Kenneth F. Ehrlich
Direct Line: 617-439-2989
Fax: 617-310-9989
E-mail: kehrlich@nutter.com

March 5, 2003

3

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 1-5
Washington D.C 20219
Attention: Docket No. 02-15

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

Secretary, Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. R-1139

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, D.C. 20552
Attention: 2002-58

Ladies and Gentlemen:

We appreciate the opportunity to comment on regulations that have been proposed by the four federal banking agencies (the "Agencies") relating to Removal, Suspension, and Debarment of Accountants From Performing Audit Services, which were published in the Federal Register on January 8, 2003 (68 Fed. Reg. 1116) (the "Proposal") and on which comments are due by March 10, 2003. We submit these comments on behalf of three accounting firms headquartered in Massachusetts that provide audit services to publicly held and non-publicly held depository institutions.

For the reasons described below, we believe that negligence in any form was never intended by Congress to constitute "good cause" for removing, suspending or debarring accountants from performing audit services for depository institutions under Section 36(g)(4) of the Federal Deposit Insurance Act (the "FDI Act"), 12 U.S.C. 1831m(g)(4). Unlike the federal securities laws and regulations on which the Proposal was modeled, the federal banking laws do not contemplate administrative sanctions against accountants for conduct short of knowing or reckless behavior, and any decision to change that policy should be made by Congress, not the Agencies. As a result, for the reasons described below, we urge you to remove negligence in any form as a basis for removing, suspending or debarring accountants in the final regulations.

In addition, as discussed below, there is no authority in the statute to remove, suspend, or debar a firm or office. The removal, suspension and debarment allowed by Section 36(g)(4) of the FDI Act is of "an independent public accountant." Such an interpretation would allow an Agency, after finding good cause with respect to one accountant, to effectively remove, suspend or debar other individual accountants within the same firm from performing audit work for banks, despite the fact that good cause to remove, suspend or debar *each of them* may not exist or in any event has not been determined. As a result, we urge you to remove from the final regulations the Agencies' authority to remove, suspend or debar an entire accounting firm or office on the basis of the acts of one of its independent public accountants.

Finally, the reinstatement procedures should explicitly permit a firm to petition for the reinstatement of an office which has been suspended, removed or debarred, which the Proposal does not allow.

1. <u>Negligence in Any Form Was Not Intended by Congress to Constitute "Good Cause"</u>

Section 36(g)(4)(A) of the FDI Act, 12 U.S.C. 1831m(g)(4)(A), provides that, in addition to any authority contained in Section 8 of the FDI Act, 12 U.S.C. 1818, the Agencies may "remove, suspend or bar an independent public accountant, upon a showing of good cause, from performing audit services required by this section."[1] Section 36(g)(4)(B) requires the Agencies to jointly issue rules of practice to implement that authority.

The Proposal, in pertinent part, would allow the Agencies to remove, suspend or debar an accountant if the accountant has engaged in, among other conduct, "negligent" conduct in the form of (A) a single instance of "highly unreasonable conduct" that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that "heightened scrutiny is warranted" or (B) repeated instances of "unreasonable conduct," each resulting in a violation of applicable professional standards, that indicate a lack of competence to perform audit services. The terms "highly unreasonable conduct" and "unreasonable conduct" are not defined in the Proposal.

---

[1] As implemented by 12 C.F.R. Part 363, Section 36 of the FDI Act requires, in pertinent part, that each depository institution with total assets of $500 million or more produce an annual report containing the institution's financial statements and certain management assessments, and that each such institution obtain an audit of its financial statements and an attestation on management's assertions regarding internal controls over financial reporting by an independent public accountant. The accountant's audit and attestation reports are required to be included in the institution's annual report. Section 36(d)(2) of the FDI Act requires each independent public accountant performing an audit to determine and report whether the institution's financial statements are presented fairly in accordance with GAAP and comply with such other disclosure requirements as the Agencies may prescribe.

The standards in the Proposal were "drawn principally" from the Agencies' existing practice rules and from the SEC's practice rules at 17 C.F.R. 201.102(e). 68 Fed. Reg. 1118. The SEC practice rules were recently codified in Section 602 of the Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (2002). 68 Fed. Reg. 1118, n. 12.

Although the SEC rules do permit removal, suspension or debarment for what the rules acknowledge amounts to *gross* negligence, the SEC preferred to use the term "highly unreasonable" conduct because courts have not interpreted the term "gross negligence" on a uniform basis. 63 Fed. Reg. 57168, n. 49. Furthermore, in determining that this "intermediate" standard, which covers conduct worse than ordinary negligence but not as severe as recklessness, 63 Fed. Reg. 57167, was an appropriate standard to include in its rules, the SEC expressly relied on provisions of the federal securities laws that have been interpreted by the courts as imposing liability on auditors "without requiring intentional misconduct." 63 Fed. Reg. 57167, n. 38.

For example, the SEC pointed out that the Supreme Court has recognized that Section 11 of the Securities Exchange Act of 1934 (the "1934 Act") allows recovery for "negligent conduct." 63 Fed. Reg. 57167, n. 38 (citations omitted). The SEC also relied on Section 21C of the 1934 Act, which imposes liability when a person is a "cause" of a "violation 'due to an act or omission the person knew or should have known would contribute to such violation'." *Id.; see* 15 U.S.C. 78u-3.

By contrast, there is no place in the FDI Act where Congress imposes, or authorizes the Agencies to impose, any similar liability of any kind upon any institution-affiliated party, as that term is defined in 12 U.S.C. 1813(u),[2] other than against officers and directors of failed depository institutions.[3] The sanctions - including, in pertinent part, removal, suspension and prohibition orders - which the Agencies are authorized to impose under Section 8 of the FDI Act against an accountant for various types of misconduct may *only* be imposed if, among other things, the accountant has engaged in knowing or reckless behavior. *See* 12 U.S.C. 1818.

[2] The definition of "institution-affiliated party" includes bank officers and directors and, in pertinent part: "any . . . accountant . . . who *knowingly or recklessly* participates in (A) any violation of any law or regulation; (B) any breach of fiduciary duty; or (C) any unsafe or unsound 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) (Emphasis supplied).

[3] In a civil action by the FDIC acting as conservator or receiver or in certain other capacities, a director or officer of an insured depository institution may be held personally liable for monetary damages for "gross negligence" or conduct that "demonstrates a greater disregard of a duty of care . . . ." 12 U.S.C 1821(k).

The FIRREA House Report stated that the knowing or reckless standard "*limits the exposure* of independent contractors to those who knowingly or with reckless disregard participate in a violation of law or engage in an unsafe or unsound practice, which caused or is likely to cause a loss or other adverse effect." H.R. REP. No. 54, 101st Cong., 1st Sess., 392 (1989) (emphasis supplied).

Although Section 36(g)(4) of the FDI Act authorizes the Agencies to remove, suspend or debar an accountant upon a showing of "good cause" *in addition to* any authority contained in Section 8 of the FDI Act, there is no evidence that Congress by the use of the italicized language above intended to authorize the Agencies to expand on the bases for sanctions against independent contractors contained in 12 U.S.C. 1813(u).

Fundamental principles of statutory construction require that the authority granted in Section 36(g)(4) be construed in a manner consistent with, and able to be rationalized with, the FIRREA sanctions set forth in 12 U.S.C. 1813(u) and 1818. If Congress had wanted to authorize the Agencies to remove, suspend or debar accountants upon a showing of ordinary or gross negligence in connection with violations of law, unsafe or unsound practices or other conduct covered under 12 U.S.C. 1818, Congress would not have gone to the effort to fashion the "knowing or reckless" standard in 12 U.S.C. 1818.

Because FDICIA, which added Section 36(g)(4), indicated no intention to revise the specific statutory approach Congress had taken two years earlier in FIRREA, and in particular said nothing about creating a limited exception to the FIRREA rules to cover accountants, the best interpretation is that Congress meant "good cause" to address transgressions by accountants *other than those already covered by the FIRREA sanctions*.

The transgressions, we submit, that Congress intended in 1991 to be covered by the term "good cause" may include certain failures to provide working papers or adhere to professional qualification requirements, practice standards and other similar requirements and standards, including peer reviews, that would not directly constitute those kinds of violations of law, unsafe or unsound practices, or other acts that can give rise to sanctions under 12 U.S.C. 1818.

This interpretation is supported by the FDICIA legislative history. The House Report stated:

> "Audit services required by new section 36 may be performed only by an independent public accountant who has agreed to provide related working papers, policies, and procedures to the FDIC and the appropriate Federal banking agencies, if requested; and who has received a peer review that meets guidelines acceptable to the FDIC. The FDIC or the appropriate Federal banking agency may remove, suspend or bar an independent public account for

good cause from performing audit services required by new section 36." H. REP. No. 330, 102nd Cong., 1st Sess., 117 (1991).

Like the House Report, the Senate Report included the only explanation of the removal, suspension and debarment provision in the same paragraph that included the committee's explanation of the working paper, peer review and other qualification standards.

> "Title II includes standards for the qualification of independent public accountants for insured depository institutions performing audits required by the amendment. Specifically, such accountants must agree to provide, upon request, any related working papers, policies and procedures to the FDIC and any appropriate Federal or State regulator, and must have received a peer review that conforms to guidelines acceptable to the FDIC. The FDIC and the appropriate Federal banking agency may remove, bar or suspend any independent public accountant from performing these audit services upon a showing of good cause." S. REP. No. 167, 102nd Cong., 1st Sess., 41 (1991).

These FDICIA committee report excerpts indicate that the Section 36(g)(4) sanctions are intended to address an accountant's failure to provide working papers or adhere to professional qualification requirements, practice standards and other similar requirements and standards, including peer reviews, that would not directly constitute those kinds of violations of law, unsafe or unsound practices, or other acts that can give rise to sanctions under 12 U.S.C. 1818.

As a result, if the final regulations include negligence in any form – including gross negligence – as a basis for removing, suspending or debarring accountants, the Agencies, in effect, will be expanding upon the bases for sanctions against independent contractors contained in 12 U.S.C. 1813(u), which is a policy determination we urge you to leave to the Congress.

We also note that the SEC has indicated that the term "repeated instances of unreasonable conduct" could include "as few as two separate instances of unreasonable conduct occurring within one audit, or separate instances of unreasonable conduct occurring within different audits." 63 Fed. Reg. 57169. Such an interpretation effectively would permit an ordinary negligence standard to be applied to determine if accountants should be removed, suspended or debarred. If negligence is retained in the final rules as a basis for removal, suspension or debarment, the final rules should make clear that the Agencies do not agree with the SEC's assessment that "repeated instances of unreasonable conduct" might include as few as two separate instances of merely negligent conduct occurring within one audit, or separate instances of unreasonable conduct occurring within different audits.

2. There Is No Authority in the Statute for the Removal, Suspension, or Debarment of Firms or Offices

The Proposal also provides, in pertinent part, that if an Agency determines that there is good cause for the removal, suspension or debarment of a member or employee of an accounting firm, the Agency "also may remove, suspend, or debar such firm or one or more offices of such firm." In considering whether to remove, suspend, or debar a firm or one or more offices of such firm, and the term of any sanction permitted by the Proposal, the Agency "may consider, for example" one or more of five listed factors.[4]

The removal, suspension and debarment allowed by Section 36(g)(4) of the FDI Act is of "an independent public accountant." There is no mention in the statute of the possible extension of those sanctions to accounting firms or offices, or of extended or vicarious liability in any other way or of any kind. Such an interpretation would allow an Agency, after determining that good cause exists with respect to one accountant, to effectively remove, suspend or debar other individual accountants within the same firm from performing audit work for banks, in the discretion of the Agency, despite the fact that "good cause," as that term would be defined in the rules, to remove, suspend or debar *each of them* may not exist or in any event has not been determined.

As a result, we urge you to remove from the final regulations the Agencies' authority to remove, suspend or debar an entire accounting firm or office on the basis of the acts of one of its independent public accountants.

3. The Rules Should Permit Reinstatement of Offices

The Proposal allows the removal, suspension or debarment of individual public accountants, offices of firms, and the firms themselves, but only allows reinstatement of individual public accountants and the firms themselves. If authority to remove, suspend or debar firms and offices is retained in the final rules, we suggest that the reinstatement procedures explicitly permit a firm to petition for the reinstatement of an office which has been suspended, removed or debarred in addition to individual public accountants and the firms themselves.

[4] The five factors which the Agencies "may consider" include: (1) the gravity, scope or repetition of the act or failure to act that constitutes good cause for the removal, suspension, or debarment, (2) the adequacy of, and adherence to, applicable policies, practices or procedures for the accounting firm's conduct of its business and the performance of audit services, (3) the selection, training, supervision and conduct of members or employees of the accounting firm involved in the performance of audit services, (4) the extent to which managing partners or senior officers of the accounting firm have participated, directly, or indirectly through oversight or review, in the act or failure to act, and (5) the extent to which the accounting firm has, since the occurrence of the act or failure to act, implemented corrective internal controls to prevent its recurrence. 68 Fed. Reg. 1118.

Thank you for your attention to the foregoing comments. If you have any questions, please do not hesitate to contact the undersigned at the telephone number or address set forth above.

Sincerely,

Kenneth F. Ehrlich

1197797.1