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March 10, 2003

BY HAND

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW, Mailstop 1-5
Washington, DC 20219
ATTN: Docket No. 02-15

Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
ATTN: Docket No. R-1139

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552
ATTN: Docket No. 2002-58

Re: **Joint Notice of Proposed Rulemaking**

Dear Sirs:

These comments are submitted by the undersigned counsel on behalf of Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP and the American Institute of Certified Public Accountants (collectively, "the Firms and the AICPA") in response to the Joint Notice of Proposed Rulemaking (the "Joint Notice") issued by the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Board of Governors of the Federal Reserve System

("Federal Reserve"), and the Office of Thrift Supervision ("OTS") (collectively, the "Agencies") (68 Fed. Reg. 1116 (Jan. 8, 2003)) proposing regulations to remove, suspend or debar accountants from performing audit services for insured depository institutions with total assets of $500 million or more, pursuant to Section 36 of the Federal Deposit Insurance Act, codified at 12 U.S.C. § 1831m (hereinafter referred to as "Section 36 Actions").

The Firms and the AICPA strongly support the goals of (i) developing and implementing uniform, high quality professional standards applicable to accountants and (ii) establishing a consistent mechanism to provide oversight for adherence to such standards. These goals were central in the enactment of the Sarbanes-Oxley Act of 2002. Pub. L. No. 107-204, 116 Stat. 745 (2002). However, for the reasons described in greater detail below, the Firms and the AICPA believe that the timing and substance of the Joint Notice will not promote, and could impede, the achievement of these goals. In addition, the proposed rules in their current form raise substantial due process concerns.

Among other things:

- The Joint Notice does not explain why the Agencies believe that the statutory and regulatory framework contained in the Sarbanes-Oxley Act and the current statutes and regulations empowering the Agencies to take administrative enforcement actions against accountants are insufficient to address the requirements of Section 36. Since the proposed regulations could duplicate or impinge upon other existing and developing rules and standards the Agencies should first identify regulatory gaps they need to fill in additional rulemaking.

- The Firms and the AICPA believe that the Agencies must articulate clear and consistent standards for "good cause" to warrant the initiation of a Section 36 Action. In order to promote uniform standards, the Agencies' standards should be, at a minimum, consistent with those promulgated by the Securities and Exchange Commission ("SEC") and the Public Company Accounting Oversight Board ("PCAOB"). This is particularly important where an insured depository institution is part of, or is itself, a publicly-held issuer of securities subject to the registration requirements of Section 12 of the Securities and Exchange Act of 1934 ("1934 Act") and the jurisdiction of the SEC.

- The Firms and the AICPA believe that in sanctioning accountants, the Agencies should defer to the PCAOB and the SEC in the case of banks or savings associations that are "issuers" within the meaning of the 1934 Act. In the absence of such deference, an accountant or firm might find its conduct

subject to overlapping and conflicting regulatory criteria in a given circumstance. The Firms and the AICPA believe that such a result would be inconsistent with the goals of the Sarbanes-Oxley Act and sound public policy principles.

- The proposal set forth in the Joint Notice provides that the Agencies could bring a Section 36 Action based solely on conduct that occurred at a non-depository institution. The Firms and the AICPA believe that, unless there is a showing that an audit of a non-depository institution has a *direct* bearing on the individual's or firm's fitness or competence to perform audits of a depository institution, that conduct should not disqualify the affected accountant or firm from performing Section 36 Audit Services for insured depository institutions.

- The Firms and the AICPA believe that any new regulations must specify what record the Agencies will rely on in determining whether conduct at a non-depository institution constitutes "good cause." The Firms and the AICPA do not believe that the Agencies intend to, or should, conduct independent investigations of the facts and circumstances that might suggest violations at the non-depository institution, and believe that the rule should clarify that such investigations are not intended.

- In enacting the Financial Institutions Regulatory Reform Recovery and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (1989), Congress substantially expanded the enforcement authority over institution-affiliated parties ("IAPs"). As noted below, such IAPs could, under certain circumstances, include individual accountants and accounting firms. The Agencies' authority to sanction individual accountants as IAPs reaches situations, for instance, in which the IAP "knowingly or recklessly participates in . . . any unsafe or unsound [banking] practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution." 12 U.S.C. 1813(u). Yet, the legislative history of FIRREA makes it clear that Congress did not expect the Agencies to use their enforcement authority to remove or otherwise restrict entire firms. The proposal set forth in the Joint Notice describes specific criteria that the Agencies may take into consideration in deciding whether to bring a Section 36 Action against an entire firm or office(s) of a firm. The Firms and the AICPA believe that any final regulations should, consistent with the legislative history of FIRREA, include a strong presumption against bringing Section 36 Actions against entire firms or offices absent the existence of certain egregious factors, which should be

clearly specified in advance. In addition, as described in greater detail below, given the potentially devastating impact of such actions, they should only be taken after the affected firm has had an opportunity for a meaningful hearing before an independent trier of fact.

- The proposal set forth in the Joint Notice gives the Agencies unfettered discretion, without any written standards, to consider any request for reinstatement and limits an individual's or firm's right to petition for reinstatement. The Firms and the AICPA believe that the reinstatement provisions should articulate clear and objective standards by which the Agencies will consider and act upon any request for reinstatement.

- The Joint Notice specifically solicits comments on the due process considerations associated with the suspension provisions by which the Agencies could immediately suspend an accountant, subject to the issuance of a stay by a presiding officer appointed by the Agency. The Firms and the AICPA believe that the Joint Notice raises serious due process concerns in this regard. At a minimum, the Firms and the AICPA believe that given the immediate and draconian sanctions at issue, the rules should provide for a hearing before an administrative law judge and timely judicial relief. The Firms and the AICPA also believe that the burden should be on the Agency to justify the issuance of an immediate suspension under a clear and exacting standard.

The Firms and the AICPA have a number of specific suggestions, set forth in greater detail below, that they believe will clarify and improve the proposed regulations set forth in the Joint Notice. In view of the importance of the issues the Joint Notice seeks to address and the substantive and procedural concerns raised by the proposal, the Firms and the AICPA respectfully request that, after the Agencies have had an opportunity to consider these and other comments submitted in response to the Joint Notice, the Agencies issue revised regulations to the public for final comment before such regulations are adopted by the Agencies.

I. THE IMPACT OF THE EXISTING REGULATORY FRAMEWORK

To fully appreciate certain of the Firms' and the AICPA's comments regarding the proposal contained in the Joint Notice, it is important to consider the Agencies' proposed regulations in the context of the existing statutory and regulatory framework. Congress enacted Section 36 of the FDIA on December 19, 1991. Section 36 requires that each insured depository institution with total assets of $500 million or more obtain an audit of its financial statements and an attestation by an accountant on management's

assertions concerning internal controls over financial reporting. The audit report and attestation must be included in the depository institution's annual report. Section 36 gives the Agencies authority to remove, suspend, or debar accountants from performing such audit services if there is "good cause" to do so.

Since the enactment of Section 36 in 1991, the Agencies have not previously proposed or promulgated any implementing regulations, nor are we aware of any action brought by the Agencies to disbar, remove or suspend an accountant under the Section 36 authority. This suggests that the Agencies have viewed their existing enforcement authority—which is quite broad—as sufficient to address instances of misconduct by accountants properly within the Agencies' jurisdiction. This existing authority, now coupled with the new statutory and regulatory schemes provided by the Sarbanes-Oxley Act, results in a mechanism that provides comprehensive oversight over the accounting profession, including over many accountants performing Section 36 Audit Services.

The Agencies have two ways in which they may sanction accountants. First, if an accountant is deemed to be an IAP, the accountant may be subject to the administrative enforcement authority of the appropriate federal banking agency. See 12 U.S.C. § 1818(e). In order to satisfy the statutory definition of IAP, the Agency must show wrongful conduct and harm to the institution by the accountant. See 12 U.S.C. § 1813(u). Historically, it appears that the courts have accorded deference to the agencies in satisfying the wrongful conduct element. Once an accountant is determined to be an IAP, the Agency has the authority to initiate an action to remove or suspend the accountant from office, prohibit the accountant from participating in the affairs of an insured depository institution, or assess civil money penalties, provided certain statutory criteria are satisfied. See 12 U.S.C. §§ 1818(e)(1), 1818(e)(3), 1818(i)(2).

Second, each Agency has adopted regulations to censure, suspend, or debar any person from practicing before it, which includes accountants. Under these regulations, accountants practice before each Agency by, among other things, preparing the audit or attestation report that is filed with an insured depository institution's annual report. See 12 C.F.R. §§ 19.191(a), 263.92(b)(1), 308.109(e), 513.2(e)(2). The Agencies' rules differ somewhat, but generally the Agency regulations provide for sanctions if an accountant is "incompetent" in representing a client's "rights or interests" or engages in "disreputable conduct". See 12 C.F.R. §§ 19.195, 19.196, 263.91, 263.94, 308.109, 513.4(a).

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002. Congress had passed this legislation in the wake of recent corporate scandals to ensure that investors had access to accurate and meaningful financial information concerning public companies. Specifically, Congress hoped to renew the public's faith in the reliability of the financial statements of public companies and thus increase public confidence in the capital markets of the United States. To promote these goals, Congress

invested both the SEC and the newly created PCAOB with the responsibility to oversee both the accounting profession, and the manner in which accountants interact with their public company audit clients so that audit reports on financial statements of public companies are even more reliable and independent than they have been in the past.

Significantly, for purposes of the Joint Notice, the Sarbanes-Oxley Act of 2002 created the PCAOB to, among other things, discipline members of the profession where appropriate. The jurisdiction of the Board extends to accountants who perform audits of any public company, bank or savings association that must file reports with the SEC or with one of the four Agencies, and the SEC is given oversight over the PCAOB. This supervision of accountants parallels the mandate for registered banks and savings associations themselves to adhere to Sarbanes-Oxley and the SEC's implementing regulations. See, e.g., Reporting and Disclosure Requirements for State Member Banks with Securities Registered Under the Securities Exchange Act of 1934, 67 Fed. Reg. 57938 (Sept. 13, 2002) (to be codified at 12 C.F.R. pt. 208) (amending the disclosure requirements for registered state member banks).

In order for an accountant or an accounting firm to audit a publicly held bank, savings association or other company, it must first register with PCAOB. The Board then acquires regulatory and supervisory jurisdiction over the registered accounting firm, including establishing or adopting rules regarding auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers; regularly inspecting registered firms; and, when appropriate, imposing sanctions on registered public accounting firms or persons associated with such firms. Sarbanes-Oxley Act, § 101(c).

The PCAOB is structured as a nonprofit corporation whose purpose is to promote integrity and independence. The Board by statute consists of five members with substantive accounting expertise: of the current members, two are certified public accountants, one is a former SEC General Counsel, and one served as Chief Accountant in the SEC's Division's of Enforcement and was co-chairman of the SEC's Financial Fraud Task Force. No member of the Board may accept other employment or engage in any other professional or business activity, but instead must devote his or her full time to supervising the accounting profession. Sarbanes-Oxley Act, § 101(e)(3).

The PCAOB, in turn, is supervised by the SEC, which appoints the Board's members; approves its budget; reviews, modifies as appropriate, and publishes in the Federal Register any PCAOB proposed or final regulation; and reviews Board disciplinary actions against accountants. Sarbanes-Oxley Act, §§ 101(e)(4), 107, 109. The SEC already has issued regulations implementing the provisions of sections 201, 202, 203, 204, and 206 of the Sarbanes-Oxley Act to limit accountants from providing

specified non-audit services and fees; require audit committee pre-approval of the accountant's audit and non-audit services; require rotation of audit partners; limit audit partner compensation; mandate auditor communication with the audit committee regarding critical accounting policies, alternative accounting treatments, and other management communications; and restrict client employment of former audit team members. See Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6006 (Feb. 5, 2003) (to be codified at 17 C.F.R. pt. 210, 240, 249, 274). Finally, Section 108 of Sarbanes-Oxley confers on the SEC direct responsibility to oversee development of and recognize the generally accepted accounting principles governing presentation of the financial statements on which registered accounting firms will opine. Sarbanes-Oxley Act, § 108(b).

Because Congress has authorized the SEC and the PCAOB to license, establish standards for, and, where appropriate, discipline accountants for public companies, the regulatory scheme that existed at the time the Agencies first considered the need for the proposed regulations has already been substantially altered and enhanced.

Thus, the Firms and the AICPA urge that the Agencies proceed cautiously because (1) the existing statutory framework already provides the Agencies with powerful enforcement tools over IAPs (which may include accountants under certain circumstances), and (2) with the passage of the Sarbanes-Oxley Act and the establishment of the PCAOB, the Agencies should take into consideration the PCAOB's and SEC's standards and processes before deciding how best to implement Section 36.

II. SPECIFIC COMMENTS

The Firms and the AICPA offer the following specific comments to the proposed regulations set forth in the Joint Notice.

A. Definition of "Good Cause"

Section 36 authorizes the Agencies to remove, suspend, or debar an accountant for "good cause." The Joint Notice states that the Agencies would have good cause to sanction an accountant if the accountant does not possess the requisite qualifications to perform audit services; engages in knowing or reckless conduct that results in a violation of applicable professional standards, including those standards and conflicts of interest provisions applicable to accountants through the Sarbanes-Oxley Act and developed by the PCAOB and the SEC as such standards become effective; engages in a single instance of highly unreasonable conduct that results in a violation of applicable accounting standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or engages in repeated instances of unreasonable

conduct, each resulting in a violation of applicable standards, that indicate a lack of competence to perform annual audit services. 12 C.F.R. §§ 19.243(a), 263.402(a), 308.602(a), 513.8(c). "Good cause" also includes knowingly or recklessly giving false or misleading information to the Agencies with respect to any matter before the Agency; knowingly or recklessly materially violating any provision of the federal banking or securities laws or regulations, or any other law, including the Sarbanes-Oxley Act; and removal, suspension, or debarment from practice before any federal or state agency regulating banking, insurance, or securities, on grounds relevant to the provision of audit services, other than those actions that result in automatic removal, suspension, and debarment under the Joint Notice. 12 C.F.R. §§ 19.243(a), 263.402(a), 308.602(a), 513.8(c).

The Firms and the AICPA believe that the proposed definition of "good cause" is substantively deficient in two material respects. First, the standard can result in inconsistencies with PCAOB's and the SEC's actions. Second, the Joint Notice contemplates that conduct giving rise to good cause does not have to occur in connection with performing audit services or in connection with services provided to depository institutions.

1. <u>Need for Consistency</u>

The Joint Notice seeks to regulate the accounting industry further by giving each Agency the power to sanction accountants or their firms for misconduct. However, under Sarbanes-Oxley, Congress vested the PCAOB with the power to sanction accountants or their firms for misconduct. Unless the proposal set forth in the Joint Notice is conformed to the standards to be promulgated by the PCAOB or used by the SEC, accountants may be subject to conflicting sets of principles and procedures.

Congress gave the PCAOB, overseen by the SEC, the power to investigate and discipline members of the accounting industry who audit public companies, including banks and savings associations. Under Section 105 of the Sarbanes-Oxley Act, the PCAOB is required to establish rules and procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms. These rules have not yet been issued. The Agencies must ensure that its rules are, at a minimum, consistent with those established by the PCAOB and should defer to that body in this regard. Since many insured institutions either are public companies, or are subsidiaries of public companies, accountants who audit an insured depository institution that is also a public company will be subject to potentially different sets of rules if the Agencies move forward with the current proposal.

This potential for inconsistency and conflict is particularly acute when a question arises in the context of a national bank or a state non-member bank which has exercised

its option to satisfy its reporting requirements under Section 36 by filing financial statements and an internal control report of the bank's parent holding company. See 12 C.F.R. § 363.1(b). The Agencies' proposal recognizes that the bank's primary regulator (either the OCC or the FDIC) lacks jurisdiction over the holding company's accountant, and thus confers on the Federal Reserve the authority to sanction the holding company's accountant for "good cause" even though it may be the OCC or the FDIC that questions the accountant's work or qualifications. The Firms and the AICPA believe that it should be the expert PCAOB and the SEC, which already have jurisdiction over the holding company and its accountant, who should resolve any questions about the accountant's qualifications or performance, rather than the Federal Reserve, which neither received the audit opinions in question nor has the expertise in accounting and auditing possessed by the SEC and the PCAOB.

Furthermore, the Firms and the AICPA believe that the same set of rules, and the same investigative process, should apply to accountants who audit both public and privately held insured depository institutions. In fact, it is likely in many instances that a single accounting firm will audit both an insured depository institution that is a public company and an insured depository institution that is not a public company. Having one, uniform standard for all insured depository institutions, is clearly consistent with the Congressional mandate of Sarbanes-Oxley and would best serve the public interest in consistency and certainty.

In addition, by deferring to the SEC and the PCAOB, the Agencies would not be giving up their power to discipline accountants in appropriate circumstances. As noted above, the Agencies already have broad administrative remedies to take actions against IAPs. Furthermore, if the PCAOB feels it is necessary or appropriate, the statute specifically authorizes it to refer an investigation to the appropriate federal banking agency if the investigation concerns an audit report for an institution that is subject to the jurisdiction of that regulator. Sarbanes-Oxley Act, § 105(b)(4)(B)(ii). Once an Agency receives such a referral, it may, in appropriate circumstances, use its current enforcement mechanisms to discipline accountants. The adequacy of the Agencies' current enforcement mechanisms against IAPs and under the Agencies' practice regulations is demonstrated by the fact that the Agencies have not invoked Section 36 to remove, suspend, or debar an accountant for "good cause" even though that statute was enacted twelve years ago.

2. Conduct at Non-Depository Institutions

In the Joint Notice, the Agencies make clear that conduct giving rise to "good cause" does not have to occur at an insured depository institution. 68 Fed. Reg. at 1118. This authority raises a number of significant substantive and procedural issues.

As a threshold matter, the Firms and the AICPA question the appropriateness of the Agencies taking action against an accountant or firm based solely on conduct at a non-depository institution. In the Joint Notice, the Agencies have failed to make any showing of the relevance of conduct at a non-depository institution to the fitness of an accountant or a firm to perform Section 36 Services.

Assuming *arguendo* that the Agencies could demonstrate that conduct at a non-depository institution can be probative, the Firms and the AICPA believe that, at a minimum, the final rules must clarify when and how the Agencies will use audit work at a non-depository institution to serve as a predicate to initiate a Section 36 Action. In clarifying this important issue, consideration must be given to how the Agencies will determine what occurred during the audit of a non-depository institution. For example, the Firms and the AICPA assume that the Agencies do not expect to conduct their own independent investigation or obtain information regarding the audit directly from the non-depository institution, since any such investigation would raise serious jurisdictional and policy issues for the Agencies. In addition, given the Agencies' focus on financial institutions, they may lack the relevant industry expertise to evaluate conduct at a non-depository company.

These difficulties clearly can be avoided through reliance on the work of the PCAOB.

B. Disqualification of Entire Firm

Under the proposal set forth in the Joint Notice, the Agencies theoretically can remove, suspend, or debar an entire accounting firm, or an office of the accounting firm, for the action of a single employee. 12 C.F.R. §§ 19.243(a)(2), 263.402(a)(2), 308.602(a)(2), 513.8(d). The proposal includes a list of factors and circumstances for the Agencies to consider when deciding whether to sanction an entire firm. According to the Joint Notice, these factors are not exclusive and the Agencies may take into account other factors when deciding whether to remove, suspend, or debar an entire accounting firm or office of that firm. 68 Fed. Reg. at 1118.

The Firms and the AICPA are concerned that under the language of the proposed rule, an entire firm could be disciplined for the actions of a single person. Sanctioning an entire firm is a draconian result that should be available only in the most egregious situations. The Firms and the AICPA also believe that the disqualification of an entire firm should never be automatic or immediate. This very same concern was expressed when similar issues were raised during the consideration of FIRREA. As noted herein, FIRREA gave the Agencies the authority to remove an IAP from office. 12 U.S.C. § 1818(e). FIRREA's legislative history makes clear that Congress "expect[ed] the

banking agencies **to limit enforcement actions** in the usual case **to individuals** who have participated in the wrongful action, **to prevent unintended consequences or economic harm to innocent third parties**." H.R. Rep. No. 101-54(I), at 467 (1989), reprinted in 1989 U.S.C.C.A.N. 86,263. (emphasis supplied).

Removing, suspending, or debarring an entire accounting firm from practice before an Agency indisputably will have both immediate and long term adverse consequences for the firm, its clients and employees. Thus, any new regulations should ensure that this powerful remedy is carefully circumscribed. For this reason, and consistent with Congressional intent, the Firms and the AICPA believe that there should be an explicit presumption against taking an action against an entire firm. In addition, the regulations should be drafted so that this sanction is available only in the most egregious circumstances, specifically articulated in the regulation itself. The list of factors that must be present to justify imposing sanctions on a firm should be limited to the kind of egregious circumstances that would justify the extremely serious direct and indirect effects of sanctioning an entire office or firm.

The Firms and the AICPA believe the current proposal, as it relates to the disqualification of an entire firm, is much too broad, much too subjective, and much too open ended. Furthermore, because of the potentially devastating consequences of sanctioning an entire accounting firm, the Firms and the AICPA believe that the affected firm should have the opportunity for a meaningful hearing with the presentation of evidence and the cross-examination of witnesses in front of an independent trier of fact to ensure due process. These procedural concerns are addressed in section E below.

C. REINSTATEMENT

The Joint Notice provides that an individual or an accounting firm must wait one year from the effective date of an order of suspension to petition for reinstatement. 12 C.F.R. §§ 19.246(a), 263.405(a), 308.605(a), 513.8(l)(1). If the request for restatement is denied, the accountant or accounting firm must wait an additional year to re-petition for reinstatement. The Joint Notice is silent on the factors that the Agencies must consider in evaluating a reinstatement petition.

The Joint Notice does not explain why the Agencies believe that a one-year waiting period is appropriate or warranted. The Firms and the AICPA believe that requests for reinstatement should be considered on a case-by-case basis and not be subject to an arbitrary, one-year limitation. Indeed, under the SEC's Rules of Practice (which we understand the Agencies intended to follow in the Joint Notice), an application for reinstatement may be made *at any time*. SEC Rules of Practice, Rule 102(e)(5). For example, any accountant suspended by the SEC because their license to practice has been

revoked by a state, or any person suspended because he or she was convicted of a felony involving moral turpitude, can be reinstated at any time upon a showing that the suspension has been terminated or the conviction has been reversed. SEC Rules of Practice, Rule 102(e)(5)(ii).

The Firms and the AICPA also believe that the regulations should include clear standards to be applied by the Agencies in acting upon a reinstatement petition. Such standards would assist an affected individual or firm in providing the appropriate Agency with the types of information that the Agency believes it needs to make an informed decision regarding a reinstatement petition. These standards also would assist the Agency in its decision making process and in informing persons of the standards to which they must conform their behavior in order to be reinstated.

D. AUTOMATIC SUSPENSIONS

The Joint Notice sets forth standards for automatic suspension of an accountant or an accounting firm. An accountant or an accounting firm is automatically suspended and may not provide audit services for an insured depository institution if it is subject to a final order of removal, suspension, or debarment from any federal banking agency, is subject to a temporary suspension or permanent revocation of registration by PCAOB, is subject to an order of suspension from appearing before the SEC, or is suspended or debarred from practice in any state or the District of Columbia. 12 C.F.R. §§ 19.244, 263.403, 308.603, 513.8(j).

The Firms and the AICPA believe that this provision is too broad in scope. An accountant can well be subject to suspension or revocation by the SEC or the PCAOB for reasons that are of little or no relevance to the legitimate supervisory concerns of the Agencies. For example, assume that in August 2003, a foreign affiliate of a United States accounting firm provided an overseas subsidiary of the accounting firm's United States audit client a non-audit service that the client's audit committee does not pre-approve. Under Sarbanes-Oxley § 208(b), it then becomes "unlawful" for the United States firm to prepare or sign an audit report for the United States client's fiscal year ending Dec. 31, 2003. While no one can predict what the SEC or PCAOB will do when faced with such an issue, as it inevitably will be, resolution of this issue should not trigger an automatic suspension at a banking agency without notice and some opportunity for the Agency to explore the facts, including those the United States firm may wish to present. While the Agencies may well conclude that such a suspension or revocation provides grounds for a finding of good cause upon which an accountant may be subject to a sanction, the action should not be automatic but should be based on a careful analysis of the facts and circumstances.

Indeed, the SEC rules governing suspensions do not go as far as the Agencies propose. Under its Rule 102(e)(2), an accountant is subject to automatic suspension from practice before the SEC only when the accountant's license has been suspended or revoked by a state, or where the accountant has been convicted of a felony or a misdemeanor involving moral turpitude. The SEC provides for a process somewhat similar to what the Agencies propose under SEC Rule 102(e)(3), but only if the accountant has been permanently enjoined in a case brought by the SEC for violations of the securities laws, or if the accountant has been found to have violated the securities laws in an action *brought by the SEC* or in an administrative proceeding *before the SEC*. In such proceedings, the respondent would have had a prior opportunity to present its defense before a trier of fact in a proceeding in which the agency imposing the suspension has participated. The Agencies, at a minimum, should similarly limit the reach of their automatic suspension provisions.

Furthermore, nowhere in the Joint Notice is there a process for review of an automatic suspension. Due process requires that anyone suspended from practice be afforded a meaningful review of the suspension. See FDIC v. Mallen, 486 U.S. 230, 240 (1988); Manges v. Camp, 474 F.2d 97 (5th Cir. 1973); Feinburg v. FDIC, 420 F. Supp. 109 (D.D.C. 1976). Although an accountant or an accounting firm that is automatically suspended from practicing before the Agencies may request that it be allowed to perform audit services, the Joint Notice does not include any other review procedure. The Firms and the AICPA believe that the proposed rules must be modified so that automatic suspensions will be subject to an expedited review process before an independent decisionmaker.

E. IMMEDIATE, EX PARTE SUSPENSIONS

Under the proposal set forth in the Joint Notice, the Agencies may issue a notice of immediate suspension when the Agency has a reasonable basis to believe that an accountant or accounting firm has engaged in conduct that constitutes grounds for an order to remove, suspend or debar and "if an immediate suspension is necessary to protect the insured depository institution, its depositors, or the depository system as a whole." 12 C.F.R. §§ 19.243(c)(1), 263.402(c)(1), 308.602(c)(1), 513.8(g)(1). Not only is the suspension immediate, but it is entered *ex parte* and remains in effect until the Agency dismisses the charges in the notice or issues a final order of removal, debarment or suspension. The proposal shifts the burden to the accountant or firm to seek a "stay" of the immediate suspension essentially under the high standards required for the issuance of injunctions. The proposal contemplates an "expedited" review of any appeal filed by an adversely affected accountant or accounting firm.

As an initial matter, the Firms and the AICPA do not believe that any circumstances exist where an *ex parte* suspension of an entire firm would be justified.

For example, the actions of a few individuals that might arguably justify an *ex parte* suspension of such individuals should not be grounds to disqualify an entire firm. At a minimum, the Agencies should issue standards that explain when an *ex parte* suspension of an entire firm could possibly be appropriate. Specifically, these standards should relate to the number of individuals involved, the egregiousness of their conduct, the relationship of those individuals to the overall operation of the firm, the nexus between the conduct at issue and the risks created of immediate harm that can only be prevented by immediate suspension of the entire firm, and similar factors that would be needed to justify such an extraordinary action.

In any event, the proposed procedure for immediate, ex parte suspensions would not comport with due process. There is simply no basis for the Agencies to create a process by which they will decide in a closed internal procedure to impose this death knell on an accountant or a firm, and then shift onto the accountant or firm the burden of meeting the high injunctive standards in order to obtain relief via an process that itself is not sufficiently neutral. Once again, the Agencies should refer to the rules governing the SEC's procedures in redrafting regulations governing such suspensions.

The Agencies recognized the serious due process issues raised by this aspect of the Joint Notice by specifically inviting comment on whether "additional procedures should be provided to ensure that parties have adequate due process protections." 68 Fed. Reg. at 1119. The Agencies cite to FDIC v. Mallen, 486 U.S. 230 (1988), for support for the proposal. In Mallen, the Court upheld the FDIC's procedures for suspension of an institution-affiliated party who was charged with a felony. But the Joint Notice's very description of the case reflects its limitations – it involved the particular circumstance of someone who had been indicted for a felony. The current proposal ranges far beyond that, and would purport to give the Agencies authority to suspend immediately, and shift the burden to the accountant or firm to meet the high injunctive standard, merely on an *ex parte*, internal decision under the extremely broad and vague standard that "immediate suspension is necessary for the protection of an insured depository institution, its depositors, or the depository system as a whole." 68 Fed. Reg. at 1118. Mallen does not support such an assertion of power.

In Mallen, the Court upheld a procedure used by the FDIC where a suspended party had to wait a maximum of 90 days for a decision regarding removal from office. Mallen involved a criminal felony indictment. 486 U.S. at 241, 244, 245. Thus, a grand jury and an independent U.S. Attorney—both independent of the Agency—concluded they had probable cause to believe that the charges against the respondent were true. Id. at 244. Furthermore, the indictment served as at least some objective indication that the bank operated by the respondent was not being managed in a responsible manner. Id. at 244-45. Additionally, the Court said that there was no danger of injuring the

respondent's reputation with the immediate suspension since the respondent had already been indicted by a grand jury. Id. at 243.

Under the proposal set forth in the Joint Notice, an accountant or accounting firm may petition for a stay of a notice of immediate suspension within ten (10) calendar days of receiving the notice. Thereafter, an officer appointed by the Agency will hold a hearing on the stay petition within thirty (30) days of receiving the petition and the officer will render a decision on the hearing within 30 days. Thus, the entire process could take seventy (70) days before an adversely affected individual or firm receives a final decision.

If the Agencies are looking for a barometer of what due process requires at a minimum, they should look to the SEC's rules. Presumably, the SEC will want to move expeditiously to remove persons or entities that the agency believes poses dangers to the entities it regulates – in the SEC's case, all companies issuing publicly-traded securities. Yet, the SEC has put in place rules under which (1) the circumstances under which the staff may seek a temporary cease-and-desist order are limited, and the staff must justify the proceeding on an ex parte basis, (2) the action is both initially authorized and reviewed by a much more neutral decisionmaker, an Administrative Law Judge, (3) the affected party has a mechanism to ensure much swifter consideration of its position, and (4) the burden rightfully remains on the staff of the agency throughout the process to justify its claim to this extraordinary relief.

The closest analogy in the SEC rules to what the Agencies seek to do with their immediate suspension power is the SEC's issuance of temporary cease-and- desist orders. Under the 1934 Act, the SEC's authority to issue such orders is limited. It cannot be used to suspend immediately any accountant who arguably might ultimately be subject to sanction for improper conduct. Rather, it is available in more limited circumstances and with considerably greater due process protections. The Agencies should act with similar care in promulgating Section 36 regulations.

To obtain a temporary cease-and-desist order, the SEC staff must go before an administrative law judge and make a showing that the standards for such an order have been met. Notice to the affected party is generally required. *Ex parte* applications are the exception and may be obtained only if "notice and hearing prior to entry of an order would be impracticable or contrary to the public interest." SEC Rules of Practice, Rule 513(a). If action is taken *ex parte*, the affected party may obtain a reconsideration of that decision within 20 days or less. SEC Rules of Practice, Rule 513(c). Any respondent who is subject to a temporary cease-and-desist order issued by the SEC without a prior hearing may request such a hearing within 10 days. After such a request, the hearing is held within two days and a decision rendered within five days. SEC Rules of Practice, Rule 513(c).

Before the SEC issues a temporary cease-and-desist order against a party, the SEC staff must satisfy a high evidentiary standard. Specifically, the SEC Rules of Practice follow the standards of Rule 65 of the Federal Rules of Civil Procedure and require a showing that immediate and irreparable injury, loss, or damage will result if an order is not granted. See SEC Rules of Practice, Rule 512; Fed. R. Civ. P. 65(b). Thus, under the SEC rules, the staff seeking the relief must prove immediate and irreparable harm, not the sanctioned party. That burden properly remains on the staff throughout the process.

The proposal in the Joint Notice turns this burden on its head. It would not require Agency staff to meet a clear, well-established and high standard, such as the standard for preliminary injunctions. Instead, it would in fact turn around and impose such a burden on the affected party. There is simply no justification or basis for such a skewed process.

The procedure proposed in the Joint Notice suffers from another serious defect. While the SEC holds hearings in its adjudicatory capacity, or uses administrative law judges to hear matters, the Joint Notice contemplates that the initial decision to suspend simply be made *sua sponte* by the staff, and then a "presiding officer" will be appointed to preside over a hearing on the suspension. The presiding officer fixes the time and place for the hearing and has the discretion to decide whether oral testimony will be allowed at the hearing. The presiding officer will ultimately issue the decision regarding a challenge to an immediate suspension.

The Firms and the AICPA believe this process is very deficient. An independent administrative law judge should review the immediate suspension in the first instance. The Administrative Procedure Act ("APA") created the position of administrative law judge to ensure fairness and due process in federal agency adjudication proceedings. The APA specifically addressed those goals by making administrative law judges independent of the agencies whose cases they decided. The Firms and the AICPA believe that such an impartial party should oversee the Agency hearings on all suspensions, particularly where the staff asserts that suspensions must occur immediately.

In addition, the Joint Notice does not establish a procedure for judicial review for such proceedings. Although a suspended party can appeal a presiding officer's decision within the Agency, the Joint Notice would not empower the suspended party to appeal a decision to an administrative law judge or a federal court. The Firms and the AICPA believe that such review is necessary to ensure fairness and impartiality. Thus, the final rules should include a process for appealing the initial decision to impose an immediate suspension to a neutral third party, and ultimately to the federal courts.

In sum, the Firms and the AICPA believe that the final regulations must provide for a much fairer process whenever the Agencies seek to impose immediate suspensions. *Ex parte* proceedings should be limited to those circumstances that demand it. The burden should be on the staff throughout the process to demonstrate the need for immediate action under a very high, clearly articulated and, ideally, well-established standard, such as the standard for a preliminary injunction. The party subject to any such action – ex parte or not – should have immediate recourse to a review process. Finally, a neutral decisionmaker and judicial review should be provided.

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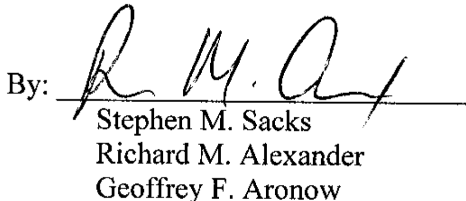
The Firms and the AICPA appreciate this opportunity to submit comments on the Joint Notice and hope their comments will be taken into consideration by the Agencies in developing final rules. In view of the substantive concerns set forth herein, representatives of the Firms and the AICPA respectively request an opportunity to meet with the Agencies to discuss the Joint Notice. If you have any questions regarding the matters discussed in this letter, please do not hesitate to contact us.

Sincerely,

Arnold & Porter

By: 

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