



CUNA & Affiliates
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June 9, 2005

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

Via E-mail: FFIEC-Comments@fdic.gov

Re: Proposed Advisory on Limitation of Liability Provisions in External Audit Engagement Letters

Dear Sir or Madam:

The Credit Union National Association (CUNA) is pleased to provide comments on the Federal Financial Institutions Examination Council's (FFIEC's) proposed Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions and Certain Alternative Dispute Resolution Provisions in External Audit Engagement Letters. If adopted, the advisory would eliminate the use of provisions that limit liability of the external auditor or provide for indemnification of auditors. By way of background, CUNA is the largest credit union trade association, representing approximately 90% of our nation's nearly 9,100 state and federal credit unions. This letter was prepared under the auspices of CUNA's Accounting Task Force.

The advisory cautions financial institutions' boards of directors, audit committees, and management against accepting any agreement that limits the liability of external auditors in preparation of the institution's financial statement audits. The guidance also advises financial institutions not to enter into pre-dispute mandatory alternative dispute resolution (ADR) arrangements that include limitations on liability provisions, whether they form part of an audit engagement letter or are set out separately. Further, institutions are encouraged to review the rules of procedure referenced in the ADR agreement to ensure that the potential consequences of such procedures would be acceptable to the institution. Financial institutions are expected to document their business rationale for agreeing to any other provisions that alter their legal rights. Finally, the guidance states that financial institutions' boards of directors, audit committees, and management should check with their insurers to determine whether the institution had losses due to actions on the part of their external auditors for which they did not recover or recovery was capped because of the limitation of liability provisions.



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Summary of Comments

- CUNA agrees that the limitation of liability provisions are inappropriate for all financial institution external audits.
- The categories and examples of limitation of liability provisions highlighted as problematic are comprehensive and helpful as a reference for financial institutions.
- While we feel there could be an increase in external audit fees as a result of this advisory, the increase would probably be small. This slight increase would likely not discourage financial institutions that voluntarily obtain audits from continuing to do so.
- We encourage the FFIEC to amend the provisions regarding the effective date of the advisory so that if limitation of liability provisions contained in engagement letters for the current year cannot be renegotiated in good faith, then the institution can retain the agreement until next year (and amend the contractual provisions for calendar year 2006 and beyond).

Discussion of Comments

CUNA commends the proposed advisory's goal of ensuring that external audits of the books of regulated financial institutions are done so in an independent and objective manner. We agree that provisions limiting liability on the part of the CPA firm may weaken an external auditor's objectivity, impartiality, and performance. Such liability limitation provisions reduce the ability of the regulatory agency as well as the institution's stakeholders, such as the members of the credit union, to rely on the audit. We believe that auditors should adhere to the auditor independence standards set by the U.S. Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA).

Scope

CUNA feels that the advisory represents a best practice with respect of external audits that should apply to all financial institutions that contract to procure an outside audit. We think there should be little effect on the ability of financial institutions to negotiate the terms of audit engagements with reputable CPA firms.

Categories of Limitation of Liability Provisions

The advisory divides limited liability provisions into the following 3 general types: (1) statements that would indemnify the external auditor against claims made by third parties; (2) agreements to hold harmless or release the external auditor from liability for claims by the client financial institution; and (3) limitations on remedies sought by the client financial institution. CUNA feels that those categories and the examples limitation of liability provisions described in Appendix A of the advisory as being especially problematic in engagement letters are complete and accurate.

Fees and Voluntary Audits

We believe that there could be an increase in external audit fees as a result of this advisory. The potential liability of CPA firms likely will rise which will, in turn, cause an increase in their malpractice insurance premiums. The CPA firms in all likelihood will pass along some of this increased cost of doing business to their financial institution clients. This situation may discourage some voluntary audits, but likely not to a significant extent. Institutions that choose to secure an audit at their option typically do so because the institution's supervisory committee does not have the time/expertise to conduct the audit or because management desires the additional/higher level of assurance and oversight -- comfort level -- provided by an independent third party. We do not believe the potential slight increase in cost would be sufficient to overcome the motivation behind the engagement of a CPA firm and dissuade the institution from doing so.

Effective Date

According to the advisory, the appropriate regulatory agency may take supervisory action if the limitation of liability provisions are included in external audit engagement letters or related agreement that are executed (accepted or agreed to by the financial institution) after the date of the Advisory (May 10, 2005). For any such letter or related agreement already accepted for a fiscal 2005 or subsequent financial statement audit (that is, fiscal years ending on or after January 1, 2005), it is strongly recommended that that boards of directors, audit committees, and management consult with legal counsel and the external auditor and take appropriate action to have any limitation of liability provision nullified.

We urge the FFIEC to modify the provisions concerning effective date in the final advisory. Specifically, we believe the provisions should be amended to say that engagements negotiated prior to the effective date of the advisory should be reviewed and a good faith effort to renegotiate should be made if limitations such as the ones laid out in the guidance are discovered. Many engagement letters cover a multiple year period and many engagement letters for the 2005 audit are already in place. If the institution and CPA firm are unable to reach an agreement to change the provisions for the current year, it would seem reasonable to allow them to make modifications for the following calendar year (2006). This would provide sufficient time for institutions to amend their audit engagement contracts so they are in compliance with the advisory.

Thank you for the opportunity to comment. If you have any questions about this letter, please contact me by phone at (202) 508-6743 or by e-mail at corr@cuna.com.

Sincerely,



Catherine Orr
Senior Regulatory Counsel
Credit Union National Association