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Subject: Comments on the Proposed Agenda of Advisory Committee on Smaller Public Companies of the Securities and Exchange Commission

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Director and Audit Committee Chairman of Optical Cable Corporation: OCCF
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Agenda Item 2. Internal Controls – Section 404 of Sarbanes Oxley

2.2.1. Seek economic input.

Comments

Sarbanes Oxley 404 has dramatically increased the cost of small public company auditing services. In fiscal 2004, actual audit cost for RGC Resources was $155,000 or 3.3% of budgeted pretax income for fiscal 2005. Executed engagement letters for outsourced internal audit (internal audit is a required new activity), the audit and the audit of controls testing and attestation for fiscal 2005 were $389,500, or 8.2% of budgeted pretax income. As a result of the delay in internal controls attestations to fiscal 2006, we expect to reduce the 2005 cost to $297,500 or 6.3% of pretax income. Unless something changes the requirements, we will return to the $400,000 level with controls testing and attestation in 2006. An increase in audit costs from 3% to 8% of pretax income is clearly burdensome and contrary to the best interest of shareholders. In addition, these increased costs do not include the impact of adding in-house accounting staff, added IT costs, and the productivity loss and opportunity cost of diverting a significant portion of senior management time away from the needs of the business to SOX 404 elaborate documentation and testing.

2.4.3 Other written or oral input.

Comments

I do not believe the extreme level of controls documentation and testing that we are being advised to engage in is justifiable from a cost to benefit perspective. Applying the same standards applicable to a multi-billion dollar company with thousands of employees to a small company ($55 million market cap and 140 employees) is simply illogical. The current approach gives absolutely no credence to the fact that as CEO, I know virtually every employee by name, see every material transaction, and have a detailed and intimate knowledge of expected results and the reasons for variances from expected results. I do agree that some "tightening up" on IT controls has been beneficial, but generally the process has been overkill and costly. The implementation focus has not been on a better run business, but on being able to prove to junior auditors through excessive levels of documentation how the business is controlled.

Agenda Item 6. Accounting Principals

6.1 Evaluating "one size fits all" vs. Big GAAP-Little GAAP"

Comments

This agenda item seems self evident, but clearly there is a strong economic reason why a "Little GAAP" approach to a whole range of issues is needed. A few examples include derivatives valuation, options valuations, asset retirement obligations assessment and valuation, asset impairment considerations, and actuarial and discount rate determinations.

6.4 Analyze overlay and impact of other regulatory schemes.

Comments

RGC Resources is a public utility holding company and as a result, we are regularly audited by the public service commissions of two states for both prudency of operating costs and for prudent gas supply procurement. As a result, on an annual basis, we typically have four audits including the independent external audit. Sarbanes Oxley 404 compliance recognizes no value for the added level of audit scrutiny by other public agencies. I believe a similar situation exists with regard to small publicly traded community banks.

6.5 Analyze role of outside audit firms with respect to small companies, e.g., environmental shift in role of auditors, communications with outside auditors, concentration of Big Four accounting firms, difficulty in switching audit firms.

Comments

There has been a distinct and deterious shift in the role of outside audit firms with respect to small companies. In the past, we believed we were "clients" and occasionally relied on outside auditors for accounting advice and guidance in addition to audit services. That advice and guidance role has significantly diminished and has been replaced by what feels more like an adversarial investigative role. Small companies are increasingly reluctant to seek advice from the outside auditor out of concern that such a request may be viewed as an indication of a material weakness. Clearly the concentration of the Big Four accounting firms, along with their dramatically strengthened position as interpreters of internal controls deficiencies and weaknesses, has given them significantly greater clout and pricing power which they are using. In addition, because of the three-year stranglehold they have over scrutinizing the inclusion of previously audited financial results in the future issuance of financial statements, an economic based decision to switch to a smaller, less costly firm becomes fraught with uncertainty. To stay with a Big Four firm has become very expensive and to leave is also likely to be very expensive because it leaves the small company at the mercy of the Big Four audit firms' billing associated with their review of financial statements incorporating previously audited results.

Thank you for the opportunity to comment on the Proposed Agenda of the Advisory Committee on Smaller Public Companies of the Securities and Exchange Commission.