

February 28, 2008

Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429.

Proposed Comment Letter on Revisions to Part 363

Dear Mr. Feldman:

The Depository Institutions Expert Panel of the American Institute of Certified Public Accountants has reviewed the proposed rule, *Annual Independent Audits and Reporting Requirements*, (12 CFR Parts 308 and 363) and is pleased to provide you with the comments developed by our Part 363 Revisions Task Force. The AICPA is the largest professional association of certified public accountants in the United States, with approximately 340,000 members in business, industry, public practice, government and education. The Depository Institutions Expert Panel addresses auditing, accounting and regulatory issues for insured depository institutions.

We support the efforts of the FDIC to clarify the existing requirements. However, as indicated below, we are concerned about several issues, particularly related to PCAOB inspection reports and audit engagement letters. We have organized our comments below to correspond to the sequence of the proposed rule.

#### **A. Scope (§363.1)**

##### **Item 2. Compliance by Subsidiaries of Holding Companies**

The proposed rule would require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the top-tier or any other mid-tier holding company's consolidated total assets as of the beginning of its fiscal year in order for an institution to comply with Part 363 at the holding company level. We support this revision and believe it provides ease of application while obtaining appropriate audit coverage of the insured depository institutions.

### Item 3. Financial Reporting

We recognize the agencies have taken the position that financial reporting covers regulatory reporting (i.e., the call and thrift financial reports). As drafted, the proposal seems to imply that the call and thrift financial reports may not be in compliance with GAAP. We suggest the definition be clarified to state both financial statements and these reports be prepared in accordance with GAAP so that it is consistent with current practice.

#### **B. Annual Reporting Requirements (§363.2)**

##### Item 1: Audited Financial Statements

The proposed rule would require that annual financial statements reflect all material correcting adjustments identified by the Independent Public Accountant (IPA). We support the concept that all material correcting adjustments should be reflected in annual financial statements, and observe the annual financial statements accompanied by an unqualified opinion of the IPA provide evidence to this effect. We also point to related AICPA Statements on Auditing Standards (SAS), as follows:

- Per SAS No. 89, *Audit Adjustments*, management is responsible for adjusting the financial statements to correct material misstatements and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
- Per SAS No. 114, *The Auditor's Communication With Those Charged with Governance*, the auditor must communicate to those charged with governance uncorrected misstatements (other than those the auditor believes are trivial.)

##### Item 2: Management Report Contents

We agree with the proposal to require management's assessment of compliance with designated safety and soundness laws and regulations to state management's conclusion regarding compliance, and disclose any noncompliance with such laws and regulations, except we believe the rule should be clarified to require disclosure only in the event of *material* noncompliance.

We recommend the following wording changes:

§363.2(b)(2) An assessment by management of the insured depository institution's compliance with such laws and regulations during such fiscal year. The assessment must state management's conclusion as to whether the insured depository institution has complied with the designated safety and soundness laws and regulations during the fiscal year and disclose any **material** noncompliance with these laws and regulations; and

The proposal as drafted seems to require management's report to disclose all identified material weaknesses pertaining to internal control over financial reporting. However, we do not believe the intent is to modify the current requirement to only disclose all material weaknesses in existence as of the end of the year, and not those identified but remediated prior to year-end.

We recommend the following wording changes:

§363.2(b)(3)(iii) A statement expressing management's conclusion as to whether the insured depository institution's internal control over financial reporting is effective. Management must disclose all material weaknesses in internal control over financial reporting, if any, that it has identified **and have not been remediated as of the end of the institution's most recent fiscal year**. Management is precluded from concluding that the insured depository institution's internal control over financial reporting is effective if there are one or more material weaknesses.

We support the efforts of the FDIC to provide illustrative management reports to ensure that institutions are complying with these reporting requirements. In order to maintain flexibility, the task force agrees with the proposed rule that states: "The use of the wording in the illustrative management reports and cover letter would not be required."

#### Item 4: Institutions Merged Out of Existence

We support the proposed change to provide relief from the annual reporting requirements for institutions that are merged out of existence.

### C. Independent Public Accountant (§363.3)

#### Item 1: Internal Control Over Financial Reporting

The proposal as drafted seems to require the report of the IPA to disclose all identified material weaknesses. We do not believe the intent is to modify the current requirement to only disclose all material weaknesses in existence as of the end of the year, and not those identified but remediated prior to year-end.

We recommend the following wording changes:

§363.3(b)(3) A statement expressing the independent public accountant's conclusion as to whether the insured depository institution's internal control over financial reporting is effective. The report must disclose all material weaknesses in internal control over financial reporting that the independent public accountant has identified **and that have not been remediated as of the end of the institution's most recent fiscal year**. The independent public accountant is precluded from concluding that the insured

depository institution's internal control over financial reporting is effective if there are one or more material weaknesses.

The proposal requires several changes to the IPA's report in an effort to be consistent with generally accepted standards for attestation engagements, PCAOB auditing standards and related PCAOB staff implementation guidance. Rather than memorializing these items in the rule, we suggest the FDIC refer to the auditing standard setters for establishing these criteria. We observe the required list is consistent with the PCAOB guidance and understand the AICPA's project to amend Chapter 5 of Statements on Standards for Attestation Engagements (SSAE) No. 10, *Reporting on an Entity's Internal Control Over Financial Reporting*, (AT501) will have similar requirements.

#### Item 2: Communications with Audit Committee

The proposal requires certain communications between the IPA and the audit committee. The requirements for auditors of nonpublic entities are included in AICPA Statement on Auditing Standards No. 114, *The Auditor's Communication With Those Charged With Governance*, (SAS 114). Likewise, established rules by the PCAOB and SEC cover required communications for auditors of public entities. Rather than memorializing these items in the rule, we suggest the FDIC refer to the existing standards for the required communications with audit committees.

#### Item 3: Retention of Working Papers

The proposal requires the retention of IPA audit work papers for 7 years. This may cause an extra burden and expense for IPAs of nonpublic FDICIA institutions, particularly for those not using electronic formats for their working papers. We urge the FDIC to weigh the costs to auditors of nonpublic insured institutions.

#### Item 5: Peer Reviews

The proposed amendment to Section 363.3(g) would require IPAs that audit FDIC-insured institutions and are inspected by the PCAOB to file their full PCAOB inspection reports with the FDIC. This would include not only the portion of the report (Part I) that the PCAOB currently makes public on its website, but also the confidential and nonpublic section of the report (Part II). We believe that this proposal is impracticable, as well as inconsistent with the intent of the Act, which created the PCAOB and the PCAOB's inspection rules.

The Act and the PCAOB's rules emphasize the confidential and non-public nature of Part II of PCAOB inspection reports. In Part II of an inspection report, the PCAOB may identify potential criticisms or defects in a firm's quality control systems. Firms are then provided with a 12-month period to work with the PCAOB Staff to develop appropriate remediation plans. The potential criticisms or defects are

made public only if, at the end of the 12-month period, a firm has not addressed them to the PCAOB's satisfaction.

In our view, it would be inconsistent with this carefully considered approach to require IPAs to file the non-public portions of inspection reports with the FDIC. Under the Act, the only Government agencies that are currently entitled to receive copies of full inspection reports are the SEC and appropriate state regulatory authorities, such as state accountancy boards. These agencies are expressly required under the Act to maintain the confidentiality of Part II, and the PCAOB separately notifies them once it has determined that a firm has taken appropriate steps to address potential quality control issues. In comparison, (1) nothing in the Act or the PCAOB's rules directs the PCAOB (or, for that matter, an IPA) to provide Part II of an inspection report to the FDIC or other federal banking regulators; (2) the FDIC would have no statutory obligation similar to the obligation currently imposed on the SEC and the state accountancy boards to maintain the confidentiality of Part II, if a firm provided an inspection report to the FDIC; and (3) no mechanism would exist under the PCAOB's rules to notify the FDIC that an IPA has taken appropriate steps to address any quality control issues identified in Part II of a report.

In light of these factors, we urge the FDIC to reconsider its proposal and recognize the strong Congressional interest in protecting the confidential nature of Part II of PCAOB inspection reports. In particular, we believe that the FDIC should simply require IPAs to give the FDIC notice, either by mail or electronically, when the PCAOB has posted Part I of an inspection report on its website or subsequently determined that portions of Part II of a report should be made public.

#### Other Matters

In addition, we recommend a wording change to the title of this section. Because the PCAOB inspections are performed by a body other than an auditing firm, we recommend §363.3(g) *Peer reviews* be titled as *Peer reviews and inspection reports*.

#### **D. Filing and Notice Requirements (§ 363.4)**

##### Item 1: Annual Reporting

We support the proposal to extend the time period within which an insured depository institution that is not a public company or a subsidiary of a public company must file its Part 363 Annual Report from within 90 days to within 120 days after the end of its fiscal year.

##### Item 2: Independent Public Accountant's Reports

We respectfully request the FDIC to reconsider the proposed requirement that institutions file copies of audit engagement letters, including any related agreements and amendments, with the FDIC, the

appropriate federal banking agency, and any appropriate state bank supervisor within 15 days of acceptance by the institution.

Institutions enter into material arrangements frequently (e.g., significant loans, hiring senior management, engaging professional services); however those contracts are not required to be submitted but rather are subject to the field examination process. We understand the need for compliance with the *Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters* (“Advisory”), but we observe the existence of many interagency advisories and policy statements for which compliance is confirmed through the field examination process.

We observe and support the proposal’s requirement that audit committees take ownership over compliance with the Advisory, including the absence of any limitation of liability provisions as described below. Given such additional oversight, we believe a submission is unnecessary and further note that no submission requirements are imposed by the SEC or PCAOB.

We also question whether the contracts would be available to the public under the Freedom of Information Act (FOIA). Engagement letters contain contractual terms, including the nature of the engagement, responsibilities of the respective parties (management, the audit committee and the auditor), and certain information that may distinguish auditors in a competitive marketplace. Such contractual arrangements were never intended to be available to the public, and we believe that public disclosure of such arrangements would be detrimental to the parties involved.

In any event, should these engagement letters be available under the FOIA, and recognizing that the disclosure of the commercial terms is not the primary objective of this proposal, we recommend the FDIC and primary regulator either accept engagement letters with those sections redacted or redact such sections for FOIA requests.

### **E. Audit Committees (Part 363.5)**

#### **Item 1: Composition**

We support the proposal to require boards of directors to adopt written criteria for evaluating an audit committee member’s independence and provide expanded guidance for boards of directors to use in determining independence.

#### **Item 3: Duties**

We support the proposal to specify that the duties of the audit committee include the appointment, compensation, and oversight of the independent public accountant. We agree it is important to emphasize that these are the duties of the audit committee.

Item 4: Independent Public Accountant Engagement Letters

We support the proposal that would require the audit committee to ensure that audit engagement letters and any related agreements with the IPA for services to be performed under part 363 do not contain any limitation of liability provisions in accordance with the *Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters*.

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The AICPA appreciates the opportunity to respond to this proposal. We would be pleased to discuss our comments with you or your representatives at your convenience. If you have any questions, please contact Myrna Parker, Technical Manager, at 202-434-9241.

Very truly yours,



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CC:

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