February 26, 2007

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 021
Release No. 2006-007 (December 19, 2006)

Dear Sir or Madame:

America's Community Bankers[1] is pleased to comment on the Public Company Accounting Oversight Board's ("PCAOB") proposed auditing standard, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, ("Revised Standard") that would supersede the PCAOB's Auditing Standard No. 2 ("AS2").

ACB Position

ACB strongly supports the PCAOB's proposed Revised Standard for the audit of internal control over financial reporting ("ICFR"). The proposed Revised Standard is a significant step in the right direction to help reduce the costs and burdens of the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). However, ACB strongly recommends that the PCAOB accept, in satisfaction of written representations from management in the Revised Standard, the reports filed by bank management in accordance with Section 36 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") and Part 363 of the Federal Deposit Insurance Corporation ("FDIC") regulations.[2] ACB also believes that the PCAOB's inspection process should be revised contemporaneously with the proposed Revised Standard.

Background

ACB is pleased that the proposed Revised Standard addresses many of our members' concerns with the audit of ICFR that were raised at the two PCAOB and Securities and Exchange Commission ("SEC") roundtables, comment letters filed in connection with the roundtables, and meetings of the PCAOB's Standing Advisory Group. The proposed Revised Standard achieves the PCAOB's goal of simplifying and clarifying the auditing standard for ICFR. In particular,

[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 and 12 C.F.R. Part 363.

ACB strongly supports provisions in the Revised Standard that permit the use of auditor judgment, emphasize an audit of the most important controls to financial reporting, permit reliance on the work of others and the work from prior audits, and require scaling the audit to fit the size and complexity of smaller companies. ACB believes that the proposed Revised Standard will improve the audit of ICFR

PCAOB Inspection Process

ACB is concerned that unless the PCAOB's inspection process is contemporaneously revised with the Revised Standard, auditors concerned with PCAOB sanctions and statutory and civil liability will continue to conduct redundant audits that require the same level of detail and testing as audits conducted under AS2. Recent PCAOB inspection reports have criticized auditors for not being diligent in their responsibilities for detecting fraud, failing to perform adequate audits, and prepare appropriate documentation.

We believe it is important for the PCAOB to revise its inspection process and provide auditors with assurance and certainty that they will not be subject to sanctions or penalized for using judgment in conducting and scaling an audit under the Revised Standard. ACB is concerned that even with the Revised Standard and a revised inspection process, because of statutory and civil liability concerns, auditors may not significantly change their audit or reduce their engagement fees.

Obtaining Written Representations

Paragraph 84 of the Revised Standard requires an auditor to obtain written representations from management regarding management's responsibility for establishing and maintaining effective ICFR and management's evaluation and assessment of ICFR as of a certain date. ACB recommends that the PCAOB recognize bank management's reports as required by Section 36 of the FDICIA and Part 363 of the FDIC rules as meeting the requirements of paragraph 84 in the Revised Standard.

Many of the representations required by paragraph 84 are similar to the representations required from bank management under FDICIA and FDIC regulations. Management of all insured banks is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Management of insured banks with over $500 million in assets is required annually to prepare a report signed by the chief executive officer and chief accounting or chief financial officer that states management's responsibilities for preparing the institutions' annual financial statements; establishing and maintaining an adequate internal control structure; and maintaining procedures for financial reporting and compliance with designated safety and soundness regulations. In addition, management of banks with over $1 billion in assets must include in the report an assessment by management of the effectiveness of the internal control structure and procedures for financial reporting as of the end of the fiscal year. Management's report is required to be included in the annual report it files with its primary federal regulator and the FDIC.

In addition, ACB believes that the representations made in a bank management's report concerning the bank's compliance with designated safety and soundness regulations during the year could provide auditors with a strong indicator that banks making this statement to their regulator have an effective regulatory compliance function rather than a material weakness in ICFR. Inclusion of the foregoing recommendations in the Revised Standard will help to reduce the audit burden for community banks.

Additional Provisions

Testing

ACB suggests that the Revised Standard include additional direction for testing key controls. Testing internal controls remain a source of concern for management and auditors. Too much testing, particularly of controls that do not affect the integrity of a company's financial statements, has been overly burdensome and costly without benefit. We support the Revised Standard's focus on the most important controls as they relate to risk assessment, but we believe that the Revised Standard should provide further direction as to the amount and frequency of testing key controls.

For example, we suggest that key controls be risk-rated so that the significance and the frequency of the control should be taken into account when determining the nature, timing and extent of the tests to be performed. Furthermore the methodologies for testing controls vary between auditors. The Revised Standard should provide a standardized but flexible approach to testing. By standardizing the testing process, confusion is minimized and a more efficient process can be implemented for management and auditors.

Although the proposed Revised Standard provides that an auditor can reduce the nature, timing and extent of testing based on knowledge of past audits, we believe that the Revised Standard should permit rotation of the audit. The Revised Standard gives the auditor flexibility based on knowledge of previous audits, but we are not convinced that auditors will reduce testing because of concerns with PCAOB sanctions and liability. Therefore, ACB believes that companies that have demonstrated effective internal controls and have had no significant deficiencies or material weaknesses for a designated number of consecutive annual audits should be eligible for rotation and reduced testing. Lower level transactional and routine controls could be tested in full periodically with controls that directly affect or impact financial statements tested every year. We believe that rotations of testing internal controls should be included in the Revised Standard so that auditors will have a safe harbor and there will be a meaningful reduction in testing internal controls and associated audit costs.

Definitions

Although ACB appreciates the PCAOB's efforts in the Revised Standard to revise the definitions of "significant deficiency" and "material weakness," the new definitions are still ambiguous and confusing to our members. We believe it is an improvement to replace "more than remote" with a less stringent "reasonable possibility" within the definitions of both material weakness and significant deficiency. We are doubtful, however, that the revisions will alter the difficulty of evaluating the most important deficiencies that may lead to a material misstatement.

ACB recommends that the Revised Standard require auditors to consider both quantitative and qualitative factors in assessing materiality for identifying deficiencies in ICFR. As an initial step, quantitative factors should be evaluated and based on a percentage of revenues or net income. This quantitative assessment should only be the basis for a preliminary assumption of materiality and should be considered in conjunction with a full analysis of qualitative considerations. The quantitative factor should be a guide that can be overridden by qualitative considerations. We believe that the addition of a quantitative factor will help clarify the revised auditing standards definitions.

Revised Auditor Opinion

ACB supports the provision of the proposed Revised Standard that would require the auditor to express an opinion directly on the effectiveness of ICFR and eliminate the auditor's opinion on management's assessment of ICFR. Eliminating this opinion should help to eliminate duplication in the ICFR process and reduce the expense of the engagement.

Section 36 of the FDICIA and Part 363 of the FDIC's rules require the external auditor of a bank to attest to the internal controls. Section 404 also requires an attestation and not an opinion on the effectiveness of ICFR. An attestation and an audit are completely different engagements and require significant differences in time and liability standards which affect the cost of an engagement. When appropriately conducted, the banking agencies have found attestation engagements to be effective. We see no reason for the SEC and PCAOB to go beyond the clear language of the statute and require an opinion audit of ICFR.

Extension for Non-Accelerated Filers

ACB believes that non-accelerated filers should be granted an additional extension from compliance with Section 404(b) of Sarbanes-Oxley. Although the SEC has the sole authority to amend its rules for non-accelerated filers' compliance with Section 404, we would like to raise our member's concerns on this issue with the PCAOB. Section 404(b) requires auditors to attest to the effectiveness of ICFR in a company's annual report filed with the SEC. ACB believes that the SEC should follow the advice of the SEC's Advisory Committee on Smaller Public Companies and not require microcap and smallcap companies to comply with Section 404 "unless and until" there is suitable framework for the implementation of Section 404. We will not know if the Revised Standard will be a suitable framework for smaller public companies until it is carefully considered in light of public comments, finalized and approved by the SEC, and tested by auditors in the field. Non-accelerated filers should not be required to comply with Section 404(b) and expend limited resources until all of the foregoing has been completed.

ACB appreciates the opportunity to comment on the PCAOB's proposed Revised Standard. If you require additional information 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 Haeger

Sharon A. Haeger
Regulatory Counsel