



February 26, 2007

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington D.C. 20549-1090

Re: Management's Report on Internal Control Over Financial Reporting
Release Nos. 33-8762; 34-54976; File No. S7-24-06; 71 FR 77635
(December 27, 2006)

Dear Ms. Morris:

America's Community Bankers ("ACB")¹ is pleased to submit comments on the U.S. Securities and Exchange Commission's ("Commission") proposed interpretive guidance to assist management in its evaluation of internal control over financial reporting ("ICFR"). We also are pleased to comment on two related proposed amendments to Commission rules: i) an amendment to Rules 13a-15(c) and 15d-15(c) of the Securities Exchange Act of 1934 ("Exchange Act") that would accept management's compliance with the interpretive guidance as meeting management's evaluation obligation under the rules; and ii) amendments to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X that would require auditors to express an opinion directly on the effectiveness of ICFR and not on management's evaluation of ICFR. We applaud the Commission's efforts to develop guidance for management to implement Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which is an important issue for community banks.

ACB Position

ACB supports the Commission's proposed interpretive guidance for management to evaluate its assessment of ICFR as required by Section 404 of Sarbanes-Oxley and Exchange Act Rules 13a-15(c) and 15d-15(c). The proposed guidance appropriately permits management to use its judgment to determine an evaluation method of internal controls that best suits the circumstances, size and complexity of its business. Further, ACB strongly believes that the Commission should recognize in the interpretive guidance bank management's compliance with the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA")² as meeting the evaluation requirements of Rules 13a-15(c) and 15d-15(c). ACB requests that the

¹ America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit www.AmericasCommunityBankers.com.

² 12 U.S.C. § 1831m

Commission extend Section 404(a) and Section 404(b) compliance dates for non-accelerated filers for at least an additional year. We believe this extension is necessary so that the proposed interpretive guidance and the Public Company Accounting Oversight Board's ("PCAOB") proposed revised auditing standard for ICFR can be finalized and tested by accelerated filers, regulators and auditors before these smaller public companies are required to comply. Finally, ACB supports the proposed amendment to Rule 2-02(f) and Rule 1-02(a)(2) of Regulation S-X that would eliminate the auditor's opinion on management's evaluation of ICFR.

Background

Guidance for Bank Management

Section 404 of Sarbanes-Oxley requires management to annually issue a report that assesses the effectiveness of ICFR. As required by Sarbanes-Oxley, the Commission adopted Exchange Act Rules 13a-15(c) and 15d-15(c) to implement this provision of Section 404. The Commission's proposed interpretive guidance sets forth an evaluation process to help management identify financial reporting risks and internal controls, evaluate the effectiveness and deficiencies of internal controls, and develop evidence to support the assessment. Most importantly, the proposed guidance permits management to design and conduct an evaluation that is tailored by management to fit its company's size, complexity and circumstances. The proposal also provides guidance for management on reporting and disclosures related to the assessment of ICFR.

ACB supports the Commission's proposed interpretive guidance to assist management in its evaluation of ICFR. Further, ACB strongly believes that the proposed guidance should recognize bank management's compliance with Section 36 of the FDICIA as an evaluation process that satisfies the requirements of Rules 13a-15(c) and 15d-15(c). We recommend that the proposed guidance specifically include such a provision.

In previous comment letters, ACB has stressed the need for relief for community banks from the requirements of Section 404 of Sarbanes-Oxley.³ Publicly held community banks are unique to all other public companies. Community banks are part of a highly regulated industry governed by numerous statutes and regulations covering almost every aspect of banking activity. Banks are subject to statutory and regulatory capital requirements. Each banking institution is regulated by two agencies: the agency that issued the bank's charter and the Federal Deposit Insurance Corporation ("FDIC"). In addition to banking laws and regulations, publicly traded banks also must comply with the Commission's recordkeeping and reporting requirements. We believe that no other publicly traded company is subject to the same scrutiny as a publicly traded bank.

³ See letter from ACB Regulatory Counsel, Sharon Haeger, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated September 15, 2006; letter from ACB Regulatory Counsel, Sharon Lachman, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated May 1, 2006; letter from ACB Regulatory Counsel, Sharon Lachman, to the Advisory Committee on Smaller Public Companies ("Advisory Committee"), dated April 3, 2006; and letter from ACB Senior Vice President Regulatory Affairs, Charlotte M. Bahin, to the Advisory Committee dated August 9, 2005. The foregoing letters are available at www.AmericasCommunityBankers.com.

Section 36 of FDICIA and Part 363⁴ of the FDIC's regulations govern bank management's responsibility for financial statements and ICFR. Section 36 requires banks to have annual financial statements prepared in accordance with generally accepted accounting principles. That section also requires each bank to prepare annual management reports signed by the chief executive officer and the chief accounting or chief financial officer that contain a statement of management's responsibilities for i) preparing the banks' annual financial statements; and ii) establishing and maintaining an adequate internal control structure and procedures for financial reporting and compliance with safety and soundness regulations. Bank management's report must include assessments by management of the effectiveness of the bank's internal control structure and procedures for financial reporting and the institution's compliance with designated safety and soundness regulations. Bank management's report is required to be included in the annual report the bank files with the FDIC and its primary federal regulator. These annual reports are available to the public.

Section 36 of FDICIA and Part 363 of the FDIC's regulations require the bank's independent public accountant to examine, attest to, and report separately on management's assertion concerning internal controls. The attestation report also is required to be included in the annual report the bank files with the FDIC or its primary federal regulator. The FDIC adopted regulations establishing thresholds for the reporting requirements of Part 363. Banks with over \$1 billion in total assets are required to provide management's assessment of the effectiveness of internal controls and an independent public accountant's attestation on management's assertions on internal controls. Banks with \$500 million or more are required to establish and maintain an adequate internal control structure and procedures for financial reporting and include a statement to that effect in the Part 363 annual report.

Management of all size banks is responsible for establishing and maintaining an adequate internal control structure, procedures for financial reporting and an annual audit of financial statements performed by an independent public accountant. Banks with less than \$500 billion in assets were granted relief by the FDIC from the burden of internal control assessments. The FDIC concluded that these thresholds would be consistent with the underlying statutory objectives of Section 36 of FDICIA. The Commission should reach the same conclusion for all smaller public companies and grant relief under Section 404 of Sarbanes-Oxley.

After the enactment of Sarbanes-Oxley and the SEC's rules implementing Section 404, banks were faced with the additional burden and costs of a second layer of ICFR regulation. In its Concept Release,⁵ the Commission acknowledged that the implementation of Section 404 had resulted in the identification of too many controls, many of which were inconsequential to the integrity of financial reports, and an excessive amount of documentation to support the identification of internal controls. According to the Concept Release, the documentation "substantially exceeded that normally produced by financial institutions under the Federal Deposit Insurance Corporation Improvement Act of 1991."⁶ However, after recognizing the excessive duplication, the Commission did not go far enough in its proposed interpretive

⁴ 12 C.F.R. Part 363

⁵ Vol. 71 FR 40866

⁶ Vol. 71 FR 40872

guidance to consider the reports required by FDICIA and eliminate the burdensome and costly duplication of effort for banks.

Bank management has been responsible for meeting statutory and regulatory requirements for ICFR for many years. Bank management in preparing its reports to meet these requirements has developed a process for evaluating internal controls based on the size and complexity of its bank and the knowledge of the bank's business and risks. ACB, therefore, strongly recommends that the Commission's proposed interpretive guidance specifically include bank management's report as required by Section 36 of FDICIA and Part 363 of the FDIC's regulations as a non-exclusive safe harbor in satisfaction of Exchange Act Rules 13a-15(c) and 15d-15(c).

Non-Exclusive Safe Harbor

ACB supports the Commission's proposed amendment to Exchange Act Rules 13a-15(c) and 15d-15(c) that would provide management's evaluation conducted in accordance with the interpretive guidance as a non-exclusive safe harbor. As noted above, the Commission should include bank management reports in the proposed interpretive guidance as meeting the proposed safe harbor. We agree that the safe harbor should be non-exclusive so that accelerated filers that may already have designed a suitable method of evaluation of ICFR need not be required to expend resources to revise its evaluation to meet the provisions of the guidance.

ACB strongly believes that the proposed guidance should not be codified as a Commission rule. As guidance, management should have the flexibility to use its judgment in developing an evaluation process for ICFR. Management should be able to adjust that process to accommodate changes in risk and business circumstances. We are concerned that the interpretive guidance as a rule would become inflexible and prescriptive.

The Accountant's Attestation Report

ACB supports the Commission's proposed amendments to Rules 1-02(a) (2) and 2-02(f) of Regulation S-X that govern accountant's attestation reports on the effectiveness of ICFR. The proposed amendment would require the auditor to express an opinion directly on the effectiveness of ICFR and not on management's assessment of the effectiveness of ICFR. Eliminating this opinion should help to eliminate some of the duplication in the ICFR process and reduce the expense of the audit engagement. However, ACB is concerned that this amendment does not go far enough in providing relief.

The literal language of Section 404 of Sarbanes-Oxley requires a registered public accounting firm to attest to and report on management's assessment of the effectiveness of its company's internal control structure and procedures. This language is based on the language of Section 36(c) of FDICIA that also requires the independent public accountant of a bank to attest to and report on management's assessment of the bank's internal control structure and procedures. Neither Section 404 of Sarbanes-Oxley nor Section 36 of FDICIA requires an auditor's opinion on the effectiveness of ICFR. Bank regulatory agencies have determined that an attestation is consistent with and meets the objective of the statutory requirements. We believe that the

Commission and the PCAOB should reach the same conclusion under Section 404 and not require an opinion audit.

Need for Additional Extension for Compliance for Non-Accelerated Filers

ACB strongly believes that non-accelerated filers should be given an additional extension of time in which to comply with Section 404 of Sarbanes-Oxley. The process of identification, evaluation and assessment of ICFR is a complex and costly endeavor for management of all size companies. This is particularly true for non-accelerated filers. We have heard from our member banks that at a minimum this process includes hiring a consulting firm and/or a full time internal auditor that deals solely with Section 404 ICFR compliance matters. This does not include the fees for the external audit of ICFR. Non-accelerated filers should not be required to unnecessarily expend resources until the proposed guidance and the PCAOB's auditing standard have been finalized and adopted.

As ACB has stated in previous comment letters,⁷ non-accelerated filers are at a disadvantage in implementing Section 404: lack of experience with implementing Section 404 for the first time; implementing Section 404 based on the existing Auditing Standard No.2; and implementing Section 404 based on guidance and accounting standards that have not been finalized and tested. The Commission should follow the recommendations of its Advisory Committee on Smaller Public Companies and provide microcap and small companies an exemption from compliance with Section 404 "if and until" there is a suitable framework. A suitable framework would include experience with the proposed guidance and auditing standard.

ACB appreciates the opportunity to comment on the Commission's proposed interpretive guidance for management to evaluate its company's internal controls. If we can be of further assistance, please contact Patricia Milon at (202) 857-3121 or pmilon@acbankers.org, or the undersigned at (202) 857-3186 or shaeger@acbankers.org.

Sincerely,



Sharon A. Haeger
Regulatory Counsel

⁷ See letter from Regulatory Counsel, Sharon A. Haeger, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission dated September 14, 2006, available at www.AmericasCommunityBankers.com.