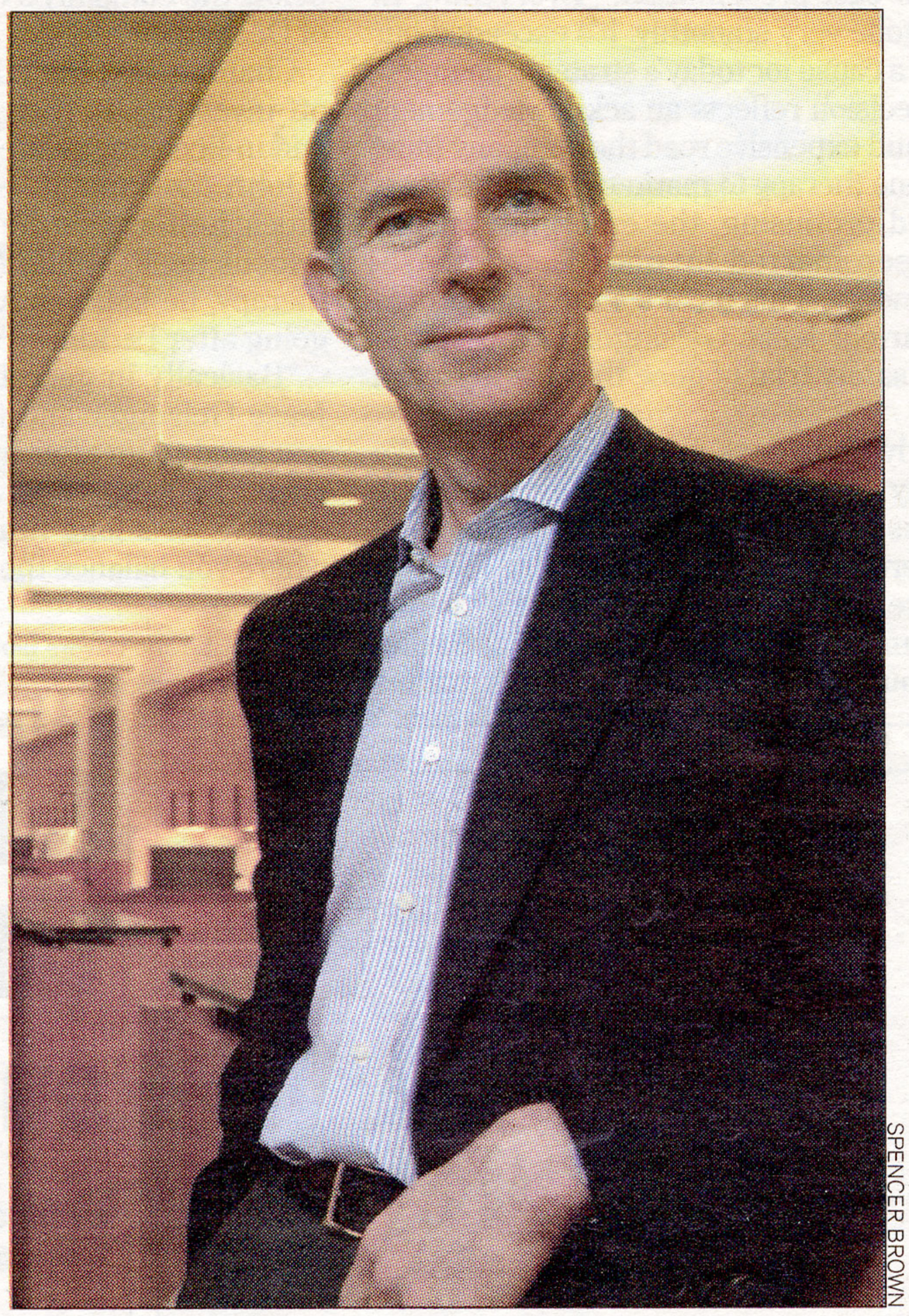
"For small businesses, it denies access to the capital markets and resources to pioneer new ideas and take them to the marketplace," he said.

Others are even more blunt.

"Sox sucks," said Michael Moe, chairman and CEO of San Francisco investment bank ThinkEquity Partners.

"The unintended consequence of Sox is that it has put a huge tax on growth and innovation that is crippling business and the economic engine that propels America," according to a recent ThinkEquity report to clients.

"We're becoming more like Germany," John Hamm, a general partner at VSP Capital, said in reference to that nation's lumbering regulatory environment.



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MORGENTHALER: "We're victims of friendly fire."

Critics say the law's one-size-fits-all approach is unfair to small companies struggling to get off the ground.

"A small public company's financial staff — from the chief financial officer to the receivables clerk — may be only a half dozen people, but it has the same regulatory burden as General Electric," said Jeffrey Kuhn, co-founder and managing principal of Financial Leadership Group, a San Mateo financial consulting firm.

In preparation for the SEC's roundtable, the Nasdaq Stock Market recently surveyed 450 CEOs from companies listed on the exchange.

Companies are concerned about the cost of complying with the new law's Section 404 requirements, said John Vitalie, regional vice president for Nasdaq, based in Menlo Park. He wouldn't disclose the survey's findings.

In a letter to the SEC, the American Bankers Association recommended two proposals that would provide regulatory relief for corporations, including small banks and businesses.

The trade group urged regulators to boost the threshold that determines which businesses are subject to SEC reporting requirements and review the role of the external audit in internal control testing required by Section 404.

"Appropriate course adjustments can be made that will buttress the purposes of the reforms and eliminate unnecessary costs that are often clouding those purposes and inhibiting their effectiveness," said Wayne Abernathy, executive director of financial institutions policy and regulatory affairs at the bankers' trade group.

The ABA recommended a higher limit on the number of shareholders a company must have in determining which businesses are subject to SEC reporting requirements, based on the belief that levels set in 1964 are outdated. The issue is significant for community banks.

"A small corporation today with a small investor footprint is considerably different from what it was 40 years ago," Abernathy said.

Abernathy also echoed the concerns of Bay Area emerging growth companies when he said "over-auditing" has significantly increased the cost of complying with Sarbanes-Oxley. The bank cited one community bank that has seen its auditing costs more than triple to $600,000 in 2004.

"Bankers report that external auditors are recreating 70 percent or more of the work of the internal auditor," Abernathy said. "Checking and verifying the work of the internal auditor is important and valuable to management and shareholders, but substantially duplicating that work seems excessive."

But how quickly changes are made to the new law is open to debate.

"In the short-term, I don't see the momentum for change," Morgenthaler said. "But in the long run, I don't see any other way."

Mark Calvey covers banking and finance for the San Francisco Business Times. ▩