

April 3, 2006

Ms. Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, N.E.  
Washington, DC 20549-9303

Re: File Number 265-23

Dear Ms. Morris:

We support the Commission's efforts to provide an efficient and effective means of ensuring that investors in public companies can reasonably rely on the financial information of the companies in which they invest. We recognize that the SEC's Advisory Committee on Smaller Public Companies (the Committee) was formed with this goal in mind, and we applaud the Committee's efforts to address the issue of cost in the application of Section 404 of the Sarbanes-Oxley Act. However, we do not believe that the recommendations proposed by the Committee (which would either eliminate or drastically reduce the internal control evaluation efforts at all smaller public companies) are in the best interests of investors, companies, their audit committees, or the capital markets at large.

Specifically, the adoption of the Committee's recommendations regarding Section 404 would:

1. Place smaller-company investors at a disadvantage compared with larger-company investors, because the larger-company financial statements would be subject to more required audit procedures;
2. Exacerbate the disparity in quality of financial reporting between larger and smaller companies, because larger companies would be held to a standard that included independent audit procedures;
3. Make it more difficult for smaller-company audit committees to fulfill fiduciary responsibilities to oversee the financial reporting process, leaving management at greater risk without independent evaluation of their controls; and finally
4. Increase the concentration of public company audits in the largest accounting firms.

Our research and experience indicates that there are three primary reasons Section 404 costs are currently higher than expected:

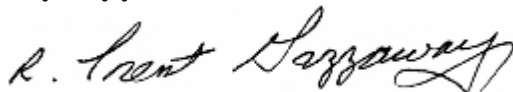
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1. Over the last 15 to 20 years, the quality and sophistication of internal controls have generally not kept pace with the growing complexities of business and financial reporting. Section 404 is helping to rectify this problem by focusing management attention on the quality of financial reporting processes.
2. Although the COSO Framework does an excellent job of establishing effective principles for good internal controls, it does not contain the practical guidance necessary to put those principles into practice in a wide variety of business situations. We have proposed a broader program that would entail forming a body of qualified professionals (auditors, industry practitioners and academics) to field questions regarding financial reporting risks and develop practical guidance demonstrating how different types of internal controls could mitigate those risks in companies of varying size, complexity and industry.
3. Like the financial reporting profession, the auditing profession needs to develop effective guidance on how to audit internal controls efficiently and effectively. This goal can be accomplished through better sharing of best practices among auditors and through some modifications to the PCAOB inspection process.

The attached Grant Thornton LLP report on *"The Effective Application of Section 404 of the Sarbanes-Oxley Act of 2002,"* highlights our position on the need for all public companies to be held to the standards Section 404 dictates. The report also presents our proposed solution to the cost issue, while at the same time retaining, and even improving, the quality of the evaluation work being performed. This report also expands our comment letter dated March 7, 2006, covering the same subject.

Please direct your questions to Trent Gazzaway, Managing Partner of Corporate Governance, at (704) 632-6834, or [trent.gazzaway@gt.com](mailto:trent.gazzaway@gt.com).

Very truly yours,



R. Trent Gazzaway  
Managing Partner of Corporate Governance, Grant Thornton LLP

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cc: Mr. Ed Nusbaum, Chief Executive Officer, Grant Thornton LLP  
Mr. Mike Starr, National Managing Partner of Public Policy & Strategy, Grant Thornton LLP  
Ms. Shelley Stein, Chief Operating Officer, Grant Thornton LLP  
Mr. Russ Wieman, Managing Partner Assurance & Advisory Services, Grant Thornton LLP  
Mr. John Archambault, Managing Partner, Professional Standards, Grant Thornton LLP

Report on the Effective Application of  
**Section 404 of the Sarbanes-Oxley Act of 2002**

Grant Thornton 

# Report on the Effective Application of Section 404 of the Sarbanes-Oxley Act of 2002

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## Introduction

Much has been written and discussed recently regarding the implementation of Section 404 of the Sarbanes-Oxley Act of 2002. Without question, this short section of the Act has had a significant impact on the financial reporting profession.

1. A significant number of “material weaknesses” in internal controls over financial reporting (ICFR) have been identified and corrected, particularly in the larger public companies to which the requirements of Section 404 have applied to date. As a result, untold numbers of future restatements have been prevented and investors now have more reliable information.
2. An even greater, and potentially innumerable, number of “significant deficiencies” in internal controls have also been identified and corrected, further improving the quality of financial reporting.
3. Corporate management and audit committees of these companies are now squarely focused on the quality of the financial information they produce.

These benefits have come with a high cost, however. The level of deferred maintenance of ICFR, the level of complexity in properly evaluating internal controls and a general lack of guidance regarding what “good internal controls” look like – in practice in various corporate settings – has caused the implementation of Section 404 to be inefficient and costly.

Some have proposed reducing or eliminating the requirements in part or all together for some public companies; but drastic solutions such as this will, in the end, cause significant harm to investors, companies, their audit committees, and the capital markets. **The inefficiencies in the process must be addressed, and they can be addressed effectively, but not by reducing the reasonable requirements of Section 404.**

This paper addresses three topics:

1. The adverse effect of proposed recommendations to reduce or eliminate the requirements of Section 404;
2. The necessity for auditors to audit internal controls; and
3. Action steps required for improving the efficiency of the controls evaluation process.

## **The adverse effect of proposed recommendations to reduce or eliminate the requirements of Section 404**

Real-world execution of Section 404 requirements has led to significant problems, chief among them costs. Responding to these concerns, the SEC’s Advisory Committee on Smaller Public Companies recommended that the SEC (1) fully exempt certain small companies from this requirement, and (2) exempt slightly larger companies from the requirement to have management’s assessment audited.

This recommendation would create three classes of public companies:

1. One in which management would not have to assert to the quality of their controls;
2. Another in which management would have to assert to the quality of their controls (but their independent auditors would not audit that assertion); and

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3. A final group of non-exempt public companies (i.e., those with public market capitalization of more than \$700 million or revenues of more than \$250 million) in which management would be required to issue an audited assertion regarding the quality of their internal controls.

The creation of such a hierarchy would confuse investors and negatively affect audit committees, companies and capital markets. The following four points highlight the significant negative impact on investors, companies and audit committees if the Committee's recommendations are adopted:

1. **The recommendations place smaller-company investors at a disadvantage compared with larger-company investors.**

Investors would not be able to place as much reliance on the financial statements of smaller public companies as on those of larger public companies because auditors of the non-exempt public companies would, by default, perform more overall audit work than auditors of smaller public companies.

2. **The relative quality of financial reporting processes would be lower for smaller companies than if all companies were held to the same standard.**

Historically, effective independent auditing has driven proper performance. Without an adequate level of independent auditing, the divergence in the quality of financial reporting between smaller and larger companies will be wider than it is today. It would be unfair to smaller-company investors to hold their investments to a lower standard than those of larger-company investors.

3. **Smaller-company audit committees would find it difficult to fulfill fiduciary responsibilities for ensuring proper internal controls, and management, having spent the time and money to ensure proper controls, would be left at greater risk without independent evaluation of those controls.**

With inherently weaker financial reporting systems, the number of significant period-end adjustments and restatements at smaller companies will rise in proportion to that of larger companies. This increased error rate will result in a higher cost of capital and increased litigation for these companies and their executives and, potentially, for audit committee members, but more significantly, it will also place individual investors in an unacceptable position of risk. The lack of sufficient third-party affirmation would represent a significant competitive disadvantage.

Glass Lewis & Co.'s recently issued report on restatements indicated that smaller public companies (which they define as companies with under \$250 million in market capitalization) are twice as likely to restate their financial statements as the largest public companies.<sup>1</sup> Likewise, a recent analysis within Audit Analytic's database of companies with market capitalizations between \$75 million and \$100 million<sup>2</sup> indicates that 20 percent of those companies have had one or more material weaknesses in internal controls. Further analysis indicates that 17 percent of even larger companies (i.e., those with market capitalizations between \$100 million and \$700 million) have reported one or more material weaknesses. Clearly, the smaller companies need to maintain their focus on internal controls. As has been proven

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<sup>1</sup> Source: Glass Lewis & Co., March 2, 2006, report, *Getting it Wrong the First Time*. In 2005, the restatement rate for companies under \$250 million in market capitalization was 11.3 percent. The rate for companies with \$2.5 billion or more in market capitalization was 6.3 percent. In 2004, the rate for smaller companies was 7.8 percent, compared with 2.3 percent for larger companies.

<sup>2</sup> These would be the companies that were required to meet the Section 404 requirements last year, but that would be candidates for exemption under the Committee's recommendations. Given their market capitalizations, one might expect them to have the highest-quality financial reporting processes of all "smaller" companies.

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with larger companies, compliance with Section 404 of Sarbanes-Oxley will be an important part of identifying and correcting their as-yet unidentified control issues.

4. **The effect of not auditing internal control in companies smaller than the proposed cutoff between the largest public companies and all other public companies would increase the concentration of audits in the largest accounting firms.**

If the Committee's recommendations are adopted as presently proposed, less than 10 percent of the public companies currently audited by firms other than the largest six will be subject to a full audit of ICFR. As a result, nearly all of the skills, methodologies and tools to audit ICFR will reside exclusively in the Global Six, thus stifling competition among audit firms and further cementing the present concentration of audits in the largest firms. Accordingly, investors and audit committees would be limited yet further in their choices for qualified auditors as they attempt to align a public company with the culture, skills and resources of the Global Six, national, regional or local accounting firms. Although Grant Thornton LLP is the U.S. member firm of a global accounting organization and is among these six firms, this concentration is not in the best interests of the profession or the capital markets.

## Necessity for auditors to audit internal controls

Sarbanes-Oxley Section 404 requires issuers to assess the effectiveness of their ICFR, and for the independent auditor to "*attest to, and report on, the assessment made by the management of the issuer.*" The auditing standard implementing this requirement (Auditing Standard No. 2 or AS2) requires that the auditor both examine management's documentation supporting their assertions and perform enough audit procedures to conclude independently that the controls are effective.

Some have asserted that the auditor's responsibility under this requirement can be met by reviewing management's assessment documentation and performing some independent testing, but this scenario requires relatively less testing compared with that required for the auditors to render independent opinions on the effectiveness of the issuer's systems of internal controls. Recent experience has indicated that this reduced level of effort by the auditor is not sufficient to verify effectively that management has identified all control weaknesses that need to be addressed.

The premise that the auditor could review management's control evaluation documentation and perform some minimal or moderate level of testing was the model generally adopted for compliance with the FDIC Improvement Act of 1991 (FDICIA). Section 112 of FDICIA requires the independent public accountant (IPA) to "*attest to, and report separately on, the assertions of the institution's management.*" Section 112 goes further to say that the IPA is to perform these attest procedures "*in accordance with generally accepted standards for attestation engagements.*"

In order to implement these requirements, auditors looked to the AICPA's attest standard AT 501, "Reporting on an Entity's Internal Control Over Financial Reporting." AT 501, in turn, requires the auditor to perform certain procedures including "*testing and evaluating the operating effectiveness of the controls,*" and "*forming an opinion on the effectiveness of the entity's internal control*" (paragraphs 17d & e). However, actual implementation of AT 501 in FDICIA audits suffered from three primary limitations:

1. A lack of experience in the profession in performing internal control evaluations at the time AT 501 was introduced;
2. The relatively limited circumstances in which AT 501 was being used (i.e., it was used almost exclusively in FDICIA attestation engagements, and rarely used otherwise); and

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3. A general lack of guidance regarding the level of independent testing necessary to support an auditor's opinion on the effectiveness of internal controls.

Federal Reserve Governor Sue Bies summarized this issue in a May 2003 speech at the Conference of State Bank Supervisors in Asheville, North Carolina. In her remarks she said, *"There is virtually no guidance on the criteria auditors should use to issue a qualified opinion. We have long argued that the professional standards in this area need to be more robust."*

These comments and others<sup>3</sup> were made nearly 12 years after the passage of FDICIA, during which period FDIC inspectors and audit-firm peer reviewers, who presumably reviewed numerous FDICIA audit engagements, did not report pervasive defects in auditors' related work. We know now, however, that the proportion of FDICIA banks with material weaknesses in internal controls is not significantly different than the proportion of companies in other industries. (The statistics supporting this fact are presented below.) In effect, the inspectors and peer reviewers suffered from the same limitations as the auditors – namely, a lack of experience with internal control audits and a lack of available practical guidance regarding the level of independent testing needed.

As a result, the AICPA has now undertaken a project to amend AT 501 so that it more closely matches the testing concepts effectively spelled out in AS2. In this regard, AS2 more effectively codifies what FDICIA intended at the outset.

To understand this issue more clearly, it may be helpful to look at some statistics. **If the original application of AT 501 had been truly effective, we would expect to see the vast majority, if not all, of the material weaknesses present in these FDICIA banks to have been identified and addressed prior to the effective date of SOX Section 404.** Stated differently, if the auditor's additional procedures needed to reach an independent opinion on the effectiveness of ICFR were truly unnecessary, then we would expect that their execution would not identify a meaningful number of material weaknesses at these FDICIA banks. **Such was not the case with the first year's implementation of the Section 404 audit requirements.**

According to Audit Analytics' most recent report,<sup>4</sup> 14.8 percent of all filings subject to Section 404 indicated that the issuer had one or more material weaknesses in ICFR. Likewise, the latest *Compliance Week* Internal Control Report Scorecard<sup>5</sup> indicates that 11.5 percent of companies in the Russell 3000 reported one or more material weaknesses in ICFR. Consistent with these statistics, it is generally believed that between 11 percent and 15 percent of issuers subject to Section 404 have identified at least one material weakness in ICFR.

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<sup>3</sup> See Appendix I for more excerpts from various speeches by Governor Bies.

<sup>4</sup> Audit Analytics,™ Section 404 Internal Control Material Weakness Dashboard, Results for the first three Quarters of Section 404. Disclosures Based on filings as of November 15, 2005.

<sup>5</sup> Report generated on December 17, 2005, using SEC filings from the Russell 3000.



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Using data available from Audit Analytics, we ran a report listing all banks that were subject to the FDICIA requirement for at least two years and were accelerated filers last year and, thus, subject to Section 404 and Auditing Standard No. 2. Audit Analytics lists 372 financial institutions that met those criteria last year, of which 40 (nearly 11 percent) received adverse opinions on internal controls (see Table 1 below).

**Table 1: FDICIA banks subject to SOX Section 404 and AS2 in 2005**

<u>Effective Internal Controls</u>	<u>Total</u>	<u>Percent</u>
No	40	10.8%
Yes	<u>332</u>	89.2%
Total	<u>372</u>	

**Note:** Appendix II lists these 372 entities.

**The fact that the instances of material weaknesses in ICFR for these financial institutions are not significantly less than those in other public companies is a strong indicator that the auditors' additional procedures do help identify material weaknesses that would otherwise go undetected.** There are two fundamental reasons for this:

1. The evaluation of effective internal controls is a complex process that entails a deep understanding of the risks inherent in financial reporting and the controls that best mitigate those risks. Many organizations do not possess the skills necessary to identify all their potential weaknesses. The auditor can only truly verify that management has, in fact, identified those weaknesses by performing enough audit procedures to reach an independent conclusion regarding the effectiveness of the controls.
2. Experience demonstrates that independent auditing drives proper performance. When company management knows that the auditor is going to be performing audit procedures at a meaningful level of detail, they instinctively improve the quality of their own evaluation work.

It is vital that management's own evaluation form the basis for their assertions regarding internal controls. The additional procedures performed by the auditor help encourage management to perform an effective evaluation and also help identify weaknesses that management may have missed. In the end, both companies and investors are better served.

## **Improving the efficiency of the controls evaluation process**

The Committee's recommendations were born out of a fundamental disparity that does exist between larger and smaller public companies. Section 404 requirements are not the source of the problem, however. The root cause is the lack of guidance for good internal controls that are applicable in myriad business situations.

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Every public company, regardless of size, should have good controls over its financial reporting processes. It follows, then, that management of every public company should be in a position to state, at least annually, that they have good controls over their financial reporting processes. If these two statements are true, then the accounting and auditing profession and regulators should be able to agree upon the criteria against which management and auditors would base their conclusions on internal controls. They should also be able to develop reasonable audit procedures that would allow auditors to say whether they agree with management's assessment.

To date, we have not succeeded in accomplishing that goal. The Committee of Sponsoring Organizations (COSO) made a valiant attempt to draft guidance for smaller public companies, but COSO never had the resources to develop the type of case-study material required to address the underlying disparity.

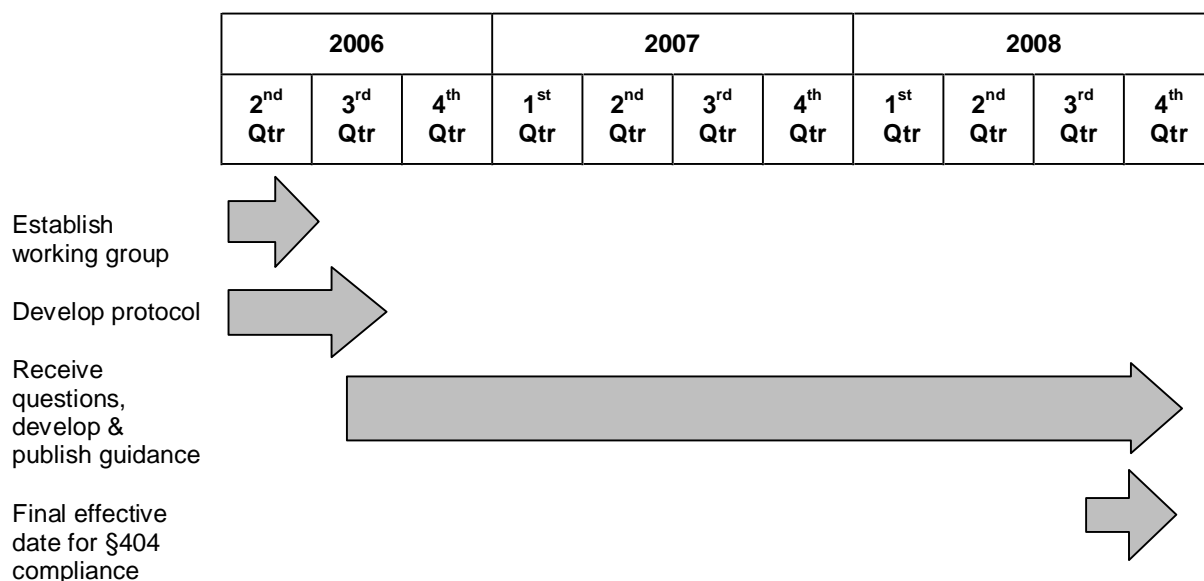
Appropriate guidance that would be useful to both companies and auditors can be developed:

**We recommend the formation of a body of professionals composed of auditors, accountants from industry, regulators and academics to field practical examples from issuers and then author such guidelines, including case studies highlighting appropriate control and audit procedures relevant for a range of companies in varying circumstances.**

This approach would quickly eliminate the most egregious execution expense for all companies and gradually help the profession establish a point of equilibrium in which every public company is held to an appropriate – and shared – standard of quality in financial reporting.

In order to provide adequate development time, as well as application by smaller public companies, a final delay in the effective date for non-accelerated filers is appropriate. Giving these companies one additional year (e.g., making the effective date applicable to companies with fiscal years ending on or after December 15, 2008) would provide an adequate period of time to optimize effectiveness of this approach.

The following table presents a possible timeline for forming a qualified group of professionals and developing the needed practical guidance.



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Similarly, the auditing procedures necessary for reaching a proper conclusion regarding the effectiveness of ICFR offer another opportunity for enhanced efficiencies. Both the Commission and the PCAOB have published frequently-asked-question (FAQ) documents that help companies and auditors evaluate and implement certain aspects of the Act. Although these FAQs were eagerly and enthusiastically received by companies and auditors alike, they did not effectively stem the flood of implementation issues that arose. To address these issues, the large accounting firms and other bodies formed implementation groups to discuss ways to implement AS No. 2 correctly, practically and consistently. However, with the exception of a white paper on the evaluation of control deficiencies, the work produced by these groups is not available to the public. Accordingly, there is inconsistency among accounting firms and companies and a high potential for performing work beyond that required by AS No. 2. In addition, small accounting firms, their clients and consulting firms that do not participate in these groups are at a distinct disadvantage.

Improvements in two areas could vastly improve the efficiency and consistency of the internal controls audit process. First, the firms participating in these implementation groups should publish their agreed-upon, best-practice audit procedures for all practitioners to use. The exposure will allow every firm, large and small, to achieve an appropriate level of consistency and efficiency in their audit approaches. Second, the PCAOB inspection process should be modified slightly to align the inspections more closely with the PCAOB's broader goals of establishing both effectiveness and efficiency in the audit process. The current inspection process, particularly for the larger firms, is designed to search almost exclusively for instances of "under-auditing." As a consequence, line partners often have reasonable judgments questioned to such an extent that they naturally become more conservative in their audit approach. Where judgments are unreasonable, the inspection process should call those judgments into question. Designing the inspection process to give credit to reasonable judgments, as well as identify areas of over-auditing, will help the global audit process become more effective.

## Conclusion

The application of Section 404 and its related auditing standard are both less than two years old. Early recommendations must be scrutinized for the consequences of implementation in all possible environments. Before making fundamental changes in underlying requirements, it is critical to consider the implications for all interested parties. Ultimately, any such changes must prove fair to all investors, audit committees and companies in order to be perceived as being in the best interests of the capital markets.

Questions regarding this report may be directed to R. Trent Gazzaway, Managing Partner of Corporate Governance, at (704) 632-6834 or [trent.gazzaway@gt.com](mailto:trent.gazzaway@gt.com).

## Appendix I

### **Selected Comments from Federal Reserve Governor Susan Bies Regarding FDICIA and Internal Controls at Financial Institutions**

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During 2003, Federal Reserve Governor Susan Bies made several speeches in which she commented about the adequacy of internal controls at financial institutions and the auditor's role in evaluating those controls. The following are excerpts from three of those speeches (emphasis added):

#### **1. Before the Conference of State Bank Supervisors, Asheville, North Carolina, in May 2003:**

“A secondary cause of the audit failures was lax professional standards. Examples in the banking area are the professional standards for attestation engagements. **Currently, the standards don't require auditors to perform any independent testing of controls. Under the current standards, auditors can simply rely on the work of internal audit as the basis for issuing an attestation report on management's report on the effectiveness of internal controls.** There is virtually no guidance on the criteria auditors should use to issue a qualified opinion. **We have long argued that the professional standards in this area need to be more robust.** In response to our criticisms and those of others, the AICPA recently proposed revisions to their professional standards to address some of these issues. However, the AICPA no longer has the authority to issue standards or to administer the quality assurance (peer review) function for audit or attestation engagements of public companies. The newly created Public Company Accounting Oversight Board has this authority and is just beginning to develop a framework for quality assurance. So, this may take a little time to correct. However, as supervisors, we will continue to work with the AICPA and the PCAOB to ensure that high-quality professional standards are created for public and nonpublic companies and that a robust process for ensuring audit quality is implemented.”

#### **2. Before the Oregon Bankers Association, Independent Community Banks of Oregon, and Idaho Bankers Association in June 2003:**

“**Having seen weaknesses in the quality of external auditors' review of financial reporting and internal controls, the bank regulators have issued an exposure draft to define a policy under which an auditor can be debarred from serving as an auditor of a bank.** Bank regulators have had this authority since FDICIA but have not chosen to use it in the past. Regulators have relied on the quality assurance process of public accounting firms and the peer review process of the American Institute of Certified Public Accountants (AICPA) to monitor the quality of auditors.

But as you all are aware, the events of the past year have clearly shown that these self-regulatory controls have not always been effective. The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board, which will be the regulator charged with monitoring the quality of audit work. Since bank regulators rely heavily on the work of external auditors, we are proposing that bank regulators also lay out the expectations for the quality of audit work and the conditions under which an individual or firm would be debarred from audit work at a bank. We expect to work closely with the Oversight Board, as it gets fully up and running, to improve the quality assurance for audit services.

As bankers, you should make certain that you are receiving value for audit services. As you hire your independent accountant, or if you outsource internal auditing, look for an auditor who regularly works for another financial institution or is part of a larger organization that is aware of and concerned about emerging risks and best practice controls. Such a firm will provide resources to ensure that corporate governance and controls are appropriate for your organization and that internal controls evolve to keep pace with changing business practices.”

# Appendix I

## Selected Comments from Federal Reserve Governor Susan Bies Regarding FDICIA and Internal Controls at Financial Institutions

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### 3. At the Community Bank Directors Conference of the Federal Reserve Bank of Chicago in August 2003.

“At the Fed, we have been looking at the FDICIA reports produced by banks at which internal control breakdowns led to significant losses. We have found instances in which failures of internal controls that were known to management were not mentioned in the management report. **These failures include various types of internal control breakdowns, such as failure to reconcile accounts in a timely fashion or failure to segregate duties in critical transaction-processing or accounting functions. Our review also identified more serious internal control deficiencies. In some of these cases, the external auditor did not identify the known failure in the attestations.** We are working with banks and independent auditors to make sure this basic control process has substance in the future.

Examiners also observed that at some banks with breakdowns in internal controls the process of reporting on internal controls had become a "paper pushing" exercise rather than a robust part of the corporate governance process. FDICIA is now twelve years old, and the results of these regulatory reviews again show how important the tone at the top is to reinforcing the importance of good governance and effective internal controls. Banks which try to delegate the update of annual control assessments to junior auditors, rather than "wasting the time" of management, lose an opportunity to remind managers that they have the responsibility for maintaining effective internal control – a responsibility that cannot really be delegated. These banks also demonstrated how challenging it can be to keep focused on doing the basics well, year after year, when the excitement and rewards of management are focused on developing and implementing strategies for the future.”

## Appendix II

### FDICIA Banks Subject to SOX Section 404 in 2005

Source: Audit Analytics™ database extraction of banks filing financial statements in 2005 that were subject to Section 404 of the Sarbanes-Oxley Act and that were subject to the internal control requirements of FDICIA for at least the last two consecutive years. See page 4 for further discussion.

<b>Institutions with Ineffective Internal Controls</b>	
1	ACNB CORP
2	ANCHOR BANCORP WISCONSIN INC
3	ASSOCIATED BANC-CORP
4	BANC CORP
5	CAMCO FINANCIAL CORP
6	CARDINAL FINANCIAL CORP
7	CENTER FINANCIAL CORP
8	CLIFTON SAVINGS BANCORP INC
9	COLONIAL BANCGROUP INC
10	COMPASS BANCSHARES INC
11	FARMERS NATIONAL BANC CORP /OH/
12	FINANCIAL INSTITUTIONS INC
13	FIRST CHESTER COUNTY CORP
14	FIRST CITIZENS BANC CORP /OH
15	FLAGSTAR BANCORP INC
16	FRANKLIN FINANCIAL SERVICES CORP /PA/
17	HARLEYSVILLE NATIONAL CORP
18	HERITAGE COMMERCE CORP
19	INTEGRITY FINANCIAL CORP
20	IRWIN FINANCIAL CORP
21	MAIN STREET BANKS INC /NEW/
22	MIDWEST BANC HOLDINGS INC
23	NARA BANCORP INC
24	NATIONAL PENN BANCSHARES INC
25	NEW YORK COMMUNITY BANCORP INC
26	OAK HILL FINANCIAL INC
27	PACIFIC CAPITAL BANCORP /CA/
28	PROSPERITY BANCSHARES INC
29	PROVIDENT BANKSHARES CORP
30	RIGGS NATIONAL CORP
31	ROYAL BANCSHARES OF PENNSYLVANIA INC
32	SEACOAST BANKING CORP OF FLORIDA
33	SOUTH FINANCIAL GROUP INC
34	STERLING BANCORP
35	SUNTRUST BANKS INC
36	SVB FINANCIAL GROUP
37	TAYLOR CAPITAL GROUP INC
38	UCBH HOLDINGS INC
39	UNIZAN FINANCIAL CORP
40	WILSON BANK HOLDING CO

<b>Institutions With Effective Internal Controls</b>	
1	1ST SOURCE CORP
2	ABC BANCORP
3	ALABAMA NATIONAL BANCORPORATION
4	ALLIANCE FINANCIAL CORP /NY/
5	AMCORE FINANCIAL INC
6	AMEGY BANCORPORATION, INC.
7	AMERICAN NATIONAL BANKSHARES INC
8	AMERICANWEST BANCORPORATION
9	AMES NATIONAL CORP
10	AMSOUTH BANCORPORATION
11	ARROW FINANCIAL CORP
12	ASSOCIATED BANC-CORP
13	ASTORIA FINANCIAL CORP
14	BANCFIRST CORP /OK/
15	BANCORP RHODE ISLAND INC
16	BANCORPSOUTH INC
17	BANCTRUST FINANCIAL GROUP INC
18	BANK MUTUAL CORP
19	BANK OF AMERICA CORP /DE/
20	BANK OF GRANITE CORP
21	BANK OF HAWAII CORP
22	BANK OF KENTUCKY FINANCIAL CORP
23	BANK OF NEW YORK CO INC
24	BANK OF THE OZARKS INC
25	BANKATLANTIC BANCORP INC
26	BANKNORTH GROUP INC/ME
27	BANKUNITED FINANCIAL CORP
28	BANNER CORP
29	BAR HARBOR BANKSHARES
30	BAYLAKE CORP
31	BB&T CORP
32	BERKSHIRE HILLS BANCORP INC
33	BFC FINANCIAL CORP
34	BOK FINANCIAL CORP ET AL
35	BOSTON PRIVATE FINANCIAL HOLDINGS INC
36	BROOKLINE BANCORP INC
37	BRYN MAWR BANK CORP
38	C & F FINANCIAL CORP
39	CAMDEN NATIONAL CORP
40	CANADIAN IMPERIAL BANK OF COMMERCE /CAN/
41	CANANDAIGUA NATIONAL CORP

## Appendix II

### FDICIA Banks Subject to SOX Section 404 in 2005

Institutions With Effective Internal Controls	
42	CAPITAL BANK CORP
43	CAPITAL CITY BANK GROUP INC
44	CAPITAL CORP OF THE WEST
45	CAPITOL BANCORP LTD
46	CAPITOL FEDERAL FINANCIAL
47	CASCADE BANCORP
48	CASCADE FINANCIAL CORP
49	CATHAY GENERAL BANCORP
50	CENTER BANCORP INC
51	CENTRAL PACIFIC FINANCIAL CORP
52	CENTURY BANCORP INC
53	CFS BANCORP INC
54	CHARTER FINANCIAL CORP/GA
55	CHEMICAL FINANCIAL CORP
56	CHEMUNG FINANCIAL CORP
57	CHITTENDEN CORP /VT/
58	CITIGROUP INC
59	CITIZENS & NORTHERN CORP
60	CITIZENS BANKING CORP
61	CITIZENS FIRST BANCORP INC
62	CITIZENS HOLDING CO /MS/
63	CITY HOLDING CO
64	CITY NATIONAL CORP
65	CIVITAS BANKGROUP INC
66	CNB CORP /SC/
67	CNB FINANCIAL CORP/PA
68	COASTAL FINANCIAL CORP /DE
69	COBIZ INC
70	COLONY BANCORP INC
71	COLUMBIA BANCORP
72	COLUMBIA BANCORP /OR/
73	COLUMBIA BANKING SYSTEM INC
74	COMERICA INC /NEW/
75	COMMERCE BANCORP INC /NJ/
76	COMMERCE BANCSHARES INC /MO/
77	COMMERCIAL BANKSHARES INC
78	COMMERCIAL CAPITAL BANCORP INC
79	COMMUNITY BANK SYSTEM INC
80	COMMUNITY BANKS INC /PA/
81	COMMUNITY TRUST BANCORP INC /KY/
82	COMPUCREDIT CORP
83	CORUS BANKSHARES INC
84	CULLEN FROST BANKERS INC
85	CVB FINANCIAL CORP
86	DCB FINANCIAL CORP
87	DIME COMMUNITY BANCSHARES INC

Institutions With Effective Internal Controls	
88	DOWNEY FINANCIAL CORP
89	EAST WEST BANCORP INC
90	EASTERN VIRGINIA BANKSHARES INC
91	ENTERPRISE BANCORP INC /MA/
92	ENTERPRISE FINANCIAL SERVICES CORP
93	ESB FINANCIAL CORP
94	EXCHANGE NATIONAL BANCSHARES INC
95	FARMERS & MERCHANTS BANCORP
96	FARMERS & MERCHANTS BANCORP INC
97	FARMERS CAPITAL BANK CORP
98	FFLC BANCORP INC
99	FIDELITY BANKSHARES INC
100	FIDELITY SOUTHERN CORP
101	FIFTH THIRD BANCORP
102	FIRST BANCORP /NC/
103	FIRST BANCORP /PR/
104	FIRST BUSEY CORP /NV/
105	FIRST CHARTER CORP /NC/
106	FIRST CITIZENS BANCORPORATION INC
107	FIRST CITIZENS BANCSHARES INC /DE/
108	FIRST COMMONWEALTH FINANCIAL CORP /PA/
109	FIRST COMMUNITY BANCORP /CA/
110	FIRST COMMUNITY BANCSHARES INC /NV/
111	FIRST DEFIANCE FINANCIAL CORP
112	FIRST FARMERS & MERCHANTS CORP
113	FIRST FEDERAL BANCSHARES OF ARKANSAS INC
114	FIRST FEDERAL BANKSHARES INC
115	FIRST FINANCIAL BANCORP /OH/
116	FIRST FINANCIAL BANKSHARES INC
117	FIRST FINANCIAL CORP /IN/
118	FIRST FINANCIAL HOLDINGS INC /DE/
119	FIRST FINANCIAL SERVICE CORP
120	FIRST HORIZON NATIONAL CORP
121	FIRST INDIANA CORP
122	FIRST M&F CORP/MS
123	FIRST MANITOWOC BANCORP INC
124	FIRST MARINER BANCORP
125	FIRST MERCHANTS CORP
126	FIRST MID ILLINOIS BANCSHARES INC
127	FIRST MIDWEST BANCORP INC
128	FIRST MUTUAL BANCSHARES INC
129	FIRST NATIONAL COMMUNITY BANCORP INC
130	FIRST NIAGARA FINANCIAL GROUP INC
131	FIRST OAK BROOK BANCSHARES INC

## Appendix II

### FDICIA Banks Subject to SOX Section 404 in 2005

Institutions With Effective Internal Controls	
132	FIRST OF LONG ISLAND CORP
133	FIRST PLACE FINANCIAL CORP /DE/
134	FIRST SOUTH BANCORP INC /VA/
135	FIRST STATE BANCORPORATION
136	FIRST UNITED CORP/MD/
137	FIRSTBANK CORP
138	FIRSTFED FINANCIAL CORP
139	FIRSTMERIT CORP /OH/
140	FLAG FINANCIAL CORP
141	FLORIDA COMMUNITY BANKS INC
142	FLUSHING FINANCIAL CORP
143	FNB CORP /VA/
144	FNB CORP/FL/
145	FNB FINANCIAL SERVICES CORP
146	FOOTHILL INDEPENDENT BANCORP
147	FRANKLIN BANK CORP
148	FRONTIER FINANCIAL CORP /WA/
149	FULTON FINANCIAL CORP
150	GB&T BANCSHARES INC
151	GERMAN AMERICAN BANCORP
152	GLACIER BANCORP INC
153	GOLD BANC CORP INC
154	GOLDEN WEST FINANCIAL CORP /DE/
155	GREAT SOUTHERN BANCORP INC
156	GREATER BAY BANCORP
157	GREATER COMMUNITY BANCORP
158	GREENE COUNTY BANCSHARES INC
159	HANCOCK HOLDING CO
160	HANMI FINANCIAL CORP
161	HARBOR FLORIDA BANCSHARES INC
162	HEARTLAND FINANCIAL USA INC
163	HERITAGE FINANCIAL CORP /WA/
164	HIBERNIA CORP
165	HILLS BANCORPORATION
166	HMN FINANCIAL INC
167	HOME FEDERAL BANCORP
168	HORIZON FINANCIAL CORP
169	HUDSON CITY BANCORP INC
170	HUDSON UNITED BANCORP
171	HUDSON VALLEY HOLDING CORP
172	HUNTINGTON BANCSHARES INC/MD
173	IBERIABANK CORP
174	IBT BANCORP INC
175	IBT BANCORP INC /MI/
176	INDEPENDENCE COMMUNITY BANK CORP
177	INDEPENDENT BANK CORP

Institutions With Effective Internal Controls	
178	INDEPENDENT BANK CORP /MI/
179	INDYMAC BANCORP INC
180	INTEGRA BANK CORP
181	INTERCHANGE FINANCIAL SERVICES CORP /NJ/
182	INTERNATIONAL BANCSHARES CORP
183	ITLA CAPITAL CORP
184	KEYCORP /NEW/
185	KNBT BANCORP INC
186	LAKELAND BANCORP INC
187	LAKELAND FINANCIAL CORP
188	LCNB CORP
189	LEUCADIA NATIONAL CORP
190	LNB BANCORP INC
191	LSB BANCSHARES INC /NC/
192	M&T BANK CORP
193	MACATAWA BANK CORP
194	MAF BANCORP INC
195	MAIN STREET TRUST INC
196	MAINSOURCE FINANCIAL GROUP
197	MARSHALL & ILSLEY CORP/WI/
198	MASSBANK CORP
199	MB FINANCIAL INC /MD
200	MBNA CORP
201	MBT FINANCIAL CORP
202	MELLON FINANCIAL CORP
203	MERCANTILE BANK CORP
204	MERCANTILE BANKSHARES CORP MERCHANTS & MANUFACTURERS BANCORPORATION INC
205	MERCANTILE BANKSHARES INC
206	MERCHANTS BANCSHARES INC
207	METRIS COMPANIES INC
208	MID-STATE BANCSHARES
209	MONROE BANCORP
210	MUTUALFIRST FINANCIAL INC
211	NASB FINANCIAL INC
212	NATIONAL BANKSHARES INC
213	NATIONAL CITY CORP
214	NBC CAPITAL CORP
215	NBT BANCORP INC
216	NEWMIL BANCORP INC
217	NORTH FORK BANCORPORATION INC
218	NORTH VALLEY BANCORP
219	NORTHERN EMPIRE BANCSHARES
220	NORTHERN STATES FINANCIAL CORP /DE/
221	NORTHRIM BANCORP INC
222	NORTHWEST BANCORP INC



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### FDICIA Banks Subject to SOX Section 404 in 2005

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<b>Institutions With Effective Internal Controls</b>	
223	O A K FINANCIAL CORP
224	OCEANFIRST FINANCIAL CORP
225	OCWEN FINANCIAL CORP
226	OHIO VALLEY BANC CORP
227	OLD NATIONAL BANCORP /IN/
228	OLD SECOND BANCORP INC
229	OMEGA FINANCIAL CORP /PA/
230	ORIENTAL FINANCIAL GROUP INC
231	PAB BANKSHARES INC
232	PACIFIC MERCANTILE BANCORP
233	PALMETTO BANCSHARES INC
234	PAMRAPO BANCORP INC
235	PARK NATIONAL CORP /OH/
236	PARKVALE FINANCIAL CORP
237	PARTNERS TRUST FINANCIAL GROUP INC
238	PEAPACK GLADSTONE FINANCIAL CORP
239	PENNFED FINANCIAL SERVICES INC
240	PEOPLES BANCORP INC
241	PFF BANCORP INC
242	PNC FINANCIAL SERVICES GROUP INC
243	POPULAR INC
244	PREMIERWEST BANCORP
245	PRINCETON NATIONAL BANCORP INC
246	PRIVATEBANCORP INC
247	PROVIDENT FINANCIAL HOLDINGS INC
248	PROVIDENT FINANCIAL SERVICES INC
249	PROVIDENT NEW YORK BANCORP
250	PVF CAPITAL CORP
251	QNB CORP
252	R&G FINANCIAL CORP
253	REGIONS FINANCIAL CORP
254	RENASANT CORP
255	REPUBLIC BANCORP INC /KY/
256	S Y BANCORP INC
257	S&T BANCORP INC
258	SANDY SPRING BANCORP INC
259	SANTANDER BANCORP
260	SCBT FINANCIAL CORP
261	SECURITY BANK CORP
262	SHORE BANCSHARES INC
263	SIERRA BANCORP
264	SIMMONS FIRST NATIONAL CORP
265	SKY FINANCIAL GROUP INC
266	SOUND FEDERAL BANCORP INC
267	SOUTHEASTERN BANK FINANCIAL CORP
268	SOUTHERN COMMUNITY FINANCIAL CORP

<b>Institutions With Effective Internal Controls</b>	
269	SOUTHSIDE BANCSHARES INC
270	SOUTHWEST BANCORP INC
271	SOVEREIGN BANCORP INC
272	STATE BANCORP INC
273	STATE FINANCIAL SERVICES CORP
274	STATE STREET CORP
275	STERLING FINANCIAL CORP /PA/
276	STERLING FINANCIAL CORP /WA/
277	SUFFOLK BANCORP
278	SUMMIT BANCSHARES INC /TX/
279	SUMMIT FINANCIAL GROUP INC
280	SUN BANCORP INC /NJ/
281	SUSQUEHANNA BANCSHARES INC
282	SYNOVUS FINANCIAL CORP
283	TCF FINANCIAL CORP
284	TEXAS CAPITAL BANCSHARES INC/TX
285	TEXAS REGIONAL BANCSHARES INC
286	TIB FINANCIAL CORP.
287	TIERONE CORP
288	TOMPKINS TRUSTCO INC
289	TRICO BANCSHARES
290	TRUSTCO BANK CORP N Y
291	TRUSTMARK CORP
292	UMB FINANCIAL CORP
293	UMPQUA HOLDINGS CORP
294	UNION BANKSHARES CORP
295	UNIONBANCAL CORP
296	UNITED BANCORP INC /MI/
297	UNITED BANKSHARES INC/WV
298	UNITED COMMUNITY BANKS INC
299	UNITED COMMUNITY FINANCIAL CORP
300	UNITED SECURITY BANCSHARES
301	UNITED SECURITY BANCSHARES INC
302	UNIVEST CORP OF PENNSYLVANIA
303	US BANCORP /DE/
304	USB HOLDING CO INC
305	VALLEY NATIONAL BANCORP
306	VINEYARD NATIONAL BANCORP
307	VIRGINIA COMMERCE BANCORP INC
308	VIRGINIA FINANCIAL GROUP INC
309	W HOLDING CO INC
310	WACHOVIA CORP NEW
311	WASHINGTON FEDERAL INC
312	WASHINGTON MUTUAL INC
313	WASHINGTON TRUST BANCORP INC
314	WEBSTER FINANCIAL CORP

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<b>Institutions With Effective Internal Controls</b>	
315	WELLS FARGO & CO/MN
316	WESBANCO INC
317	WEST BANCORPORATION INC
318	WEST COAST BANCORP /NEW/OR/
319	WESTAMERICA BANCORPORATION
320	WESTBANK CORP
321	WESTCORP /CA/
322	WESTERN SIERRA BANCORP
323	WESTFIELD FINANCIAL INC
324	WHITNEY HOLDING CORP
325	WILLOW GROVE BANCORP INC/NEW
326	WILMINGTON TRUST CORP
327	WILSHIRE BANCORP INC
328	WINTRUST FINANCIAL CORP
329	WORONOCO BANCORP INC
330	WSFS FINANCIAL CORP
331	YARDVILLE NATIONAL BANCORP
332	ZIONS BANCORPORATION /UT/