



1120 Connecticut Avenue, NW  
Washington, DC 20036

1-800-BANKERS  
www.aba.com

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

**Donna J. Fisher**  
Director Tax and Accounting

Tel: 202-663-5318  
Fax: 202-828-4548  
dfisher@aba.com

June 9, 2005

FFIEC  
Program Coordinator  
3501 Fairfax Drive  
Room 3086  
Arlington, VA 22226

Via email: [FFIEC-comments@FDIC.gov](mailto:FFIEC-comments@FDIC.gov)

Re: Proposed "Interagency Advisory on the Unsafe and Unsound Use of the Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions in External Audit Engagement Letters"; 70 Federal Register 24576; May 10, 2005

Dear Sir or Madam:

The American Bankers Association (ABA) appreciates the opportunity to comment on the proposed "Interagency Advisory on the Unsafe and Unsound Use of the Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions in External Audit Engagement Letters". The ABA, on behalf of the more than 2 million men and women who work in U.S. banks, brings together all categories of banking institutions to best represent the interests of this 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.

We share your concern about the impact of limitation of liability provisions and certain types of alternative dispute resolution (ADR) provisions in engagement letters. We became concerned about these types of provisions last fall, when some ABA members who had agreed to re-negotiate their 2004 engagement letters (subsequent to the issuance of final rules relating to Section 404 of the Sarbanes-Oxley Act of 2002) contacted the ABA staff with their concerns about these new provisions. It is our understanding that some firms were including the new provisions as part of the re-negotiations, and at least one firm indicated to its client that it would not complete the audit without the provisions. At that time, we contacted the Public Company Accounting Oversight Board (PCAOB) and the Federal Deposit Insurance Corporation to try to determine: (a) whether certain types of ADR provisions were problematic from an independence or from a safety and soundness perspective, and (2) whether it was an acceptable practice for an audit firm to refuse to complete an audit (for which an engagement letter had

previously been signed) on the basis that the bank was not willing to re-negotiate the engagement letter to include new ADR provisions. We learned that there were, in fact, concerns about both.

### Scope of Proposal

ABA supports the Federal Arbitration Act (FAA) and has supported the use of arbitration under the FAA before the courts, including the U.S. Supreme Court, in cases involving certain credit and deposit transactions because the use of arbitration can resolve these disputes in a cost-effective and efficient manner. That said, in the context of audit engagement letters, we share your concerns relating to both auditor independence and safety and soundness for audit services, particularly because of the focus on auditor independence in the Sarbanes-Oxley Act of 2002 (the Act). Among other things, the Act attempted to restore the confidence level in and reliance on audits and auditors. To the extent that an ADR provision violates either auditor independence or the ability to rely on audited financial statements, then the banking agencies have a valid concern that should be addressed. Further, as noted in your proposal, there is existing guidance from the SEC and others that already deems these provisions to be inappropriate with respect to auditor work. Thus, we are in agreement with the thrust of your proposal.

Moreover, we question whether your proposed advisory should be limited to banking or whether it should also be applicable to other types of companies.<sup>1</sup> That is, there may be a need for the SEC and PCAOB to address this issue alongside the banking agencies, because it appears to us that it should not be limited to the banking industry.

It would also be useful for the final advisory to list additional situations in which limitation of liability provisions and other ADR provisions should not be used. Because we believe that ADR provisions (other than the limitations of liability) are often appropriate, we request that the agencies be very careful with this identification process to ensure that any new guidance is not in conflict with the view that certain types of ADR provisions (such as credit card, deposit, and certain other transactions) are appropriate. Although the proposed advisory is clearly applicable to engagement letters for “financial statement audits,” its applicability to other situations is unclear. For example, we believe that the advisory is intended to include audits and attestations relating to internal controls (those that are required by the Act and by FDICIA), because they are so closely related to financial statement audits.<sup>2</sup> However, we are uncertain as to whether the proposed advisory is intended to apply to engagement letters for other types of accounting services provided either by the primary audit firm or by audit firms that provide services other than financial statement audits (such as internal audit work performed by a secondary accounting firm, tax, information technology

---

<sup>1</sup> We raise this because the advisory refers to SEC guidance, under which limitations of liability provisions are already inappropriate, and to AICPA independence standards, which limitations of liability provisions may violate.

<sup>2</sup> In fact, the May 16, 2005 PCAOB Policy Statement (Release No. 2005-009) states that: “An integrated audit combines an audit of internal control over financial reporting with the audit of the financial statements, such that the objectives of the two audits are achieved simultaneously through a single coordinated process.” PCAOB also notes: “Failing to integrate these audits not only wastes resources, but it also jeopardizes the quality of the overall audit and, potentially, misses key insights that could identify and uproot a budding accounting or reporting problem.”

audits, special auditing or accounting work, research, etc.). It seems logical that the advisory would apply to work relating to the primary audits of financial statements and those relating to internal controls because of the Act and the other regulatory bodies referenced in the proposed advisory. It is unclear to us whether audit services other than financial statement audits (such as internal audit work performed by a secondary accounting firm, tax, information technology audits, special auditing or accounting work, research, etc.) are intended to be included.

### Costs Relating to Proposed Advisory

We are concerned about the impact of the advisory on audit fees for financial institutions. Some ABA members believe that the firms will attempt to raise audit fees for financial institutions in order to pass through their own estimations of future litigation costs.<sup>3</sup> Others believe that audit fees are already so high that the firms could not possibly increase fees as a result of this proposal.

If the audit firms view being unable to limit their liability for their own acts as a major risk for audits of financial institutions, the result could be a contraction in the availability of auditors or an increase in audit fees for our industry.<sup>4</sup> As the SEC has already issued guidance that such provisions impede auditor independence, then a statement from the SEC that is similar to the agencies' position could be extremely valuable in ensuring that financial institutions are not viewed as higher risk than other industries.

### The Three General Categories of Limitation of Liability Provisions

We agree with the three general categories in the proposed advisory. The language relating to the first two categories (indemnify and hold harmless) are fairly straightforward and easily understood. We fully support the exclusion of these two types of provisions from engagement letters. We also agree with the third category (limit of remedies), and we believe that it should be more strongly worded, including why this type of provision is inappropriate (whether included in an ADR provision or not). For example, while arbitration may be an appropriate dispute resolution mechanism in some circumstances, if there is no ability to appeal the arbitration ruling, no legal precedent is created. This could result in different decisions relating to similar issues across the industry, inconsistent treatment on accounting and auditing issues among banks, and confusion in the marketplace. This would not only be problematic for the banking industry, but we believe it may be unacceptable from a regulatory perspective (banking regulators and the SEC). Also, in addition to other limitations on the ADR process, such as a prohibition on damage caps, ADR provisions that impair the ability to seek equitable relief (such as no declaratory judgment, no court process, etc.), should also be prohibited.

---

<sup>3</sup> Our April 1, 2005 letter to the SEC on Section 404 of the Sarbanes-Oxley Act of 2002 states that the fear that the accounting firms have of the PCAOB appears to be (aside from the duplication of work) the most significant cost relating to the application of Section 404. It would be reasonable to assume that their fear of litigation, if significant, could result in higher fees.

<sup>4</sup> Our April 1, 2005 letter to the SEC on Section 404 states that many companies believe that "...decisions are being made by the risk managers within the firms rather than audit practice staff, and those risk managers are aiming for absolute assurance rather than reasonable assurance...". Similar evaluations by the firms relating to litigation risks might lead to an unwillingness to auditing financial institutions or an increase in fees.

Transition

The proposed advisory needs to provide further details for banks that have signed engagement letters that include limitation of liability provisions and certain types of ADR provisions. Although we agree that those banks should attempt to re-negotiate such engagement letters, we do not believe it has been clear to the accounting firms or to companies that the SEC and banking regulatory guidance precluded ADR provisions. Therefore, those banks should be permitted to use pre-existing engagement letters in situations where audit firms refuse to re-negotiate.

The proposed advisory indicates that the agencies may take action for engagement letters executed after the date of “this advisory”. We interpret this as the date of the final advisory rather than the proposed advisory, and we encourage the agencies to use the date of final issuance.

Examples of Limitation of Liability Provisions (Appendix A)

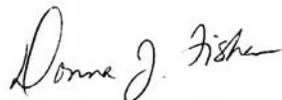
Appendix A in the proposed advisory is extremely useful, and should be expanded. We recommend that the agencies consider including additional examples relating to:

- Equitable relief
- Limits to third parties
- Arbitration consequences barring any rights of appeal

\* \* \* \* \*

In summary, the ABA shares the agencies’ concerns regarding limitation of liability provisions and certain types of ADR provisions relating to auditing services, primarily because of the unique treatment of auditing services under the Act as well as existing guidance from other regulatory bodies. We would be glad to work with you further on our recommendations or other changes as you proceed. Please feel free to contact me at (202) 663-5318.

Sincerely,



Donna Fisher