



Federal Deposit Insurance Corporation

550 17th Street, NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

March 29, 2007

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 2006-2803

Re: PCAOB Rulemaking Docket Matter No. 021

Dear Board Members:

The staff of the Federal Deposit Insurance Corporation (FDIC), as the federal insurer of deposits in banks and thrift institutions, appreciates the efforts of the Public Company Accounting Oversight Board (PCAOB) and its staff in proposing an auditing standard, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*, that would supersede the PCAOB's Auditing Standard No. 2 (AS 2).

The FDIC has a significant interest in the auditing standards issued by the PCAOB because they have direct impact on certain insured depository institutions that are subject to the FDIC's regulations. In general, Section 12(i) of the Securities Exchange Act of 1934 (Exchange Act) vests the FDIC with the powers, functions, and duties vested in the Securities and Exchange Commission (SEC) regarding insured state nonmember banks that have securities subject to the registration provisions of Sections 12(b) and 12(g) of the Exchange Act. These banks report to the FDIC pursuant to Part 335 of the FDIC's regulations. Part 335 generally incorporates through cross reference Exchange Act regulations of the SEC as those regulations are routinely issued, revised, and or updated by the SEC.

Additionally, under Section 36 of the Federal Deposit Insurance Act and its implementing regulation, 12 CFR Part 363 (Part 363), insured depository institutions with \$500 million or more but less than \$1 billion in total assets that are also public companies or subsidiaries of public companies that are required to comply with the provisions of Section 404 of the Sarbanes-Oxley Act must file a copy of the independent accountant's report on the audit of internal control over financial reporting that is required by Section 404 with the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor. Furthermore, insured depository institutions with \$1 billion or more in total assets, including those that are not public companies or subsidiaries of public companies, are required to file an independent accountant's attestation report concerning the institution's internal control over financial reporting as part of their Part 363 annual report. Institutions of this size that are also public companies or subsidiaries of public companies that are required to comply with the provisions of Section 404 must submit the independent accountant's report on the audit of internal

control over financial reporting that is required by Section 404, either as part of the Part 363 annual report or separately as another report.

Based on our review of the PCAOB's guidance in the proposed auditing standard, we recommend that the PCAOB consider the following:

Reference to Regulatory Reports

Q&A 31 to AS 2 referred to the FDIC's Financial Institution Letter (FIL) 86-94, Additional Guidance Concerning Annual Audits, Audit Committees and Reporting Requirements. In that FIL, which addressed several issues related to compliance with Part 363 of the FDIC's regulations by insured depository institutions subject to Part 363, the FDIC indicated that financial reporting encompasses both financial statements prepared in accordance with generally accepted accounting principles and those prepared for regulatory reporting purposes. Q&A 31 provides guidance indicating that the auditor may expand his or her audit of internal control over financial reporting to include the controls over the regulatory report schedules equivalent to the basic financial statements and to modify the auditor's report accordingly. However, the proposed auditing standard does not provide similar guidance on regulatory reporting. The FDIC recommends that the PCAOB provide guidance comparable to that contained in Q&A 31 in the proposed auditing standard. In this regard, the FDIC suggests that paragraph C1 in Appendix C of the proposed auditing standard may be an appropriate place to provide this guidance.

Auditor's Report on Management's Assessment of the Effectiveness of Internal Control Over Financial Reporting

Since paragraph 94 of the proposed auditing standard does not specifically require the auditor's report on management's assessment to include a statement that the "accountant has audited management's assessment," the proposed auditing standard appears to be inconsistent with the SEC's corresponding proposal (Release No. 33-8762). In this regard, the SEC's proposed amendment to Rule 2-02(f) of Regulation S-X states in part:

Every registered public accounting firm that issues or prepares an accountant's report for a registrant ... that is included in an annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) containing an assessment by management of the effectiveness of the registrant's internal control over financial reporting must attest to, and report on, such assessment. The attestation report on management's assessment of internal control over financial reporting shall be dated, signed manually, identify the period covered by the report, indicate that **the accountant has audited management's assessment**, and clearly state that the opinion of the accountant, either unqualified or adverse, as to whether the registrant maintained, in all material respects, effective internal control over financial reporting. ... The attestation report on management's assessment of internal control over financial reporting may be separate from the accountant's report. (Emphasis added.)

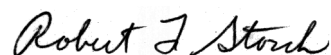
Nevertheless, the example of a combined report set forth in paragraph 96 of the proposed auditing standard specifically indicates that the accountant has “audited management’s assessment.” In contrast, the additional language set forth in paragraph 97 to be added to the auditor’s report on the financial statements when the auditor chooses to issue a separate report on internal control states that the auditor also audited the registrant’s “internal control over financial reporting,” but does not indicate that the auditor audited management’s assessment. The FDIC recommends that the staffs of the PCAOB and SEC take appropriate action to address these apparent inconsistencies in the required content of the auditor’s report.

Proposed Rule 3525 – Audit Committee Pre-approval of Services Related to Internal Control Over Financial Reporting

The discussion in Section III of the preamble to the proposed auditing standard and the text of proposed Rule 3525 indicate that an auditor can perform certain non-audit services related to internal control over financial reporting, but the proposed rule does not include any examples of such services. Also, Section III of the preamble refers to the discussion in AS 2 regarding the application of principles of independence to internal control-related services. However, the discussion in Section III of the preamble indicates that the PCOAB has decided not to repeat that independence guidance in the proposed auditing standard or in a separate independence rule. In the absence of explanatory guidance, the proposed Rule 3525 seems to conflict with the SEC’s auditor independence rules and its prohibition on certain non-audit services as more particularly set forth in Rule 2-01(c)(4) of Regulation S-X. The FDIC recommends that the PCAOB reconsider its decision not to provide the aforementioned independence guidance and provide guidance similar to paragraphs 32 to 35 of AS 2. The FDIC also recommends that the PCAOB provide examples of non-audit services related to internal control over financial reporting that, if performed by the registered accounting firm that performs the financial statement audit, would not impair the registered accounting firm’s independence.

We would welcome the opportunity to discuss our comments with you further.

Sincerely,



Robert F. Storch
Chief Accountant

cc: Mrs. Nancy M. Morris
Securities and Exchange Commission