



1120 Connecticut Avenue, NW  
Washington, DC 20036

1-800-BANKERS  
www.aba.com

*World-Class Solutions,  
Leadership & Advocacy  
Since 1875*

Sarah A. Miller  
Director  
Center for Securities, Trust  
and Investments  
202-663-5325  
Smiller@aba.com

October 31, 2005

Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, N.E.  
Washington, D.C. 20549-9303

Re: Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports; File No. S7-08-05, 70 Fed. Reg. 56862 (September 29, 2005).

Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports of Companies That Are Not Accelerated Filers; File No. S7-40-02, 70 Fed. Reg. 56825 (September 29, 2005).

Dear Mr. Katz:

The American Bankers Association ("ABA") appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed rule revising the accelerated filer definition and the accelerated deadlines for periodic filings. Under the proposed rule, the Commission would define a new category of periodic filers as those firms with over \$700 million in public float. These "large accelerated filers" would have sixty days after the end of the fiscal year to file annual reports, while accelerated filers would have seventy-five days. The accelerated and large accelerated filers would both continue to file quarterly reports within forty days after the end of the quarter.

The ABA also appreciates the opportunity to comment on the Commission's final rule and extension of compliance dates for reports on internal controls over financial reporting. Under the final rule, companies that are not accelerated filers ("non-accelerated filer") must begin complying with Section 404 of the Sarbanes-Oxley Act of 2002<sup>1</sup> ("Act") for their first fiscal year ending on or after July 15, 2007.

The ABA, on behalf of the more than two million men and women who work in the nation's banks, represents all types of banking institutions in this rapidly changing industry. The ABA's membership includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks (collectively referred to as "banks"), making it the largest banking trade association in the country.

---

<sup>1</sup> 15 U.S.C. 7262.

### Definition of Large Accelerated Filer

Under the recent proposal, the Commission is considering adding another category of registered filer to the two existing categories of “accelerated” and “non-accelerated” filers. This “large accelerated filer” would constitute those firms with more than \$700 million in total market capitalization held by non-affiliates of the firm as of the last day of its second fiscal quarter. The Commission reasons that these firms need more scrutiny because they “are more closely followed by the markets and securities analysts than other issuers.... [and] accounted for approximately 95 [percent] of U.S. equity market capitalization in 2004.”<sup>2</sup>

The ABA understands the need to apply differing scrutiny to firms based on their relative market size. The regulatory scheme imposed, however, must apply fairly to all publicly-traded companies, both large and small.

The ABA supports establishing a \$700 million threshold for “large accelerated filers.” Establishing this new threshold would bring the definition of “large accelerated filer” in line with that of “well-seasoned issuer.” Alternatively, as recommended by the Advisory Committee for Smaller Public Companies, the Commission could employ a relative threshold set at the lowest 6 percent of total market capitalization.

We also support a threshold for non-accelerated filers that is expressed in terms of the lowest one percent of market capitalization of all publicly-traded companies or those companies with a public float of \$110 million or less. We understand that approximately 400 banking organizations would fit within this threshold.

### Periodic Filing Deadlines

The ABA strongly supports the Commission's efforts to improve the *usefulness* of 10-K and 10-Q reports filed by publicly-traded companies. Our member banks rely extensively on the information disclosed in these reports. In particular, banks rely on them to determine whether to engage in credit and other similar transactions with the company. Bank trust department and bank-affiliated brokerage and investment advisory firms rely on these reports to determine whether the securities of these companies are an appropriate investment of client assets. Obviously, the sooner banks obtain these periodic reports the sooner they can conduct their lending and wealth management business.

Nevertheless, the usefulness of these reports depends not only on their timeliness but on their accuracy. Any shortening of the reporting deadlines inevitably increases the chances of inaccurate or incomplete reports. In some cases, firms must base their reports on estimates, leading to subsequent amendments or restatements. As the Commission is well aware, this concern is especially true for

---

<sup>2</sup> 70 Fed. Reg. 56862, 56865 (Sept. 29, 2005).

quarterly reports. An additional few days would make a tremendous difference to the usefulness of these reports while keeping shareholders sufficiently informed.

As a consequence, the ABA is pleased that the Commission has determined to establish a 40-day filing deadline for Forms 10-Q for all accelerated filers. The earlier move to 35 days from the original 45 days for filing Forms 10-Q met with the most concern among ALL accelerated filers that are ABA members.

In addition, the Commission should be aware that some auditors are questioning ABA member firms regarding the number of audit and disclosure committee meetings the firms have scheduled. Some state banking laws impose their own schedule for audit and disclosure committee meetings. These schedules are separate and apart from the committee meetings state chartered banks must hold to meet the newly accelerated filing periods for Form 10-Q.

#### Section 404 and Smaller Public Companies

The ABA is pleased that the Commission has determined to extend the deadline for reporting on internal controls (Section 404 reporting) for non-accelerated filers until the first fiscal year ending on or after July 15, 2007. Extending the effective dates for Section 404 compliance will provide smaller public companies the opportunity to learn from the experiences of larger companies. Similarly, the smaller audit firms that work with small businesses will have the opportunity to learn from the experiences of larger audit firms. Extensions also provide smaller companies with more time to allocate resources for compliance and a chance to absorb the Section 404 guidance recently released by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”).<sup>3</sup>

We note that many of our members either have entered or will soon cross the \$75 million public float threshold that determines whether a publicly traded institution is an accelerated filer (and thus required to comply with Section 404) or a non-accelerated filer (and not yet required to comply with Section 404).

For the following reasons, we suggest that the Commission consider delaying Section 404 compliance for these companies as well. First, these firms are only marginally accelerated filers, having just crossed the \$75 million threshold. They, too, could use the extended time to learn from the experiences of the larger companies and their auditors as well as to digest the new COSO guidance. Second, should the Commission decide to exempt certain types of publicly-traded companies, e.g., those companies within the lowest one percent of total U.S. market capitalization, from Section 404 compliance, many of these companies would become exempt. It makes no sense to require their compliance with Section 404 if there is any chance that they may become exempt in the near future.

---

<sup>3</sup> COSO, Guidance for Smaller Public Companies Reporting on Internal Control over Financial Reporting (2005), available at <http://www.coso.org/>.

*Requirements for Internal Control and Standards for Auditing Internal Control*

The ABA is equally pleased that the Commission published a staff statement<sup>4</sup> emphasizing the risk-based approach to internal control reporting and auditing. However, the Commission must work further with the Public Company Accounting Oversight Board (“PCAOB” or “Board”) to incorporate an effective risk-based approach. Due to significant potential liability, both audit firms and public companies are employing a conservative approach to creating, testing, and auditing internal controls. This fear has often led to a “check the box” approach which ignores the varying risks of different controls. To counter this inefficient method, the Commission should encourage the PCAOB to further incorporate a risk-based approach in its Auditing Standard No. 2 and May 2005 guidance<sup>5</sup> to provide appropriate relief to auditors and the institutions they audit.

In particular, auditors must feel free to communicate with the firms about how to better structure the institution’s internal controls. Given the significant changes in accounting standards, auditors’ assistance with accounting and reporting is vital for smaller public companies. This assistance is needed not only for unusual or infrequent transactions, but also for common transactions for which the accounting has existed for years. Some small businesses find it extremely difficult to keep apprised of both the formal and informal changes to accounting for financial instruments.

The PCAOB’s May 2005 guidance addresses part of this concern by clarifying that audit firms may participate in draft financials and discussions about the appropriate accounting; however, there is room for further improvement. For example, external auditors should evaluate the frequency of contact with audit committees, consider whether the issues presented to the audit committees are significant enough to require the audit committee’s attention and whether it is a wise use of the audit committee’s time.

In addition to working with the PCAOB, the ABA encourages the Commission to evaluate the need for management to perform independent testing. Smaller public businesses find it extremely difficult to segregate the duties of performing a control, checking the control, and testing the control among different employees. Often, they must hire an expensive independent firm to perform the Section 404 testing. Investors in community banks may find it acceptable simply to know that management has controls in place that are documented. Management could report on internal controls, based on the documentation it receives from the company’s various business areas, and auditors could attest to management’s assertions. The documentation would also be the basis for the auditors’ testing and reporting.

---

<sup>4</sup> Securities and Exchange Commission, Staff Statement on Management’s Report on Internal Control Over Financial Reporting (May 2005).

<sup>5</sup> PCAOB, Staff Questions and Answers: Auditing Internal Control Over Financial Reporting (May 16, 2005), available at <http://www.pcaob.org/>.

Lastly, we suggest that the Commission consider accepting compliance with Section 36 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA")<sup>6</sup> as compliance with Section 404 of the Act. Under Section 36, banks with total assets of \$500 million and more already must comply with management reporting on internal controls and auditor attestations.<sup>7</sup> The aim, if not the detailed substance, of the two regulatory requirements is the same: to insure the integrity of the financial statements of the institution.

Alternatively, the ABA recommends that the Commission require Section 404 internal control reporting less frequently than every year. The banking industry is highly regulated from a risk perspective, which mitigates the need for annual assessments of internal controls. At a minimum, the assessments should be every other year, focused on activities surrounding the core business or those areas which are considered high-risk based on the frequency and severity of material loss or misstatement.

#### *Independent Auditor Attestation*

As we have previously advocated,<sup>8</sup> the ABA strongly suggests that the Commission simply require attestations rather than both attestations and audit opinions on internal controls for all public companies regardless of its market capitalization. For the purpose of reporting on internal controls by management and the related attestations by auditors, FDICIA and the Act both require attestations rather than audit opinions. Similarly, the regulations that implement those laws<sup>9</sup> are the same, with the exception of the definition of the reporting entity, the requirements relating to material weaknesses, and certain quarterly procedures.

The PCAOB appears to have based its decision to require audits<sup>10</sup> on Section 103(a) of the Act. The ABA does not believe that Section 103(a), which describes the rules the PCAOB must establish, requires audits. Instead, Section 404 clearly states that attestations—not audits of internal controls—are required in the reporting process. We agree with the definition of an attestation in the introduction to the proposed version of AS 2, which states that: "An attestation, in a general sense, is an expert's communication of a conclusion about the reliability of someone else's assertion." This definition is also required by the Act and FDICIA, and would provide further relief to smaller public companies while remaining within both the letter and intent of the law.

---

<sup>6</sup> 12 USC §1831m.

<sup>7</sup> In an effort to provide relief to community banks, the FDIC has recently proposed to raise the threshold for internal control reporting from \$500 million to \$1 billion. 70 Fed. Reg. 44293 (Aug. 2, 2005).

<sup>8</sup> See Letter of August 31, 2005, from Sarah A. Miller, ABA, to Jonathan G. Katz, Securities and Exchange Commission.

<sup>9</sup> FDIC 12 CFR Part 363; SEC Release No. 33-2838.

<sup>10</sup> PCAOB, Auditing Standard No. 2, ¶¶ E15-E16.

### Non-accelerated Filers: Preparation for Section 404 Compliance

Many community banks, not yet required to comply with Section 404, have had to devote scarce resources to prepare for the internal control reporting requirements. In one case, an ABA member community bank with \$56 million in assets expects to pay between \$80,000 and \$105,000 in auditing expenses for Section 404 compliance based on requests for proposals from the audit firms; a considerable cost for a bank of that size. In expectation of becoming subject to Section 404, another community bank “brought an attorney aboard who was already doing some outside work for our firm. She does more than just Sarbanes and SEC filings, but clearly a large reason for bringing her on board was to be prepared for all of this. The cost isn’t inconsequential, but we think having the expertise in house is much more efficient.”<sup>11</sup>

Because of the increased demand for auditing services, due primarily to Section 404, the auditing fees have risen significantly for all clients, both accelerated and non-accelerated filers. For example, a community bank with \$140 million in assets saw its auditing fees double from \$20,000 to \$40,000 after the Act. In addition, many smaller public companies have a difficult time acquiring the services of the Big Four accounting firms which are overwhelmed with Section 404 work. Many of these firms are concerned that getting dropped by a Big Four firm will affect their reputation.

### Accelerated Filers: Burdens of Section 404 Compliance

One of the greatest burdens of Section 404, auditing costs, has increased dramatically since compliance began. These fees are significantly larger than what the Commission expected during the rulemaking process, especially for smaller public companies. According to a Foley & Lardner study, for companies with less than \$1 billion in revenues auditing expenses rose by 96 percent from 2003 to 2004.<sup>12</sup> However, for firms with more than \$1 billion in revenues, the increase in auditing fees rose a significant but more modest 58 percent. In addition, after the PCAOB issued new guidance back in May 2005, many institutions had to revise their reports on internal control to comply with the new guidance. Revising already completed work is costly for all businesses regardless of size. Moreover, we have begun to hear anecdotal evidence from our members that the cost for compliance with Section 404 has not decreased to any discernable degree.

Many of our members contract with third parties to conduct their internal audits. However, these banks still must assign what few employees they have to oversee the compliance. For example, the employees of a bank with \$2.3 billion in assets spent between 500 and 1,000 hours on the Act compliance, not including the time spent by outside firms.<sup>13</sup> This same bank also worries about getting dropped by

---

<sup>11</sup> ABA Banking Journal, SOX Gone Silly (Aug. 2005).

<sup>12</sup> Foley & Lardner, The Cost of Being Public in the Era of Sarbanes-Oxley, p. 12 (June 16, 2005), available at [http://www.foley.com/news/news\\_detail.aspx?newsid=1270](http://www.foley.com/news/news_detail.aspx?newsid=1270).

<sup>13</sup> ABA Banking Journal, *supra* note 11.

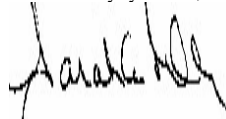
its auditing firm: “A problem on the horizon is that these firms are stretched thin and it’s going to make it harder for smaller companies like all of ours to get to talk to other firms when we want to make a change in firm. Some are working with very large companies and may not want to bother stretching further to serve our tier.”<sup>14</sup>

As the Commission has already acknowledged, some firms have delayed the implementation of information technology projects to avoid Section 404 internal control reporting on the system.<sup>15</sup> In many cases, the firms are postponing these important improvements by six to nine months, according to an American Electronics Association study.<sup>16</sup> These delays can significantly impair a firm’s competitive advantage especially with respect to private companies.

### Conclusion

The ABA appreciates the opportunity to comment on the proposed rule revising the definition of accelerated filer and the periodic filing deadlines for accelerated filers, as well as the extension of compliance dates for management's reports on internal control over financial reporting. We hope that our comments will assist the Commission's efforts to make internal control reporting and periodic filing more effective. Please do not hesitate to contact the undersigned if you wish to discuss these matters further.

Sincerely yours,



Sarah A. Miller

---

<sup>14</sup> *Id.*

<sup>15</sup> SEC Staff Statement, *supra* note 4, at Part F.

<sup>16</sup> American Electronics Association, Sarbanes-Oxley Section 404: The 'Section' of Unintended Consequences and its Impact on Small Business (2002), *available at* <http://www.aeanet.org/governmentaffairs/AeASOXPaperFinal021005.asp>.