

Statement of

W. Anderson (Andy) Bishop
Chief Financial Officer and Chief Accounting Officer
Hallador Energy Company

Before the Public Company Accounting Oversight Board
Concerning the Auditor's Reporting Model

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I would like to extend my appreciation and thanks to the Board for including me in this panel discussion.

Hallador is an underground and surface coal mining company serving Indiana and Florida electric utilities. Our mines are located in Indiana. We trade on the NASDAQ: HNRG (play on words: energy=N.R.G). We are a smaller reporting company as defined by SEC rules and our public float on June 30, 2013 was below \$75 million although our market cap exceeds \$240 million.

I started my career with Price Waterhouse in 1975 in their OKC office after graduation from the University of Oklahoma (the team that trounced Alabama in the Sugar Bowl this year). In 1984 I transferred to their Denver office. Practically all my audit clients were SEC registrants. In 1990 I joined Hallador as their CFO, left in 1993 and returned again as CFO in 2009. From 1993 to March 2009, I was the Executive Vice President, CFO and 1/3 owner of the SEC Institute Inc. During those 16 years I also assisted Hallador in preparing their SEC filings. In July 2009 I sold my interest in the SEC Institute. I also served on the audit committee of SemGroup Energy Partners, L.P., now called Blueknight Energy Partners, L.P. (NASDAQ:BKEP) from July 2007 through July 2008.

Before I go further, I should tell you that the views I express today are my personal views and do not necessarily reflect the views of any of the officers and/or directors of Hallador.

So for the past 39 years I have been intimately involved in this space and along with many others have noted that the auditor's report has not substantially changed. Now is the time for change. Nobody likes change but a wet baby.

I recall years ago in the self-regulation days when the Big 8 (now the Final 4: I picked the Gators) audited each other. I worked both sides of that fence. I firmly believe in less regulation than more but will have to admit there were serious flaws in that system. We

audited each other and I recall each firm received an A+ year after year. Not unlike asking your mother if you are good looking. The PCAOB system was a much needed change.

“Other Information” in the Auditor’s Report

I am in favor of having the auditor’s report on “other information” disclosed in the Form 10-K. Also consider a mechanism where they also report on the earnings release. The earnings release moves the market more than 10-K disclosures. For smaller companies that don’t have an audit of their internal controls I assume that “other information” includes management’s representation that the internal and disclosure controls are effective.

It is not clear to me how the auditors will report on the Proxy Statement that is incorporated by reference to the 10-K. The proposed standard states that this information is covered but what will be the mechanism to make it clear to investors that the information was in fact read and evaluated by the auditor.

Also it is not clear to me if the XBRL data that is filed as an exhibit to the 10-K is covered by the proposed standard.

Critical Audit Matters

Rather than have the auditors include in their report critical audit matters I believe the audit committee’s (AC) report should be expanded to include such matters. If the auditors are not in agreement with the report they have the obligation to report such and include those critical audit matters that were excluded from the AC report. Most likely this would be a joint effort between the AC and the auditors. The CFO and/or CAO have an intimate knowledge of these matters and such matters are included in the management rep letter to the auditors and also included in the auditor’s communication to the AC. This approach would also be more cost and time effective as we have strict reporting deadlines and at times obtaining the final wording from the auditors slows down the process. That being said, the rightful home for the AC report is the 10-K not the Proxy Statement.

Maybe this concept is a jurisdictional concern as we sure don’t want ACs regulated by the PCAOB. I’m sure the SEC and the PCAOB could come to an understanding if this approach was considered.

I would like to take advantage of this esteemed captive audience to touch on some other matters that I have observed over the years:

1. Referring to auditors as “independent” auditors could be misleading to the average investor. The issuer-pays model compromises objectivity and professional skepticism, always has, always will. For instance, General Electric (GE) pays KPMG over \$100 million for their “independent” audit. Best I can tell GE has been a client for over 100 years and probably will be for the next 100 years. For simplicity let’s say the annual profit on the audit is \$25 million. The PV of \$25 million for the next 100 years approaches \$500 million depending on assumptions. Now that’s an asset that would be safeguarded by any firm. What defies logic is if KPMG audit partners invest \$25 to buy one share of GE stock KPMG is no longer independent. This might be heresy to some but why not tweak the rules to allow some ownership by partners and staff. Certain partners and staff could be subject to Section 16 reporting the same as D&Os and others.
2. Another way to look at audit fees and independence is how significant the fees are to the firm as a whole or to the particular office. For instance, the KPMG Louisville, KY office is the reporting office for the YUM! Brands engagement. The audit fees are about \$7 million. Is the \$7 million significant to the firm? doubtful; how about to that office - could be, the point being that investors have no way of knowing. Maybe more transparency regarding these matters would assist investors in determining true independence. It’s not just KPMG; the other firms have the same issues.
3. Being a smaller reporting company (SRC) we are exempt from the 404 audits of internal control. So are emerging growth companies (EGC). I thought the passage of SOX was great, especially the CEO and CFO certifications and creation of the PCAOB; good common sense regulation. However, I think the costs of 404 internal control audits far exceed the benefits. I am not in the camp that if the regulation only saves one life, it’s worth it. One would think other jurisdictions around the world would jump on the 404 audit bandwagon if it was such a good deal, but we might be the only country. All CEOs and CFOs certify as to the effectiveness of their internal controls four times per year. That should be sufficient. As mentioned earlier, this management assertion would be subject to the auditors obligation to report on “other information” in the 10-K. Let the investors decide if they see value in the requirement. Make it an optional requirement subject to shareholder approval. Call it Say on Sox. In the interim the SEC should at least raise the public float test from \$75 million to \$250 million or higher as recommended by the Advisory Committee on Small and Emerging Companies in their March 2013 letter.
4. Another required cost that far outweighs the benefit is XBRL. At a minimum SRC and EGC should be exempt from this tedious and time consuming project. For

sure the requirement to detail tag the footnotes to the financial statements is ludicrous. We are followed by three analysts; they seem to be oblivious to XBRL.

I'm surprised Congress did not exempt EGC from XBRL in the JOBS Act. Maybe they too were oblivious. The only groups I know singing the praises of XBRL are the service providers.

We have fewer public companies on the national exchanges than 17 years ago; 8,800 in 1997 compared to 5,000 or so today. XBRL might have made sense years ago to assist the SEC in their mission of protecting investors, but today it does not. EDGAR is a fabulous tool, XBRL is not.

5. In my opinion either the CFO or the CAO or a member of the Audit Committee should be required to be a CPA.
6. I applaud the PCAOB for moving forward with the requirement to name the audit partner. For the last two years we have named the audit partner and the concurring partner in our Information Statement filed with the SEC. We also include their ages and their tenure as auditors. We considered including biographical information for the partner not unlike that required for our own D&Os. I do believe that more than just the name of the partner is needed. Their age, years on the engagement, industry experience and any regulatory issues would also prove useful. As has been said many times, a little sunshine is the best disinfectant.
7. We include the auditor's review report in our Form 10-Q. Over 15% of the S&P 500 does the same. I'm surprised that the percentage is so low. Consider extending the "other information" standard to the quarterly review procedures and encourage or require the inclusion of the review report in the 10-Q.
8. Final comment: kudos to the SEC for jumping off the IFRS bandwagon.

Thank you for this opportunity to speak to you today.

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