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M E M O R A N D U M

February 6, 2006

To Our Clients and Friends

Re: Interagency Advisory on Limitations on Liability of External Auditors

The Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the National Credit Union Administration and the Office of Thrift Supervision (the “Agencies”) have advised banking institutions that engagement letters entered into with external auditors regarding audits of financial statements and internal controls over financial reporting, and attestations on management’s assessment of internal control over financial reporting should not limit the auditor’s liability in an unsafe and unsound manner.

The advisory applies to all audits of both public and non-public banking organizations, including audits required by the Agencies or voluntary audits. The Agencies will regard the following types of provisions to be unsafe and unsound:

- Provisions that indemnify the auditor against third-party claims
- Provisions that hold harmless or release the auditor from liability for claims or potential claims that might be asserted by the client
- Provisions that limit remedies available to the client institution

The advisory provides examples of provisions that the Agencies conclude may weaken an auditor’s objectivity, impartiality and performance, making audit results less reliable. Such provisions, in the Agencies’ view, raise safety and soundness concerns.

The Agencies encourage banking institutions to review proposed engagement letters to understand any limitations on their ability to recover damages from audit firms imposed by mandatory pre-dispute alternative dispute resolution agreements or waivers of a jury trial. The advisory also provides that while provisions that waive the right to seek punitive damages are not deemed unsafe and unsound, agreements to

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indemnify auditors against third-party punitive damages are regarded as unsafe and unsound.

The advisory does not apply to:

- Non-audit services performed by auditors
- Audits of 401K and pension plans
- Services such as loan review and outsourced internal audits
- Other service providers such as legal advisors

The advisory applies to engagement letters or other agreements executed on or after the date the advisory is published in the *Federal Register*. The Agencies encourage institutions to amend multi-year arrangements for periods ending in 2007 or later that contain prohibited limitations of liability provisions.

A copy of the Agencies' advisory can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Heidi Wicker or Tom Fox at (202) 776-0700.