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

Via e-mail: Comments@FDIC.gov

Re: Part 363-Independent Audits and Reporting Requirements

Dear Mr. Feldman,

We appreciate the opportunity to comment on the proposed rule (12 CFR Parts 308 and 363), *Annual Independent Audits and Reporting Requirements*, issued by the Federal Deposit Insurance Corporation (FDIC). Overall, we support the proposed rule and believe it codifies existing practice, as well as strengthens certain requirements of management, the audit committee, and the independent public accountant. We respectfully submit our comments and recommendations to further clarify such requirements below.

§363.1 – Scope and definitions

Compliance by subsidiaries of holding companies (b)

We concur with the FDIC in establishing the 75 percentage-of-assets threshold to permit an insured depository institution to comply with Part 363 at the top-tier or mid-tier holding company level. We believe this is reasonable and in the public's best interest.

Financial reporting (c)

We believe the definition of financial reporting should be clarified, within the proposed rule, to more clearly align with current reporting practices. Accordingly, we propose the definition read as follows:

> "For purposes of the management report requirement of § 363.2(b) and the internal control reporting requirement of § 363.3(b), "financial reporting" includes both financial statements prepared in accordance with generally accepted accounting principles for the institution or

> holding company and the institution's or holding company's appropriate regulatory report. Financial reporting also includes, as applicable, the schedules equivalent to the basic financial statements prepared in accordance with the institution's or holding company's appropriate regulatory report."

We believe such clarification is necessary, as management and the independent public accountant are permitted to report at the holding company level. In such circumstances, "regulatory reporting" would not extend to assertions about internal control over financial reporting at the subsidiary level. It is imperative that the FDIC's rules in this area are transparent (also refer to our comment on the illustrative management reports below).

§363.2 – Annual reporting requirements

Audited financial statements (a)

We believe the requirement in §401 of the Sarbanes Oxley Act of 2002 (SOX) for the annual financial statements to reflect (or "to be adjusted for") material correcting adjustments identified by the independent public accountant should apply to all insured depository institutions, not just those that are public companies or those that are otherwise subject to such requirement via the holding company. Accordingly, we concur with the related amendment. However, similar to SOX §401, we recommend providing additional context regarding the phrase "material correcting adjustments identified by the independent public accountant." Accordingly, we propose the following language: "The annual financial statements must be adjusted for all material correcting adjustments identified by the independent public accountant consistent with AICPA and PCAOB standards and generally accepted accounting principles."

Management report (b)(2)

We believe it is appropriate for the FDIC to require management to state its conclusion as to whether the insured depository institution has complied with designated safety and soundness laws and regulations. We also believe the FDIC should require management to publicly disclose material noncompliance with such laws and regulations, as disclosure of such information is in the public's best interest. However, noncompliance that is not material or is deemed insignificant can be privileged and confidential.

With regard to the independent public accountant, it may be helpful to stipulate that the accountant is not responsible for reporting on management's conclusion. This is particularly important in a combined report on compliance and internal control over financial reporting where the accountant would ordinarily disclaim an opinion on management's conclusion relating to compliance with the designated laws and regulations.

§363.3 – Independent public accountant

Internal control over financial reporting (b)(3)

We believe the requirement that the phrase "the report must disclose all material weaknesses in internal control over financial reporting that the independent public accountant has identified" is technically inaccurate and contradicts the standards of the American Institute of Certified Public Accountants (AICPA) and the Public Company Accounting Oversight Board (PCAOB). This seems "duplicative" in nature and will cause confusion as to the independent public accountant's responsibilities in relation to professional standards**.** For example, under PCAOB standards, the

independent public accountant is permitted to refer to the material weaknesses identified in management's report in lieu of disclosing such weaknesses in his or her report. Further, under both AICPA and PCAOB standards, the independent public accountant is required to disclose material weaknesses in internal control over financial reporting that exist as of the date of management's assessment (not all material weaknesses identified *only* by the auditor *during* the engagement).

With regard to items (b)(1) through (b)(3), however, we believe these matters that are to be included in the independent public accountant's report can be deleted in their entirety, as they are already addressed by AICPA and PCAOB standards.

Communications with audit committee (d)

We urge the FDIC to reconsider the necessity of the independent public accountant's communication requirements with the audit committee. Our recommendation stems from existing requirements to communicate matters with those charged with governance (or the audit committee) under AICPA and PCAOB standards and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). For instance, we believe the communication requirements (a) overlap communications required by AICPA standards, such as those pertaining to the qualitative aspects of the entity's significant accounting practices, and (b) do not align with the communications required by SEC rules and regulations; for example, the materiality threshold for communications related to alternative accounting treatments has been removed and should be reinstated. We fear that such duplication and inconsistencies may cause confusion as to the required communications and therefore, the requirements should either be removed in their entirety or clarified and aligned.

Retention of working papers (e)

We understand the FDIC's concern to have a standard retention period for all audits of insured depository institutions; however, we believe the five-year period specified by AICPA standards is appropriate for non-issuers. Accordingly, we suggest the FDIC reconsider the necessity of this duplicative provision.

Independence (f)

The proposal imposes compliance with AICPA, SEC and PCAOB independence standards and interpretations. Although the FDIC guidelines currently require compliance with AICPA and SEC independence requirements, we believe the current proposal is unclear as to whether the independent public accountant should (a) comply with the most restrictive requirements, and (b) comply with those requirements that pertain only to issuers, as that term is defined by SOX, in all circumstances.

We suggest the FDIC evaluate and clearly articulate the applicability of AICPA, SEC and PCAOB independence standards and interpretations, particularly those requirements that are applicable only to issuers. We stress the importance of the clarification and education efforts that will be needed if the FDIC elects to apply the SEC and PCAOB "issuer" independence rules to privately-held insured depository institutions due to the following:

- Many insured depository institutions that meet the requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) are non-issuers.

- Many independent public accountants of those institutions may not be registered with the PCAOB and therefore, may not be familiar with and may not have implemented the appropriate systems to comply with such SEC and PCAOB standards.

- The proposal, as interpreted to equally apply the issuer independence rules, may prohibit certain qualified accountants that may have been previously afforded some relief from the FDIC from performing such engagements.

As the SEC and PCAOB will continue to set independence requirements applicable to issuers, the FDIC should individually evaluate and clarify the applicability of each new requirement. In addition, guidance and training in this area may also be necessary to eliminate potential noncompliance due to inadvertent violation.

We further recognize that the proposed rule has incorporated certain requirements that exist within SEC independence rules, such as providing material written communications between the independent public accountant and management to the audit committee. We suggest the FDIC consider the clarity of this duplication and whether such duplication is necessary. At a minimum, any duplication should be consistent between the various requirements.

Peer reviews (g)

We believe the independent public accountant should only be required to file (or otherwise provide notification of availability) the public portions of any peer review and, if applicable, PCAOB inspection reports. Accordingly, we object to the proposed requirement and believe it is contrary to existing law and professional standards, specifically SOX and PCAOB standards. For example, an independent public accountant has the right to expect, and the PCAOB is required by law, to maintain "Part II" of a PCAOB inspection report confidential. Accordingly, such report should only be submitted if it is made public by the PCAOB in accordance with the law.

§363.4 – Filing and notice requirements

Independent public accountant's letters and reports (c)(2)

We do not believe it is essential, practical or beneficial for the insured depository institution to file the audit engagement letter, including any related agreements and amendments, with the FDIC, the appropriate federal banking agency, or any appropriate state bank supervisor. We believe the requirement in §363.5(c) for the audit committee to ensure such letter does not contain inappropriate limitation of liability provisions is sufficient and appropriate. If the filing requirement is to be retained, we propose an automatic provision in the rule that unless the regulator protests, the audit engagement letter is deemed to be acceptable 15 days after receipt by the regulator.

Appendix B to §363 – Illustrative management reports

We commend the FDIC for providing examples of illustrative management reports. However, in lieu of an appendix to §363, we believe such illustrative reports would be better suited in an accounting and auditing guide, which can be updated more regularly to reflect changes in professional standards or other requirements that would affect management's reports. We also believe an accounting and auditing guide can illustrate the differences in reporting under AICPA and PCAOB standards.

In addition, we note the illustrative report on internal control over financial reporting at the holding company level states that the scope of management's assessment includes internal control over financial reporting at the identified subsidiary institutions. We believe this form of reporting is inconsistent with current practice and does not clearly and appropriately describe the scope of management's assessment or the independent public accountant's examination/audit. From a user's perspective, it is unclear whether or not management has separately assessed the effectiveness of

internal control over financial reporting of each subsidiary institution listed. We believe that this not the case, and that the user may incorrectly make this incorrect assumption.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Mr.. John L. Archambault, Managing Partner of Professional Standards, at (312) 602-8701.

Very truly yours,

Grant Thornton LLP