



June 9, 2005

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

RE: FFIEC Advisory on the Limitation of Liability Provisions in Audit Engagement Letters

Dear Examination Council,

The Michigan Credit Union League (MCUL) appreciates the opportunity to provide comments to the Federal Financial Institutions Examination Council (FFIEC) concerning the proposed Advisory on limitation of liability provisions in audit engagement letters. The MCUL is a trade association representing over 90% of state and federally chartered credit unions in the state of Michigan. This comment letter was drafted in consultation with the MCUL Government Affairs Committee, which is comprised of Michigan credit union staff and officials.

The MCUL recognizes that in the course of business, a credit union relies on auditors as a form of “checks and balances” to ensure its operation is running effectively and that they are complying with the vast sets of rules and standards that its industry requires. We also understand that auditors have a professional responsibility to stand behind their findings, that credit unions rely on the accuracy of their information, and that the safety and soundness of a credit union is at least partially based on an auditing firm’s ability to provide accurate, unbiased information and stand behind that information. MCUL believes that audit letters that limit the liability of the auditing firm may indeed pose a threat to the safety and soundness of a credit union and there should be guidance provided to credit unions with regards to what is acceptable in audit engagement letters, however we believe that the scope of the proposal may exceed what is necessary for all audits.

Summary of Comments

- MCUL believes the scope of the Advisory may go beyond what is necessary to the safety and soundness of financial institutions and may, in fact, discourage a credit union from obtaining audits on non-essential aspects of its operations. Decreased costs offered by audits with liability limitations, for elements that are not required by law, regulation, or order would present a valid business purpose for financial institutions to agree to a limitation of liability provision.
- MCUL believes, that because of the size of many credit unions, this Advisory might negatively impact a credit union’s ability to negotiate or renegotiate favorable terms in many audit engagements, which might result in higher audit fees.
- MCUL supports the recommendation that financial institutions take appropriate action to nullify limitation of liability provisions in 2005 audit engagement letters, however we oppose

any requirement to do so because of the additional burden and potential costs to credit unions of doing so.

- MCUL supports the structure of Appendix A of the Advisory which contains examples of limitation of liability provisions and believe they clearly and sufficiently illustrate the types of provisions that are inappropriate.

Discussion

Impact of Advisory on Credit Union Audit Procedures. MCUL believes that the Advisory, as written, may go beyond what is necessary for safety and soundness issues for audits. We recognize that there are valid reasons for preventing credit unions from creating limits of liability provisions in many of its auditing agreements, however we don't believe it is necessary for all audit agreements. MCUL believes that auditing firms should have a responsibility to the credit union and its members for those audits required by law, regulation, or order, however we recognize that some credit unions may use auditing firms to review other aspects of its credit union not covered under these provisions.

For those audits, which are not required by law, regulation, or order, we believe that credit unions should have the option as to whether or not they negotiate a limitation of liability for its auditors. With additional risk comes the likelihood of increased expense. By preventing a credit union or other financial institution from placing limit of liability provisions in its non-essential audits, FFIEC may increase the costs of these services and the expense to the members. By preventing limitation of liability provisions in the non-mandatory audits, credit unions and other financial institutions may cease to obtain audits on these areas, which may be to the detriment of the credit union and its members.

There may be valid business reasons for financial institutions to agree to a limitation of liability provision. If the audit is of a non-essential, operational aspect that is not required by law, regulation, or order, then it may be to the credit union's benefit to negotiate a limitation of liability with the auditing firm. If the auditing firm will offer them a better deal if they place the limitations within the contract, and the credit union does not foresee a need to hold the auditing firm liable because the audit is on a non-essential aspect of the credit union, then there does not appear to be a financial reason to hold the auditing firm liable.

Effect of Advisory on Negotiating Audit Engagements and Fees. MCUL believes that the Advisory could negatively impact a credit union's ability to negotiate the terms of audit engagements. We expect that larger financial institutions will have the experience and leverage to effectively negotiate with auditors, and auditors will want their business badly enough to work with them, however we believe that a small credit union may not be able to effectively understand and negotiate or renegotiate the provisions of their contract in a manner that will best benefit them and their members.

By requiring all audits to be devoid of any limitations of liability, then this may increase the costs of audits to our credit unions, though we are unsure of how significantly. The more risk that an auditing firm takes on, in the event that incorrect information provided in an audit results in a financial loss to a financial institution and subsequently to the auditing firm through a lawsuit, the more likely the auditing firm will pass these expenses on to their clients.

If FFEIC believes that this is a significant enough problem to justify guidance, financial institutions might best benefit from FFEIC passing a rule to prescribe a set of required and prohibited provisions. This would allow smaller institutions to point to the rule to assist in the negotiation of the changes with the auditing industry. The audit engagement contract could then just say "the provisions of NCUA Rule XXX are herein incorporated by reference." Auditors would know that if they are going to provide audits for the financial services industry that they will have to comply with these rules.

Nullifying Limitation of Liability Provisions in 2005 Audit Engagement Letters.

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 negotiated. MCUL believes that this is a good recommendation, provided that the credit union or financial institution is capable of nullifying its engagement letter in a way that would not adversely affect its business. We believe many credit unions may have to use the services of an attorney to break its contract, costing them excess legal fees on top of the additional costs to renegotiate a contract in a way that is more favorable to the credit union.

MCUL believes that credit unions should examine options that will allow them to get out of any engagement letters that affect the safety and soundness of its institutions, however if the costs are too great we do not believe they should be penalized for these contracts at this time. We believe that the regulators should allow any credit union that has already signed its engagement letters, at least a year to resolve the issue. If FFEIC believes that this issue is serious enough, again, we believe that they should make the prohibition of limit of liability clauses a regulatory requirement, which would assist a credit union or other financial service company in renegotiating or breaking its letter of engagement.

Appendix A. MCUL finds that Appendix A of the Advisory clearly and sufficiently illustrates the types of provisions that are inappropriate. We appreciate the format which describes the type of provision, describes it with some detail, and provides an example. We believe that this format helps provide clarity to the reader. We are not aware of any other inappropriate limitation of liability provisions that should be included in the Advisory.

We thank you for the opportunity to comment.

Sincerely,



Matthew Beard
Regulatory Specialist
Michigan Credit Union League

cc: Credit Union National Association, Inc.