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December 10, 2003

Mr. Thomas Ray
Deputy Chief Auditor
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: Release No. 2003-17, Rulemaking Docket Matter No. 008 Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

Dear Mr. Ray,

The American Bankers Association (ABA) is pleased to have this opportunity to comment on the proposed auditing standard issued by the Public Company Accounting Oversight Board (PCAOB), "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements" (the proposal). ABA brings together all categories of banking institutions to best represent the interests of the 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 commends the PCAOB on its efforts to establish standards for the audit of internal controls over financial reporting in conjunction with the audit of the financial statements as directed under the Sarbanes-Oxley Act of 2002. The banking industry is unique compared with other industries, as it has been required to follow rules to maintain strong internal control environments for many years under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Strong internal controls 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 the company's risks.

We are concerned the proposal goes beyond the requirements set forth under the Sarbanes-Oxley Act and what is prudent at this time. The proposal requires an audit of internal controls over financial reporting rather than the attestation regarding management's assessment of internal controls that is required under the Sarbanes-Oxley Act. We agree with the definition of an attestation in the introduction to the proposal, 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 is what was intended in the Sarbanes-Oxley Act, and we believe that the PCAOB should require attestations rather than audits.

During the development of FDICIA, the accounting profession lobbied members of Congress to require that financial institutions provide certifications and accounting firms provide attestations on management assertions. Banking institutions are responsible for maintaining strong internal control environments. Banks document internal control responsibilities of employees, document the functions of internal controls and flow of processes, and test the reliance on internal controls. Since 1991, banks have been required to produce annual reports on internal controls, and external audit firms have assessed the effectiveness of bank internal controls and have attested to these reports. Many hours have been spent among bankers, banking regulators, and representatives from the accounting profession to specifically determine how such attestations were to be achieved. The Sarbanes-Oxley Act used the FDICIA attestation as its model.

The PCAOB's requirement to go beyond an attestation, to require a full audit, significantly alters the requirements under the Sarbanes-Oxley Act and will significantly increase the costs to companies. Audit firms are already quoting exorbitant fees to bankers under the assumption that the PCAOB will require audits rather than attestations. (In fact, audit firms are telling their banking clients that they must follow the PCAOB proposal for 2003 reporting – even though the rule is not final.) The accounting firms have not been able to sufficiently justify to bankers how their procedures will differ, how they are more valuable to shareholders, or specifically why the costs are so excessive.

We strongly suggest that the PCAOB require attestations rather than audits. Many industries, other than banking institutions, will have an enormous amount of work to do to document their internal control systems so that management will have a foundation on which to certify to its internal controls. Piling on the huge additional fees that are being quoted by the accounting firms for audits, as opposed to attestations, is simply unnecessary at this time. We believe that it would be much better for the PCAOB to require attestations, as contemplated during the development of and required by the Sarbanes-Oxely Act. We believe that the quality of attestations will likely improve dramatically even if the PCAOB does not require audits, simply because of the focus that has recently been placed on the accounting profession. Additionally, we respectfully encourage the PCAOB to reconsider the following areas in the proposal:

- External auditors should be permitted to rely on work performed by internal audit when appropriate.
- The walkthrough requirements are excessive and unnecessary.
- The requirement for external auditors to evaluate the effectiveness of audit committee should be removed from the proposal.
- The definitions of "significant deficiency" and "material weakness" are too broad and should be modified.
- "Except for opinions" should be permitted for circumstances involving business combinations or operating system changes.

External auditors can rely on work of others.

The proposal requires certain procedures to be followed by the external auditor to complete an audit of the internal controls over financial reporting. Because of the vast number of tests and extent of the audit, we believe that external auditors will need to be and should be permitted to exercise discretion on the extent to which the external auditor can rely on information provided by internal auditors.

We are concerned that the proposal creates unnecessary work for external auditors, and, frankly, unnecessary costs. Many functions performed by internal auditors within a company are recurring and routine in nature, and to require the external audit firm to prepare its own original documentation is duplicative. Further, if the quality of the internal audit function within a company is deemed to be reliable, there is no reason why the external auditor must duplicate such work. In fact, we would argue that if the external auditor relies on the work of a sound internal audit process, it frees up the auditing firm to focus on the important issue: areas of risk. We believe that the external audit firm, the company, and investors would benefit more by permitting the external audit firm to identify which tests should be performed and exercise professional judgment regarding the completion of the attestation. External auditors should not be prohibited from relying on the work of internal auditors, and should be permitted to use their work when it is prudent to do so.

Walkthroughs are excessive.

The proposal requires external audit firms to perform walkthroughs of all significant processes of a company each year as part of the audit firm's attestation on the effectiveness of internal controls. Banking institutions are required to maintain a reliable internal control environment. Instead of automatically requiring walkthroughs, external audit firms should use professional judgment to determine what additional evidence is needed each year regarding accounts, disclosures, or processes for the audit firm to gather sufficient, competent evidence to attest to management's assertion on internal controls.

External auditors should not assess audit committee.

The proposal requires that the external audit firm assess the effectiveness and independence of the audit committee. This should be eliminated from the proposal. External audit firms are not necessarily equipped to make such an assessment, they are not trained in making these types of evaluations, and there are no rules or guidelines against which firms would make such assessments. Further, this requirement creates a conflict of interest between auditors and audit committees with respect to independence. Under rules issued by the SEC and stock exchanges, the external audit firm reports to the audit committee. The audit committee also has the sole authority to hire and remove the external audit firm and establishes the compensation for the external audit firm. Independence of the accounting firm is also disclosed to shareholders by the Board of Directors for shareholders to evaluate. We believe that the proposal, as drafted, is not workable and should be removed from the proposal.

<u>Definitions of "significant deficiency" and "material weakness" are too prescriptive.</u>
The terms "significant deficiency" and "material weakness" in the proposal are too narrowly defined and could cause unwarranted concern over a company's internal control structure. Defining a material weakness as having a "more than remote likelihood of occurrence" is broad and too low a threshold to assist in evaluating internal control deficiencies.

The American Institute of Certified Public Accountants (AICPA) identified thresholds for evaluating reportable conditions regarding material weaknesses in its Professional Standard AU Section 325 and Standard AT Section 501. Rules issued by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act reference the AICPA's Section 325 and Section 501 as the standards that should be used in determining whether a significant deficiency or material weakness exists within a company. We believe that those particular AICPA Standards contain a more clear definition of a reportable material weakness than the definition provided in the PCAOB proposal. We encourage the PCAOB to modify the definitions of "significant deficiency" and "material weakness" to be based on the reasonably likelihood that an internal control would cause a significant or material misstatement of the annual or interim financial statements. In this way, disclosures would be based on a reasonable level and would provide investors with more important and useful information about failures in internal controls. It is important that the definitions be based on reasonable thresholds that would provide reasonable assurance that a failure in internal controls exists.

<u>"Except for opinions" should be permitted.</u>
External audit firms should be permitted to issue "except for" opinions in situations that involve mergers, acquisitions, or systems changes that affect the internal control environment of the bank. During the time when companies engage in mergers or acquisitions, it often takes time for the acquiring company to learn the internal functions of the acquired company, integrate operating systems, and convert internal control processes to the acquiring company. Often, legacy systems are maintained for a brief period of time until systems can be transitioned to the surviving company. There can also be situations near the end of the reporting cycle that would make it difficult for the acquiring company to consolidate, evaluate, and certify the internal control environment of the combined company. In these situations, it may not be possible for the audit firm to conduct a comprehensive evaluation of the combined company's internal controls, and external audit firms should be given permission to issue "except for" opinions on the attestation on the combined company's internal control environment.

In conclusion, we believe that the PCAOB should require attestations rather than audits. We believe that external auditors should be permitted to rely on work performed by internal audit when appropriate and that external auditors should evaluate processes in order to determine whether walkthroughs on all processes are needed. The requirement for external auditors to evaluate the effectiveness of audit committees should be removed from the proposal. The definitions of "significant deficiency" and "material weakness" are too narrow and should be modified to provide users of financial statements with useful and meaningful information. Last, we believe that "except for opinions" should be permitted for circumstances involving business combinations or operating system changes.

Thank you for the opportunity to comment on this proposal and for your consideration. If you would like to discuss this letter in more detail, please contact me at 202-663-5318.

Sincerely,

Donna Fisher