GLASS
LEWIS & Co.

June 6, 2005

Ms. LaJuan Williams-Dickerson, Program Coordinator
Federal Financial Institutions Examination Council
3501 Fairfax Drive
Room 3086
Arlington, Virginia 22226

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

Dear Ms. Williams-Dickerson:

Glass Lewis strongly supports the efforts of the Federal Financial Institutions Examination Council (FFIEC) to promote greater auditor independence and objectivity. Strengthening financial statement audits can only result in more transparent and meaningful financial reporting. We believe audit engagement letters containing liability limitations impair the auditor's independence and reduce audit quality to an unacceptable level.

Glass, Lewis & Co., LLC

Glass, Lewis & Co., LLC is an independent proxy and financial research firm that provides research to institutional investors that manage over $5 trillion. In that regard, we rely on audited financial statements and disclosures that public companies provide to investors and the capital markets. Our staff has many years of experience as financial analysts, as senior executives and preparers of financial statements, corporate board members and as independent auditors. From our perspective it is vitally important that the registered public accounting firms perform their audits with the greatest level of professionalism and care, and should be independent both in fact and appearance. Only then, we believe, will investors and regulators have full confidence in relying on audited financial statements. For the proper functioning of the U.S. bank regulatory system and capital markets, it is vitally important that investors and regulators have confidence in information presented in audited financial statements.

Comments

Question 1: *The advisory, as written, indicates that limitation of liability provisions are inappropriate for all financial institution external audits.*

a. Is the scope appropriate? If not, to which financial institutions should the advisory apply and why?

b. Should the advisory apply to financial institution audits that are not required by law, regulation, or order?

Response:

We concur with the FFIEC that the limitation of liability provisions should apply to all financial institution external audits, including those not required by law. External audits provide assurance that the financial statements fairly reflect the company's financial position and results of operations, in accordance with generally accepted accounting principles. All users of audited financial statements should be able to express the same degree of confidence as to the representational faithfulness of these statements. Permitting a lower standard for some financial statement audits might create both real and perceived reductions in audit quality, and external users might place less reliance on them. Investors are likely to apply a risk premium on these companies, which would be justified in some cases and unjustified in others.

Question 2: *What effects would the issuance of this advisory have on financial institutions' ability to negotiate the terms of audit engagements?*

Response:

The advisory should have no impact on financial institutions' ability to negotiate the terms of their audit engagements. We believe a fair audit fee for a high quality audit is a small cost to pay to reduce the potential risk to investors related to low quality financial reporting. We anticipate that some auditors may attempt to increase their audit engagement fees when these provisions are removed. As the FFIEC correctly stated in the proposal, engagement letters containing limitations on auditor liability violate SEC auditor independence rules. Therefore, an auditor of an SEC registrant who uses the absence of such provisions as a bargaining tool must be violating SEC rules. Companies should not engage auditors who use this as a negotiating tool.

There has been a significant increase in the number of companies changing auditors over the last two years. This suggests that companies are able to find suitable replacements if they are unable to agree on proper terms with their auditors. Therefore, the advisory should have a muted impact on financial institutions' ability to negotiate terms of engagement.

Question 3: *Would the advisory on limitation of liability provisions result in an increase in external audit fees?*

Response:

No. Fees should remain the same as the scope and quality of the audit should not change because of the removal of the limited liability provisions. If audit fees do increase as a result of the removal of a liability limiting provision, we would be concerned it was the result of a substandard audit being performed while such limitations existed.

Question 3 (a): *If yes, would the increase be significant?*

See question 3.

Question 3 (b): *Would it discourage financial institutions that voluntarily obtain audits from continuing to be audited?*

Response:

Financial institutions that voluntarily obtain audits usually do so to enhance the reputation and quality of their financial statements. This impacts their cost to participate in the capital markets, including, among other things, the rate at which they are able to borrow. We do not believe that there is likely to be a significant reduction in the number of these companies having their financial statements audited.

Question 3 (c): *Would it result in fewer audit firms being willing to provide external audit services to financial institutions?*

Response:

Audit firms have provided audit services without such restrictions, including to publicly listed companies. As a result, we do not believe that firms are likely to reduce the number of companies they audit in the financial sector, or cease auditing these companies completely. New regulations and increasing claims against auditors have forced them to improve their audits. Therefore, we would expect firms withdrawing their services to be in the minority.

Question 4: *The advisory describes three general categories of limitation of liability provisions.*

(a). Is the description complete and accurate?

Response:

We understand the categories in the description to be:

a. The financial institution indemnifies the auditor against third party claims;
b. Release the auditor from liability for any claims that might be made against it by the financial institution;
c. The company being audited should limit the remedies available to it.

We are also aware of engagement letters in which audit firms have required a company to (1) waive its right to a jury trial, (2) to limit damages, including punitive damages and (3) to limit discovery in arbitration.

(b). Is there any aspect of the advisory or terminology that needs clarification?

Response:

Although it includes legal and accounting terminology, we believe the advisory should be clear to the average user of financial statements.

Question 5: *Appendix A of the advisory contains examples of limitation of liability provisions.*

(a). Do the examples clearly and sufficiently illustrate the types of provisions that are inappropriate?

(b). Are there other inappropriate limitation of liability provisions that should be included in the advisory? If so, please provide examples.

Response:

We believe it is inappropriate for an audit contract between a company and its auditor to limit the auditor's liability including (1) any limitations on rights to trial (2) limits on compensatory or punitive damages, or (3) limits on discovery including in arbitration.

Question 6: *Is there a valid business purpose for financial institutions to agree to any limitation of liability provision? If so, please describe the limitation of liability provision and its business purpose.*

Response:

We do not believe there are any valid business reasons for limited liability provisions.

Question 7: *The advisory strongly recommends that financial institutions take appropriate action to nullify limitation of liability provisions in 2005 audit engagement letters that have already been accepted. Is this recommendation appropriate? If not, please explain your rationale (including burden and cost).*

Response:

We believe this recommendation is appropriate. We also strongly believe audit committees should fully disclose any past and continuing limited liability provisions.

We note there are current efforts underway in the United Kingdom that would require public disclosure of audit engagement letters and we support such efforts.

Thanks for providing us the opportunity to comment. We would be pleased to respond to any questions you might have after considering our comment letter. Please contact Mike Lofing at 303-532-2416.

Sincerely,

Lynn E Turner

Lynn E. Turner
Managing Director of Research