



1303 J STREET, SUITE 600, SACRAMENTO, CA 95814-2939 T. 916.441.7377 F. 916.441.5756

April 5, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number 4-497 (Sarbanes Oxley Act Section 404)

Dear Mr. Katz:

The California Bankers Association (ABA) appreciates this opportunity to provide written comments to the SEC in connection with the upcoming roundtable discussion on the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 (the Act). CBA is a professional nonprofit organization established in California in 1891, and is the largest bank trade association in the state of California, representing most of the 300 commercial banks, savings associations and industrial loan companies in the state.

We have suggested two bankers from this state, Kent Steinwert or Steve Haley from Farmer & Merchants Bank in Lodi, California and Byron Scordelis from Greater Bay Bancorp in Palo Alto, California, to participate in the April 13 SEC roundtable on Section 404 compliance. Both are community bankers and are well positioned to provide constructive input on the effect of Section 404 on medium sized financial institutions.

Section 404 Recommendations

CBA and its members recognize the importance of establishing effective internal controls. Indeed, the principles of Section 404 find their genesis in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which have applied to banks with assets greater than \$500 million for almost 15 years. However, we are very concerned about the considerable time and cost burdens associated with Section 404 compliance, particularly for smaller institutions.

While our members acknowledge that Section 404 has helped to improve awareness of internal controls throughout the bank, including at the board level, there are also significant concerns that the level of detail required by the accounting firms make the process extremely expensive when compared with the benefits achieved. We have conducted informally and

formally surveys of our members on Section 404 compliance, and have determined that even banks of modest size spend inordinate amounts in hard dollar costs.

In one example, a bank with approximately \$2.2 billion in total assets had incurred approximately \$1 million in additional costs to comply with the Act, with about 80% of that amount allocated to Section 404 compliance. Another bank of similar size that was closely held (subject to FDICIA but not Section 404) spent only about \$100,000 in additional corporate governance compliance costs.

Because the Section 404 requirements are not scaled, the burdens fall particularly hard on community banks that are SEC registrants. In concept, small registered companies must undergo the same extensive procedures of the largest companies, at much greater relative cost. In addition, institutions must undergo the additional associated burdens of having to change or retain additional accounting firms because of the restrictions on multiple services. This could present a hardship particularly for banks because of the limited firms that have specific banking expertise.

CBA appreciates that the SEC is undertaking a process to determine how the regulations implemented pursuant to the Act and the rules of the Public Company Accounting Oversight Board (PCAOB) may be amended to ensure that the purposes of the Act are met but without imposing undue burdens on companies. Toward that end, we believe the SEC should consider adopting different rules based on the size of the company, and review whether to adjust the number of shareholders that trigger SEC registration requirements.

PCAOB Recommendations

As to the PCAOB guidance, we note the great similarities between FDICIA and the Act in the area of reporting on internal controls. The main difference lies in the PCAOB's Auditing Standard No. 2 - "An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements" (AS 2). We do not believe that the Act requires an additional stand-alone opinion by auditors on internal controls. The SEC should consider whether Section 404 in fact requires attestations in addition to audits of internal controls. These duplicative requirements result in the expenditure of significant resources that are not balanced against significant corresponding benefits.

Even if eliminating the additional audit requirement entirely is not an option, the SEC should nevertheless consider improving the manner in which accounting firms conduct the independent audit of internal controls. For example, the PCAOB should establish guidelines permitting accounting firms to make more use of the work of internal auditors. If the quality of the internal audit function within a company is deemed to be reliable, then requiring the external auditor to duplicate the work is unnecessary and costly.

The PCAOB should also consider adopting a risk management approach to the Section 404 process rather than, for example, requiring the same degree of documentation and testing for all risks without regard to the relevance and significance of the type of risk. A risk-based approach

Mr. Jonathan G. Katz
April 5, 2005
Page 3

would help ensure that resources are properly allocated to controls that have an effect on the purposes of the Act.

In working with the accounting firms, the PCAOB should assess whether they are properly applying AS 2 and other guidance. CBA and its members believe some firms are overly stringent in applying requirements because of the fate of Arthur Andersen and the prevailing mood in the government, including at the Justice Department. It is not helpful if the firms have a self-serving (though understandable) incentive to apply the guidance in the most stringent manner possible in order to avoid criticism from the PCAOB and possible shareholder law suits in the event that an audited company gets in trouble. The companies being audited should not bear the brunt of the anxiety felt by auditors in the form of unreasonable, inflexible demands. Like all regulatory guidance, the PCAOB issuances should be narrowly tailored to achieve the relevant statutory purposes and should be reasonably applied. The PCAOB could reintroduce a sense of balance by working more cooperatively with the auditing community.

CBA appreciates this opportunity to provide these written comments. We hope that our organization will be represented at the roundtable meeting to provide further comments. If you have any questions, please call me.

Sincerely,



Leland Chan
General Counsel