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September 18, 2006

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File No. S7-11-06

Dear Ms. Morris:

The American Bankers Association (ABA) appreciates the opportunity to respond to the Securities Exchange Commission's (the Commission) Concept Release No. 34-54122, *Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting (the Release)*. We are pleased that the Commission is continuing to identify opportunities to streamline the internal control reporting process required by Section 404 of the Sarbanes-Oxley Act of 2002 for both management and external auditors.

The ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

The ABA fully supports the establishment and use of strong internal controls, which are critical not only to provide users of financial statements with reasonable assurance about the integrity of financial statements but also to provide management with a foundation for appropriately managing a company's risks. However, we continue to be very concerned about the huge time and cost burdens experienced in complying with Section 404, and the associated business opportunity costs. Some of these costs can be reduced by the efforts of the Commission, and some may require legislative changes. The purpose of this letter is to provide some answers to your questions to assist in the common goal of reducing unnecessary costs.

General Response

The ABA appreciates the efforts that the Commission and the Public Company Accounting Oversight Board (PCAOB) are making to understand and remedy problems in practice with Section 404. The Commission's serious focus on these efforts has resulted in some significant changes. Hopefully, your continued work will lead to reduced costs in both time and money for complying with Section 404 for companies currently subject to its requirements and prior to it being required of every public filer.

We appreciate the Commission's delay of the effective date for auditor attestations for non-accelerated filers. We believe that the efforts to streamline the Section 404 process must be re-evaluated to ensure a proper level of implementation efficiencies for smaller companies prior to requiring compliance with attestations. We believe that Section 404 was intended to help shareholders gain confidence in the internal controls over their investments. A shareholder in a smaller company does not have the same expectations for complexity of internal controls that a shareholder in a larger company would expect, as smaller companies tend to have more direct management oversight, generally are less complex, and have fewer staff. Thus, the requirements of Section 404 can and should be scaled.

Clearly, the efforts to introduce a degree of reasonableness to the process for smaller companies is critical; however, there is also a need for streamlining the requirements for larger companies. We hope that this will not be overlooked by the Commission as it moves forward with bringing about much-needed change.

Questions Raised in the Release

1. Would additional guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting be useful? If so, would additional guidance be useful to all reporting companies subject to the Section 404 requirements or only to a sub-group of companies? What are the potential limitations to developing guidance that can be applied by most or all reporting companies subject to the Section 404 requirements?

Any additional guidance needs to be tailored to suit the needs of companies of different sizes, and we would like to work further with you to develop such guidance. For example, smaller companies – especially those that have not yet implemented Section 404 – need additional guidance. They have smaller numbers of qualified personnel, they anticipate expensive third-party internal control assistance, and they have smaller budgets to absorb the enormous costs of compliance. Again, shareholders expect smaller companies to have a less complex array of internal controls and more direct management oversight than larger companies.

Larger companies generally prefer not to have new guidance that might conflict with current practice; however, some within that group would appreciate further clarification on certain issues. The concern is that with new guidance could come an expectation that their current management reporting process should adhere to such guidance, resulting in even further implementation costs. Mid-size companies that have in-house expertise may also benefit from additional clarification, because they often do not have the same depth of staff that the larger companies have, and are often held hostage by the expectations of their audit firms. Thus, for the larger and mid-size companies, clarification – rather than new management guidance – could be useful.

We are in agreement with the Commission's Advisory Committee on Smaller Public Companies (ACSPC) that the Commission should provide, and should request that the PCAOB provide, additional guidance for smaller companies and their audit firms to help facilitate the assessment and design of internal controls

and make processes related to internal controls more cost-effective. The recent guidance issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) contains examples of internal controls employed by smaller companies that comply with the requirements of Section 404. These examples are expected to be helpful to small companies in designing, implementing and improving their internal controls. During the first year of Section 404, some companies documented more controls than were necessary, and auditors audited them. Thus, too much work was done. This should help ensure that the level of detail relating to the internal controls framework is appropriate for smaller companies.

We are recommending additional guidance, but we do so with a fairly high level of hesitation. This hesitation is because the guidance would need to be:

- Brief and concise – Our members already have an enormous volume of regulatory burden. Any further required reading should be brief and concise. Providing a lengthy and debatable document could result in overblown auditor, attorney, and consulting fees.
- Focused on streamlining rather than expanding the requirements – One concern is that overly protective risk managers within the accounting firms may read words into the document that do not exist and require more work rather than less. While developing the guidance, the Commission should bear in mind the goal of scaled or proportional regulation of smaller public companies and the criteria proposed by the ACSPC.
- Focused on a top-down approach – The most valuable guidance would address the implementation and execution of a top-down approach so that when management identifies its risks and limits the scope of its testing to riskier processes, the work is not ignored by accounting firms that prefer wholesale testing due to revenue considerations and fear of second-guessing by the PCAOB auditors.
- Not inconsistent with current practice – Although the guidance does not necessarily need to be consistent with current practice, it should not be inconsistent with current practice. That is, the guidance could be different for smaller companies, but should not have the effect of requiring larger, more sophisticated filers to unwind the years of work they have already undertaken.
- Issued expeditiously – The guidance needs to be issued soon in order to be useful.
- Withdrawn if not workable – The Commission should provide companies with the draft guidance to determine whether it meets their needs. If not, then it should not be issued.

3. Should additional guidance be limited to articulation of broad principles or should it be more detailed?

This is another area in which guidance should be tailored. Smaller banks prefer guidance with specific examples to preclude misunderstandings between management and auditors and second guessing of management decisions. Larger banks tend to appreciate the broad principles that allow management the ability to

determine risks and controls. The details are cause for concern for some larger banks due to their expertise and the potential for detailed guidance to invalidate previous decisions. Guidance for larger banks that is intended to clarify certain issues has the potential to resolve existing and ongoing disputes between issuers and auditors.

4. Are there additional topics, beyond what is addressed in this Concept Release, that the Commission should consider issuing guidance on? If so, what are those topics?

Yes. There continues to be an emphasis on extremely extensive coverage (coverage as high as 99% in some cases). Coverage appears to be given more weight by audit firms than top-down, risk-based approaches to assessing risk. Management and firms should be clearly instructed away from applying coverage ratios, and they should be directed to use top-down approaches. Additionally, a related issue is checklisting. Several firms are applying a checklist procedure to test and evaluate internal controls, which does not account for the varying risks and structures of different businesses.

5. Would additional guidance in the format of a Commission rule be preferable to interpretive guidance? Why or why not?

We believe it is premature to determine whether it should be in the format of a rule, interpretive guidance, a safe harbor provision, or as an optional tool for management. Generally speaking, the content would largely govern the format.

6. What types of evaluation approaches have managements of accelerated filers found most effective and efficient in assessing internal control over financial reporting? What approaches have not worked, and why?

Some of our members believe that the most effective approach to evaluation they have encountered is the key account/key control approach. This approach has the potential to be the most cost-effective and efficient due to its focus on specific controls and accounts, allowing companies to sort more quickly through the thousands of controls they may have in place.

Our members have also indicated that evaluations of processes have generally not been effective or efficient. Evaluations conducted by examining processes lend themselves to broad and unfocused reviews of non-integral controls and low-risk accounts.

Additionally, we believe that a good legislative change would be to have a single certification for internal controls rather than separate certifications for Sections 302 and 404.

7. Are there potential drawbacks to or other concerns about providing additional guidance that the Commission should consider? If so, what are they? How might those drawbacks or other concerns best be mitigated? Would more detailed Commission guidance hamper future efforts by others in this area?

It all depends on the nature of the guidance. Guidance that reduces burden would be helpful and welcome. Guidance that adds burden, or that imposes additional – or merely different – requirements would not be helpful. The cost of compliance has been a major concern of filers since the onset of Section 404.

8. Why have the majority of companies who have completed an assessment, domestic and foreign, selected the COSO framework rather than one of the other frameworks available, such as the Turnbull Report? Is it due to a lack of awareness, knowledge, training, pressure from auditors, or some other reason? Would companies benefit from the development of additional frameworks?

COSO is the format that banks have used under the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Banks anticipated little change from the FDICIA process to the Section 404 process, making COSO the logical choice due to familiarity with it.

As to the development of additional frameworks for all companies to follow, the theory is appealing, but we are wary of requiring such a change unless it truly reduces costs – including the initial year of application. Too much time and too many shareholder dollars have been spent on COSO and Section 404 to switch to a new framework, unless there are significant and immediate savings. Even a new optional framework would likely result in either increasing the inconsistency in internal controls development or an expectation that entities must follow the “best practices” of the new framework. The more immediate aim should be to tailor the existing framework to different business models and risk profiles and to streamline reporting in light of the requirements of Section 404.

As for the development of an additional framework for smaller companies to follow, this could be a positive development. However, such framework should be developed prior to requiring the smaller companies to implement Section 404. It is inappropriate to require smaller companies to adopt two different frameworks in quick succession.

9. Should the guidance incorporate the May 16, 2005 “Staff Statement on Management’s Report on Internal Control Over Financial Reporting”? Should any portions of the May 16, 2005 guidance be modified or eliminated? Are there additional topics that the guidance should address that were not addressed by that statement? For example, are there any topics in the staff’s “Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions (revised October 6, 2004)” that should be incorporated into any guidance the Commission might issue?

Some clarification and guidance around the use of work of others and the use of judgment would be helpful. These concepts were included in the May 16, 2005, guidance, and it was helpful, but it appears to us that they were never fully embraced by the auditors.

10. We also seek input on the appropriate role of outside auditors in connection with the management assessment required by Section 404(a) of Sarbanes-Oxley, and on the manner in which outside auditors provide the attestation required by Section 404(b). Should possible alternatives to

the current approach be considered and if so, what? Would these alternatives provide investors with similar benefits without the same level of cost? How would these alternatives work?

We continue to believe that the expansion by the Public Company Accounting Oversight Board (PCAOB) of the *auditing standards* to require audit opinions for Section 404 (over and above the attestations that are required under Section 404) resulted in significant increases in costs for companies. We believe this was an inappropriate extension beyond the PCAOB's authority, and the Commission should clarify that its rule and the law do not require stand-alone opinions. Such clarification could help streamline the costs of Section 404 for large companies as well as for those companies that have not yet implemented the Section 404 attestations.

The current approach of integrating internal control audits with financial statement audits is still too uncoordinated. Continued movement towards integrated audits can alleviate some of the expense and time cost of the attestations.

Separately, there is very real risk that firms who conduct integrated audits will require integrated audits for companies that are not subject to Section 404, effectively resulting in a mandate by the audit firms for all companies to be subject to Section 404. Similarly, we are extremely concerned about an American Institute of Certified Public Accountants' proposal, *Reporting on an Entity's Internal Control Over Financial Reporting* (AT 501), which appears effectively to require the Section 404 process for certain banks not covered by that provision of the law. The Commission or the PCAOB will need to direct audit firms carefully not to overstep their bounds by broadly applying Section 404 to every audit client, unnecessarily driving up the costs of compliance for nonpublic businesses. We have anecdotally been informed that firms are beginning to increase fees based on their experiences with Section 404 for clients that are non-filers and for companies that are not yet subject to the attestation requirements of Section 404. Section 404 has, with questionable benefit, put serious dents in the finances of many public companies, and auditors should not be permitted in effect to over-ride the decisions that Congress made regarding applicability.

Case in point, a large accounting firm recently informed its non-public bank audit client that the audit for companies subject to Section 404 and for those not subject to Section 404 will be conducted the same, regardless of the difference in requirements. This information was provided to the bank in response to the bank's questioning why the audit firm needed additional information around the company's voluntarily implemented whistleblower hotline and code of conduct. In other words, the company is not required to have either of these controls, but the auditor is auditing them. The auditor is spending the bank's time and money examining control features for which there is no directive to examine. It is inappropriate that the auditing firms be able to rewrite the laws established by Congress, and such actions may discourage companies from adopting "best practices".

Finally, the external auditor attestation requirement may provide insufficient incremental benefit for the cost incurred by smaller companies. For smaller companies, we recommend that this requirement be removed. The management

certification would still ensure the effectiveness of the company's internal controls. This would also result in an easier to implement top-down, risk-based strategy for design and evaluation, because auditors would not be able to impose audits based on minutia. In the case of the smallest companies, observation and inquiry can provide some level of certainty. Additionally, external auditors could be required to document and provide any material weaknesses in financial internal controls noted in their audits *of the financial statements* to the audit committee, and management could be required to report such weaknesses to shareholders along with a discussion of how they were corrected or will be corrected.

We recognize that certain recommendations of the ACSPC may require legislation, and we urge the Commission to support those recommendations.

11. What guidance is needed to help management implement a "top-down, risk-based" approach to identifying risks to reliable financial reporting and the related internal controls?

Specific guidance that aids management in identifying risks and the applicable controls that mitigate those risks could be useful in helping to reduce unnecessary expenditures of time and energy. The guidance would also direct management toward a top-down, risk-based approach and away from simply performing statistical sampling and coverage, which are often counter to a risk-based approach.

It appears that much more work needs to be done with the auditing firms in implementing the top-down approach. Some financial institutions have reported little change in the approach of their auditors; that is, the expectation of a decrease in hours the auditors spend has not occurred. Instead, the hours seem to have flattened out, with very few efficiencies gained. These firms seem to be taking a defensive posture rather than following the thrust of the May 16, 2005, PCAOB guidance, perhaps revealing a continuing fear that they will be cited in the PCAOB inspections for lack of work. Additionally, in some cases the audit firms are using some of their less experienced people, which tends to waste time because of their lack of seeing the "big picture" from a top-down or risk-based view.

Guidance that helps steer auditors away from auditing unlikely and/or infrequent events could be useful. The past insistence of the auditors that they must audit these events leads to a disproportionate amount of time and effort wasted on minutia.

Auditors should be able to consider other compensating controls that are not included in the internal controls flowcharts, including risk management practices. The PCAOB rules are being implemented on an excessively detailed level, and smaller companies simply do not have the numbers of staff that auditors will likely expect for performing controls. Some of the broader and more important company practices, such as risk management practices, internal audit testing, banking regulatory examinations, etc., could be viewed as compensating controls. Auditors should be able to consider business processes in place that control risks that are beyond the flowcharts.

14. In areas where companies identified significant start-up efforts in the first year (e.g., documentation of the design of controls and remediation of deficiencies) will the COSO guidance for

smaller public companies adequately assist companies that have not yet complied with Section 404 to efficiently and effectively conduct a risk assessment and identify controls that address the risks? Are there areas that have not yet been addressed or need further emphasis?

The length of the document is of concern; however the examples appear to be useful.

16. Should guidance be given about the appropriateness of and extent to which quantitative and qualitative factors, such as likelihood of an error, should be used when assessing risks and identifying controls for the entity? If so, what factors should be addressed in the guidance? If so, how should that guidance reflect the special characteristics and needs of smaller public companies?

While there is disagreement among our members whether additional guidance is needed related to the quantitative and qualitative factors, any guidance issued will have to recognize and be tailored to the differences and limitations of smaller companies in designing and implementing internal controls.

19. What type of guidance would help explain how entity-level controls can reduce or eliminate the need for testing at the individual account or transaction level? If applicable, please provide specific examples of types of entity-level controls that have been useful in reducing testing elsewhere.

Some specific examples of entity-level controls used by banks are loan committees, investment committees, pricing committees, asset/liability committees, review of budget versus actual performance by management, planning audit report committees, and independent financial statement audits, to name a few.

Also, see our answer to question #32.

20. Would guidance on how management's assessment can be based on evidence other than that derived from separate evaluation-type testing of controls, such as on-going monitoring activities, be useful? What are some of the sources of evidence that companies find most useful in ongoing monitoring of control effectiveness? Would guidance be useful about how management's daily interaction with controls can be used to support its assessment?

Focusing on monitoring controls could eliminate a lot of time-consuming testing. To that end, additional guidance related to appropriate types of evidence that support ongoing monitoring activities would be helpful.

With respect to some of the sources used for monitoring, some sources of evidence are logs and reconciliations.

21. What considerations are appropriate to ensure that the guidance is responsive to the special characteristics of entity-level controls and management at smaller public companies? What type of guidance would be useful to small public companies with regard to those areas?

Real-life examples can be a useful source of guidance. The COSO guidance is a step in the right direction, but companies may require additional examples specific to different businesses, industries, and sizes of entities.

22. In situations where management determines that separate evaluation-type testing is necessary, what type of additional guidance to assist management in varying the nature and extent of the evaluation procedures supporting its assessment would be helpful? Would guidance be useful on how risk, materiality, attributes of the controls themselves, and other factors play a role in the judgments about when to use separate evaluations versus relying on ongoing monitoring activities?

The second part of this question raises the issue of how testing of monitoring activities should be undertaken. This is an area in which additional guidance may be useful to some companies.

24. What type of guidance would be appropriate regarding the evaluation of identified internal control deficiencies? Are there particular issues in evaluating deficient controls that have only an indirect relationship to a specific financial statement account or disclosure? If so, what are some of the key considerations currently being used when evaluating the control deficiency?

One particular issue that has been raised repeatedly is that of “sign and file”. This issue relates to auditors’ tendency to focus on the presence of a signature to validate whether a control is missing and not whether the control is actually functioning and preventing errors as designed. There was some relief provided by the May 16, 2005, guidance, but these isolated lapses in documentation continue to be reported to the audit committees despite the guidance and despite the fact that the control is functioning.

25. Would guidance be helpful regarding the definitions of the terms “material weakness” and “significant deficiency”? If so, please explain any issues that should be addressed in the guidance.

For larger banks, the definitional issues of the first years of compliance have abated with experience. For smaller banks, guidance in this area could eliminate some confusion when they are implementing and testing their internal controls, as long as it does not conflict with the currently accepted understanding (causing new issues for experienced filers).

26. Would guidance be useful on factors that management should consider in determining whether management could conclude that no material weakness in internal control over financial reporting exists despite the discovery of a need to correct a financial statement error as part of the financial statement close process? If so, please explain.

The closing process that companies go through is an internal control in itself, as it can identify weaknesses or errors in the continuous internal control structure. This, in addition to the external independent audit, serves to correct accounting errors prior to the release of annual financial statements.

Often, the accounting rulemakers, the Commission, or the accounting firms set forth new views about the application of old accounting rules. In these instances, companies *and their auditors* have believed for many years that they were following GAAP. These instances should not be defined as material weaknesses of the reporting entity.

27. Would guidance be useful in addressing the circumstances under which a restatement of previously reported financial information would not lead to the conclusion that a material weakness exists in the company's internal control over financial reporting?

Yes, this has been an area of contention, and guidance in this area would be helpful in preventing and/or resolving restatement disagreements between auditors and filers.

28. How have companies been able to use technology to gain efficiency in evaluating the effectiveness of internal controls (e.g., by automating the effectiveness testing of automated controls or through benchmarking strategies)?

Technology has provided limited benefit in gaining efficiency in the evaluations of effectiveness of internal controls. This benefit diminishes with decreasing company size due to cost and practicality.

For current filers, the information technology (IT) emphasis has been interpreted too broadly by external auditors, and the current level of external audit review and testing of IT controls seems to be excessively burdensome. In some cases, much of the burden is caused because the accounting firm relies on a separate team of "IT specialists" to do this portion of the work. The approaches used within the same firm to do the IT work compared with the rest of the Section 404 work seem to vary; thus, companies often feel as though they are dealing with two separate firms.

Specifically, it appears that auditors are struggling to define clearly for their clients the appropriate level of IT controls documentation to achieve the intended scope and focus of Section 404 (i.e., financial reporting and disclosure). A company's IT approach should, for Section 404 purposes, remain focused on significant applications truly critical to the accurate reporting and presentation of financial data. The accounting firms also appear to have a significant staffing shortage in this area. This is a significant portion of the cost of Section 404, and although there appears to be some reduction in cost due to a more reasonable interpretation by auditors, there is still an apparent significant shortage of qualified audit staff to address the IT issues adequately.

In general, the time and effort required to do the IT review is excessive because of: (a) the inexperience of the external audit IT reviewers, and (b) the lack of clarity on the part of the auditing firm on the approach to be used for the IT work.

29. Is guidance needed to help companies determine which IT general controls should be tested? How are companies determining which IT general controls could impact IT application controls directly related to the preparation of financial statements?

Guidance would be helpful, but this is an area where different industries and even different businesses within an industry employ vastly different IT systems. For this reason, it is likely that a lot of individualized and specific guidance would be required in order to be of use. It may be that for smaller companies, the scope of IT controls should be limited to those items that interface with the company's general ledger.

31. Were the levels of documentation performed by management in the initial years of completing the assessment beyond what was needed to identify controls for testing? If so, why (e.g., business reasons, auditor required, or unsure about “key” controls)? Would specific guidance help companies avoid this issue in the future? If so, what factors should be considered?

A few of our members have indicated that with each new year of experience with Section 404, documentation has adjusted toward a more appropriate level. However, it has not decreased sufficiently for most to have realized a significant improvement. Generally, excessive documentation is due to poor understanding of what is required, a lack of guidance from regulators, fear of liability at auditing firms, and efforts on the part of companies not to misstep in the slightest for fear of being penalized by the market for a misperception of weak controls.

32. What guidance is needed about the form, nature, and extent of documentation that management must maintain as evidence for its assessment of risks to financial reporting and control identification? Are there certain factors to consider in making judgments about the nature and extent of documentation (e.g., entity factors, process, or account complexity factors)? If so, what are they?

Yes, certain factors should be included with regard to making judgments about the nature and extent of documentation. Consistent with our view that a risk-based approach should be applied, banks are highly regulated entities, which has resulted in strong internal controls.

It would be useful to illustrate with an example provided by an ABA member, in a situation that is fairly common. A \$125 million publicly-held bank holding company has one national bank. The holding company’s primary federal regulator is the Federal Reserve, and the bank receives oversight from the Office of the Comptroller of the Currency. (Even though the bank holding company is required to follow Section 404, it has never been required to follow the FDICIA management reporting, due to its size.) The holding company has professional internal audits (partially outsourced, so it is done by an independent, qualified professional), regulatory compliance audits, and an independent financial statement audit. The banker’s question is legitimate: “With all of these people in here looking for things, what could we possibly be doing that could be missed and be material???. Why pay so much for very little more?”

If guidance is issued, this banker recommends that the guidance be written to take into account these existing control structures and existing documentation. We concur. This could help ensure a more risk-based approach and could help reduce documentation (which is often based on the desires of a “litigation-wary independent auditor”).

33. What guidance is needed about the extent of documentation that management must maintain about its evaluation procedures that support its annual assessment of internal control over financial reporting?

Flexible, general guidance that can be tailored to an individual company’s structure and needs would be helpful.

34. Is guidance needed about documentation for information technology controls? If so, is guidance needed for both documentation of the controls and documentation of the testing for the assessment?

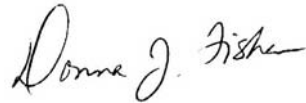
Similarly, due to vast differences in companies and industries, the information technology guidance should be flexible and general so that it can be applied across industry and size delineations.

Conclusion

Additional guidance for companies that have yet to comply with Section 404 would be useful in order to make the process more efficient, prevent over-documentation and excessive testing, and reduce the unreasonably steep costs associated with the compliance experience thus far. This guidance, if it is well written, could be very useful. The difficulty is in finding guidance that provides genuine relief from regulatory burden.

Again, we appreciate the Commission's and the PCAOB's efforts in these matters. The roundtables, the PCAOB's town meetings, the May 16 guidance, and this comment process have helped identify problems and solutions. We look forward to working with you further as you proceed in streamlining the Section 404 process. Please contact me at 202.663.5318 with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Donna J. Fisher". The signature is written in black ink and is positioned to the right of the typed name.

Donna J. Fisher