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FDIC Law, Regulations, Related Acts

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2000 - FDIC Rules and Regulations

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PART 363—ANNUAL INDEPENDENT AUDITS AND REPORTING REQUIREMENTS

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AUTHORITY: 12 U.S.C. 1831m.

SOURCE: The provisions of this Part 363 appear at 58 Fed. Reg. 31335, June 2, 1993, effective July 2, 1993, except as otherwise noted.

§ 363.0 OMB control number.

The collecting of information requirements in this part have been approved by the Office of Management and Budget under OMB control number 3064–0113.

[Codified to 12 C.F.R. § 363.0]

§ 363.1 Scope.

(a) *Applicability.* This part applies with respect to fiscal years of insured depository institutions which begin after December 31, 1992. This part does not apply with respect to any fiscal year of any insured depository institution, the total assets of which, at the beginning of such fiscal year, are less than \$500 million.

(b) *Compliance by subsidiaries of holding companies.* (1) The audited financial statements requirement of § 363.2(a) may be satisfied for an insured depository institution that is a subsidiary of a holding company by audited financial statements of the consolidated holding company.

(2) The other requirements of this part for an insured depository institution that is a subsidiary of a holding company may be satisfied by the holding company if:

(i) The services and functions comparable to those required of the insured depository institution by this part are provided at the holding company level; and

(ii) The insured depository institution has as of the beginning of its fiscal year:

(A) Total assets of less than \$5 billion; or

(B) Total assets of \$5 billion or more and a composite CAMELS rating of 1 or 2.

(3) The appropriate federal banking agency may revoke the exception in paragraph (b)(2) of this section for any institution with total assets in excess of \$9 billion for any period of time during which the appropriate federal banking agency determines that the institution's exemption would create a significant risk to the Deposit Insurance Fund.

[Codified to 12 C.F.R. § 363.1]

[Section 363.1 amended at 61 Fed. Reg. 6493, February 21, 1996, effective April 1, 1996; 71 Fed. Reg. 20527, April 21, 2006]

§ 363.2 Annual reporting requirements.

(a) *Audited financial statements.* Each insured depository institution shall prepare annual financial statements in accordance with generally accepted accounting principles which shall be audited by an independent public accountant.

(b) *Management report.* Each insured depository institution annually shall prepare, as of the end of the institution's most recent fiscal year, a management report signed by its chief executive officer and chief accounting or chief financial officer which contains:

(1) A statement of management's responsibilities for preparing the institution's annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with laws and regulations relating to safety and soundness which are designated by the FDIC and the appropriate federal banking agency; and

(2) An assessment by management of the institution's compliance with such laws and regulations during such fiscal year; and

(3) For an institution with total assets of \$1 billion or more at the beginning of such fiscal year, an assessment by management of the effectiveness of such internal control structure and procedures as of the end of such fiscal year.

[Codified to 12 C.F.R. § 363.2]

[Section 362.2 amended at 70 Fed. Reg. 71232, November 28, 2005, effective December 28, 2005 and applies to part 363 annual reports with a filing deadline (90 days after the end of an institution's fiscal year) on or after the effective date of these amendments]

§ 363.3 Independent public accountant.

(a) *Annual audit of financial statement.* Each insured depository institution shall engage an independent public accountant to audit and report on its annual financial statements in accordance with generally accepted auditing standards and section 37 of the Federal Deposit Insurance Act (12 U.S.C. 1831n). The scope of the audit engagement shall be sufficient to permit such accountant to determine and report whether the financial statements are presented fairly and in accordance with generally accepted accounting principles.

(b) *Additional reports.* For each insured depository institution with total assets of \$1 billion or more at the beginning of the institution's fiscal year, such independent public accountant shall examine, attest to, and report separately on, the assertion of management concerning the institution's internal control structure and procedures for financial reporting. The attestation shall be made in accordance with generally accepted standards for attestation engagements.

(c) *Notice by accountant of termination of services.* An independent public accountant performing an audit under this part who ceases to be the accountant for an insured depository institution shall notify the FDIC and the appropriate federal banking agency in writing of such termination within 15 days after the occurrence of such event, and set forth in reasonable detail the reasons for such termination.

[Codified to 12 C.F.R. § 363.3]

[Section 363.3 amended at 62 Fed. Reg. 63257, November 28, 1997, effective January 1, 1998; 70 Fed. Reg. 71232, November 28, 2005, effective December 28, 2005 and applies to part 363 annual reports with a filing deadline (90 days after the end of an institution's fiscal year) on or after the effective date of these amendments]

§ 363.4 Filing and notice requirements.

(a) *Annual reporting.* Within 90 days after the end of its fiscal year, each insured depository institution shall file with each of the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor, two copies of an annual report containing audited annual financial statements, the independent public accountant's report thereon, management's statements and assessments, and the independent public accountant's attestation report concerning the institution's internal control structure and procedures for financial reporting as required by §§ 363.2(a), 363.3(a), 363.2(b), and 363.3(b) respectively;

(b) *Public availability.* The annual report in paragraph (a) of this section shall be available for public inspection.

(c) *Independent accountant's reports.* Each insured depository institution shall file with the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor, a copy of any management letter, qualification, or other report issued by its independent public accountant with respect to such institution and the services provided by such accountant pursuant to this part within 15 days after receipt.

(d) *Notice of engagement or change of accountants.* Each insured depository institution shall provide, within 15 days after the occurrence of any such event, written notice to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor of the engagement of an independent public accountant, or the resignation or dismissal of the independent public accountant previously engaged. The notice shall include a statement of the reasons for any such event in reasonable detail.

[Codified to 12 C.F.R. § 363.4]

[Section 363.4 amended at 61 Fed. Reg. 6493, February 21, 1996, effective April 1, 1996; 62 Fed. Reg. 63257, November 28, 1997, effective January 1, 1998]

§ 363.5 Audit committees.

(a) *Composition and duties.* Each insured depository institution shall establish an audit committee of its board of directors, the composition of which complies with paragraphs (a)(1), (2), and (3) of this section, and the duties of which shall include reviewing with management and the independent public accountant the basis for the reports issued under this part.

(1) Each insured depository institution with total assets of \$1 billion or more as of the beginning of its fiscal year shall establish an independent audit committee of its board of directors, the members of which shall be outside directors who are independent of management of the institution.

(2) Each insured depository institution with total assets of \$500 million or more but less than \$1 billion

as of the beginning of its fiscal year shall establish an audit committee of its board of directors, the members of which shall be outside directors, the majority of whom shall be independent of management of the institution. The appropriate Federal banking agency may, by order or regulation, permit the audit committee of such an insured depository institution to be made up of less than a majority of outside directors who are independent of management, if the agency determines that the institution has encountered hardships in retaining and recruiting a sufficient number of competent outside directors to serve on the audit committee of the institution.

(3) An outside director is a director who is not, and within the preceding fiscal year has not been, an officer or employee of the institution or any affiliate of the institution.

(b) *Committees of large institutions.* The audit committee of any insured depository institution that has total assets of more than \$3 billion, measured as of the beginning of each fiscal year, shall include members with banking or related financial management expertise, have access to its own outside counsel, and not include any large customers of the institution. If a large institution is a subsidiary of a holding company and relies on the audit committee of the holding company to comply with this rule, the holding company audit committee shall not include any members who are large customers of the subsidiary institution.

[Codified to 12 C.F.R. § 363.5]

[Section 363.5 amended at 61 Fed. Reg. 6493, February 21, 1996, effective April 1, 1996; 70 Fed. Reg. 71232, November 28, 2005, effective December 28, 2005 and applies to part 363 annual reports with a filing deadline (90 days after the end of an institution's fiscal year) on or after the effective date of these amendments]

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36. Modifications of Guidelines

Introduction

Congress added section 36, "Early Identification of Needed Improvements in Financial Management" (section 36), to the Federal Deposit Insurance Act (FDI Act) in 1991.

The FDIC Board of Directors adopted 12 CFR part 363 of its rules and regulations (the Rule) to implement those provisions of section 36 that require rulemaking. The FDIC also approved these "Guidelines and Interpretations" (the Guidelines) and directed that they be published with the Rule to facilitate a better understanding of, and full compliance with, the provisions of section 36.

Although not contained in the Rule itself, some of the guidance offered restates or refers to statutory requirements of section 36 and is therefore mandatory. If that is the case, the statutory provision is cited.

Furthermore, upon adopting the Rule, the FDIC reiterated its belief that every insured depository institution, regardless of its size or charter, should have an annual audit of its financial statements performed by an independent public accountant, and should establish an audit committee comprised entirely of outside directors.

The following Guidelines reflect the views of the FDIC concerning the interpretation of section 36. The Guidelines are intended to assist insured depository institutions (institutions), their boards of directors, and their advisors, including their independent public accountants and legal counsel, and to clarify section 36 and the Rule. It is recognized that reliance on the Guidelines may result in compliance with section 36 and the Rule which may vary from institution to institution. Terms which are not explained in the Guidelines have the meanings given them in the Rule, the FDI Act, or professional accounting and auditing literature.

Scope of Rule (§ 363.1)

1. *Measuring Total Assets.* To determine whether this part applies, an institution should use total assets as reported on its most recent Report of Condition (Call Report) or Thrift Financial Report (TFR), the date of which coincides with the end of its preceding fiscal year. If its fiscal year ends on a date other than the end of a calendar quarter, it should use its Call Report or TFR for the quarter end immediately preceding the end of its fiscal year.

2. *Insured Branches of Foreign Banks.* Unlike other institutions, insured branches of foreign banks are not separately incorporated or capitalized. To determine whether this part applies, an insured branch should measure claims on non-related parties reported on its Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (form FFIEC 002).

3. *Compliance by Holding Company Subsidiaries.* Audited consolidated financial statements and other reports or notices required by this part which are submitted by a holding company for any subsidiary institution, should be accompanied by a cover letter identifying all subsidiary institutions to which they pertain. An institution filing holding company consolidated financial statements as permitted by § 363.1 (b) also may report on changes in its independent public accountant on a holding company basis. An institution that does not meet the criteria in section 36(i) must satisfy the remaining provisions of the statute and this part on an individual institution basis, and maintain its own audit committee. Multi-tiered holding companies may satisfy all requirements of this part at any level.

4. *Comparable Services and Functions.* Services and functions will be considered "comparable" to those required by this part if the holding company:

- (a) Prepares reports used by the subsidiary institution to meet the requirements of this part;
- (b) Has an audit committee that meets the requirements of this part appropriate to its largest subsidiary institution; and
- (c) Prepares and submits the management assessments of the effectiveness of the internal control structure and procedures for financial reporting (internal controls), and compliance with the designated laws defined in guideline 12 based on information concerning the relevant activities and operations of those subsidiary institutions within the scope of the rule.

Annual Reporting Requirements (§ 363.2)

5. *Annual Financial Statements.* Each institution should prepare comparative annual consolidated financial statements (balance sheets, statements of income, changes in equity capital, and cash flows, with accompanying footnote disclosures) in accordance with generally accepted accounting principles (GAAP) for each of its two most recent fiscal years. Statements for the earlier year may be presented on an unaudited basis if the institution was not subject to this part for that year and audited statements were not prepared.

6. *Holding Company Statements.* Subsidiary institutions may file copies of their holding company's audited financial statements filed with the Securities and Exchange Commission (SEC) or prepared for their FR Y-6 Annual Report under the Bank Holding Company Act of 1956.

7. *Insured Branches of Foreign Banks.* An insured branch of a foreign bank should satisfy the financial statements requirement by filing one of the following for the two preceding fiscal years: {{12-30-05 p.3162.04}}

- (a) Audited balance sheets, disclosing information about financial instruments with off-balance-sheet risk;
- (b) Schedules RAL and L of form FFIEC 002, prepared and audited on the basis of the instructions for its preparation; or
- (c) With written approval of the appropriate federal banking agency, consolidated financial statements of the parent bank.

8. *Management Report.* Management should perform its own investigation and review of the effectiveness of internal controls and compliance with the Designated Laws defined in Guideline 12. Management also should maintain records of its determinations and assessments until the next federal safety and soundness examination, or such later date as specified by the FDIC or appropriate federal banking agency. Management should provide in its assessment of the effectiveness of internal controls, or supplementally, sufficient information to enable the accountant to report on its assertions. The management report of an insured branch of a foreign bank should be signed by the branch's managing official if the branch does not have a chief executive or financial officer.

9. *Safeguarding of Assets.* "Safeguarding of assets," as the term relates to internal control policies and procedures regarding financial reporting and which has precedent in accounting literature, should be encompassed in the management report and the independent public accountant's attestation discussed in guideline 18. Testing the existence of and compliance with internal controls on the management of assets, including loan underwriting and documentation, represents a reasonable implementation of section 36. The FDIC expects such internal controls to be encompassed by the assertion in the management report, but the term "safeguarding of assets" need not be specifically stated. The FDIC does not require the accountant to attest to the adequacy of safeguards, but does require the accountant to determine whether safeguarding policies exist. ¹

10. *Standards for Internal Controls.* Each institution should determine its own standards for establishing, maintaining, and assessing the effectiveness of its internal controls. ²

11. *Service Organizations.* Although service organizations should be considered in determining if internal controls are adequate, an institution's independent public accountant, its management, and its

audit committee should exercise independent judgment concerning that determination. Onsite reviews of service organizations may not be necessary to prepare the report required by the Rule, and the FDIC does not intend that the Rule establish any such requirement.

12. *Compliance with Laws and Regulations.* The designated laws and regulations are the federal laws and regulations concerning loans to insiders and the federal and state laws and regulations concerning dividend restrictions (the Designated Laws). Table 1 to this Appendix A lists the designated federal laws and regulations pertaining to insider loans and dividend restrictions that are applicable to each type of institution.

Role of Independent Public Accountant (§ 363.3)

13. *General Qualifications.* To provide audit and attest services to insured depository institutions, an independent public accountant should be registered or licensed to practice as {{6-30-06 p.3162.05}} a public accountant, and be in good standing, under the laws of the state or other political subdivision of the United States in which the home office of the institution (or the insured branch of a foreign bank) is located. As required by section 36(g)3(A)(i), the accountant must agree to provide copies of any workpapers, policies, and procedures relating to services performed under this part.

14. *Independence.* The independent public accountant also should be in compliance with the AICPA's *Code of Professional Conduct* and meet the independence requirements and interpretations of the SEC and its staff.

15. *Peer Reviews.* As required by section 36(g)3(A)(ii), the independent public accountant must have received, or be enrolled in, a peer review that meets acceptable guidelines. The following peer review guidelines are acceptable:

(a) The external peer review should be conducted by an organization independent of the accountant or firm being reviewed, as frequently as is consistent with professional accounting practices;

(b) The peer review should be generally consistent with AICPA standards;³ and

(c) The review should include, if available, at least one audit on an insured depository institution or consolidated financial holding company. Peer review working papers are to be retained for 120 days after the peer review report is filed with the FDIC, and be made available to the FDIC upon request, in a form consistent with the SEC's agreement with the accounting profession.

16. *Filing Peer Review Reports.* Within 15 days of receiving notification that the peer review has been accepted, or before commencing any audit under the Rule, whichever is earlier, two copies of the most recent peer review report, accompanied by any letter of comments and letter of response, should be filed by the independent public accountant (if not already on file) with the FDIC, Accounting and Securities Disclosure Section, 550 17th Street N.W., Washington, D.C. 20429, where they will be available for public inspection. All corrective action required under any qualified peer review report should have been taken before commencing services under this Rule.

17. *Information to Independent Public Accountant.* Attention is directed to section 36(h) which requires institutions to provide specified information to their accountants. An institution also should provide its accountant with copies of any notice that the institution's capital category is being changed or reclassified under section 38 of the FDI Act, and any correspondence from the appropriate federal banking agency concerning compliance with this part.

18. *Attestation Report.* The independent public accountant should provide the institution with an internal controls attestation report and any management letter at the conclusion of the audit as required by section 36(c)(1). If a holding company subsidiary relies on its holding company management report, the accountant may attest to and report on the management's assertions in one report, without reporting separately on each subsidiary covered by the Rule. The FDIC has determined that management letters are exempt from public disclosure.

19. *Reviews with Audit Committee and Management.* The independent public accountant should meet with the institution's audit committee to review the accountant's reports required by this part before they are filed. It also may be appropriate for the accountant to review its findings with the institution's board of directors and management.

20. *Notice of Termination.* The notice required by § 363.3(c) should state whether the independent public accountant agrees with the assertions contained in any notice filed by the institution under § 363.4(d), and whether the institution's notice discloses all relevant reasons.

21. *Reliance on Internal Auditors.* Nothing in this part or this appendix is intended to preclude the ability of the independent public accountant to rely on the work of an institution's internal auditor. {{6-30-06 p.3162.06}}

Filing and Notice Requirements (§ 363.4)

22. *Place for Filing.* Except for peer review reports filed pursuant to Guideline 16, all reports and notices required by, and other communications or requests made pursuant to, the Rule should be filed as follows:

(a) FDIC: Appropriate FDIC Regional or Area Office (Supervision and Consumer Protection), i.e., the FDIC regional or area office in the FDIC region or area that is responsible for monitoring the institution or, in the case of a subsidiary institution of a holding company, the consolidated company. A filing made on behalf of several covered institutions owned by the same parent holding company should be accompanied by a transmittal letter identifying all of the institutions covered.

(b) Office of the Comptroller of the Currency (OCC): appropriate OCC Supervisory Office.

(c) Federal Reserve: Appropriate Federal Reserve Bank.

(d) Office of Thrift Supervision (OTS): appropriate OTS District Office.

(e) State bank supervisor: the filing office of the appropriate state bank supervisor.

23. *Relief from Filing Deadlines.* Although the reasonable deadlines for filings and other notices established by this part are specified, some institutions may occasionally be confronted with extraordinary circumstances beyond their reasonable control that may justify extensions of a deadline. In that event, upon written application from an insured depository institution, setting forth the reasons for a requested extension, the FDIC or appropriate federal banking agency may, for good cause, extend a deadline in this part for a period not to exceed 30 days.

24. *Public Availability.* Each institution's annual report should be available for public inspection at its main and branch offices no later than 15 days after it is filed with the FDIC. Alternatively, an institution may elect to mail one copy of its annual report to any person who requests it. The annual report should remain available to the public until the annual report for the next year is available. An institution may use its annual report under this part to meet the annual disclosure statement required by 12 CFR 350.3, if the institution satisfies all other requirements of 12 CFR Part 350.

25. *Independent Public Accountant's Reports.* Section 36(h)(2)(A) requires that, within 15 days of receipt by an institution of any management letter or other report, such letter or other report shall be filed with the FDIC, any appropriate federal banking agency, and any appropriate state bank supervisor. Institutions and their accountants are encouraged to coordinate preparation and delivery of audit and

attestation reports and filing the annual report, to avoid duplicate filings.

26. *Notices Concerning Accountants.* Institutions should review and satisfy themselves as to compliance with the required qualifications set forth in guidelines 13–15 before engaging an independent public accountant. With respect to any selection, change or termination of an accountant, institutions should be familiar with the notice requirements in guideline 21, and should send a copy of any notice under § 363.4(d) to the accountant when it is filed with the FDIC. An institution which files reports with its appropriate federal banking agency under, or is a subsidiary of a holding company which files reports with the SEC pursuant to, the Securities Exchange Act of 1934 may use its current report (e.g., SEC Form 8–K) concerning a change in accountant to satisfy the similar notice requirements of this part.

Audit Committees (§ 363.5)

27. *Composition.* The board of directors of each institution should determine if outside directors meet the requirements of section 36 and this part. At least annually, the board of an institution with \$1 billion or more in total assets at the beginning of its fiscal year should determine whether all existing and potential audit committee members are "independent of management of the institution" and the board of an institution with total assets of \$500 million or more but less than \$1 billion as of the beginning of its fiscal year should determine whether the

majority of all existing and potential audit committee members are "independent of management of the institution." Because an insured branch of a foreign bank does not have a separate board of directors, the FDIC will not apply the audit committee requirements to such branch. However, any such branch is encouraged to make a reasonable good faith effort to see that similar duties are performed by persons whose experience is generally consistent with the Rule's requirements for an institution the size of the insured branch.

28. *"Independent of Management" Considerations.* In determining whether an outside director is independent of management, the board should consider all relevant information. This would include considering whether the director:

- (a) Has previously been an officer of the institution or any affiliate of the institution;
- (b) Serves or served as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of or to the institution or its affiliates;
- (c) Is a relative of an officer or other employee of the institution or its affiliates;
- (d) Holds or controls, or has held or controlled, a direct or indirect financial interest in the institution or its affiliates; and
- (e) Has outstanding extensions of credit from the institution or its affiliates.

29. *Lack of Independence.* An outside director should not be considered independent of management if such director owns or controls, or has owned or controlled within the preceding fiscal year, assets representing 10 percent or more of any outstanding class of voting securities of the institution.

30. *Holding Company Audit Committees.* When an insured depository institution subsidiary fails to meet the requirements for the holding company exception in § 363.1(b)(2) or maintains its own separate audit committee to satisfy the requirements of this part, members of the independent audit committee of the holding company may serve as the audit committee of the subsidiary institution if they are otherwise independent of management of the subsidiary, and, if applicable, meet any other requirements for a large subsidiary institution covered by this part. However, this does not permit officers or employees of a holding company to serve on the audit committee of its subsidiary institutions. When the subsidiary institution satisfies the requirements for the holding company exception in § 363.1(b)(2), members of the audit committee of the holding company should meet all the membership requirements applicable to the largest subsidiary depository institution and may perform all the duties of the audit committee of a subsidiary institution, even though such holding company directors are not directors of the institution.

31. *Duties.* The audit committee should perform all duties determined by the institution's board of directors. The duties should be appropriate to the size of the institution and the complexity of its operations, and include reviewing with management and the independent public accountant the basis for their respective reports issued under §§ 363.2(a) and (b) and 363.3(a) and (b). Appropriate additional duties could include:

- (a) Reviewing with management and the independent public accountant the scope of services required by the audit, significant accounting policies, and audit conclusions regarding significant accounting estimates;
- (b) Reviewing with management and the accountant their assessments of the adequacy of internal controls, and the resolution of identified material weaknesses and reportable conditions in internal controls, including the prevention or detection of management override or compromise of the internal control system;
- (c) Reviewing with management and the accountant the institution's compliance with laws and regulations;
- (d) Discussing with management the selection and termination of the accountant and any significant disagreements between the accountant and management; and
- (e) Overseeing the internal audit function.

It is recommended that audit committees maintain minutes and other relevant records of their meetings and decisions.

32. *Banking or Related Financial Management Expertise.* At least two members of the audit committee of a large institution shall have "banking or related financial management expertise" as required by section 36(g)(1)(C)(i). This determination is to be made by the

board of directors of the insured depository institution. A person will be considered to have such required expertise if the person has significant executive, professional, educational, or regulatory experience in financial, auditing, accounting, or banking matters as determined by the board of directors. Significant experience as an officer or member of the board of directors or audit committee of a financial services company would satisfy these criteria.

33. *Large Customers.* Any individual or entity (including a controlling person of any such entity) which, in the determination of the board of directors, has such significant direct or indirect credit or other relationships with the institution, the termination of which likely would materially and adversely affect the institution's financial condition or results of operations, should be considered a "large customer" for purposes of § 363.5(b).

34. *Access to Counsel.* The audit committee should be able to retain counsel at its discretion without prior permission of the institution's board of directors or its management. Section 36 does not preclude advice from the institution's internal counsel or regular outside counsel. It also does not require retaining or consulting counsel, but if the committee elects to do either, it also may elect to consider issues affecting the counsel's independence. Such issues would include whether to retain or consult only counsel not concurrently representing the institution or any affiliate, and whether to place limitations on any counsel representing the institution concerning matters in which such counsel previously participated personally and substantially as outside counsel to the committee.

35. *Forming and Restructuring Audit Committees.* Audit committees should be formed within four

months of the effective date of this part. Some institutions may have to restructure existing audit committees to comply with this part. No regulatory action will be taken if institutions restructure their audit committees by the earlier of their next annual meeting of stockholders, or one year from the effective date of this part.

Other

36. *Modifications of Guidelines.* The FDIC's Board of Directors has delegated to the Director of the FDIC's Division of Supervision and Consumer Protection (DSC) authority to make and publish in the **Federal Register** minor technical amendments to the Guidelines in this appendix, in consultation with the other appropriate federal banking agencies, to reflect the practical experience gained from implementation of this part. It is not anticipated any such modification would be effective until affected institutions have been given reasonable advance notice of the modification. Any material modification or amendment will be subject to review and approval of the FDIC Board of Directors.

Table 1 to Appendix A

Designated Federal Laws and Regulations Applicable to		National banks	State member banks	State non-member banks	Savings associations
Insider Loans--Parts and/or Sections of Title 12 of the United States Code					
375a	Loans to Executive Officers of Banks.	✓	✓	(1)	(1)
375b	Prohibitions Respecting Loans and Extensions of Credit to Executive Officers and Directors of Banks, Political Campaign, Committees, etc.	✓	✓	(1)	(1)
1468(b)	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders.				✓
1828(j)(2)	Provisions Relating to Loans, Extensions of Credit, and Other Dealings Between Member Banks and Their Affiliates, Executive Officers, Directors, etc.			✓	{{12-30-05 p.3162.09}}
1828(j)(3)(B)	Extensions of Credit Applicability of Provisions Relating to Loans, Extensions of Credit, and Other Dealings Between Insured Branches of Foreign Banks and Their Insiders.	(2)		(3)	
Parts and/or Sections of Title 12 of the Code of Federal Regulations					
23.5	Application of Legal Lending Limits; Restrictions on Transactions With Affiliates.	✓			
31	Extensions of Credit to National Bank Insiders	✓			
215	Subpart A--Loans by Member Banks to Their Executive Officers, Directors, and Principal Shareholders.	✓	✓	(4)	(5)
	Subpart B--Reports of Indebtedness of Executive Officers and Principal Shareholders of Insured Nonmember Banks.	✓	✓	(4)	(5)
337.3	Limits on Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Insured Nonmember Banks.			✓	
349.3	Reports by Executive Officers and Principal Shareholders			✓	
563.43	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders.				✓
Dividend Restrictions--Parts and/or Sections of Title 12 of the United States Code					
56	Prohibition on Withdrawal of Capital and Unearned Dividends	✓	✓		
60	Dividends and Surplus Funds	✓	✓		
1467a(f)	Declaration of Dividends				✓
1831o	Prompt Corrective Action--Dividend Restrictions	✓	✓	✓	✓
Parts and/or Sections of Title 12 of the Code of Federal Regulations					
5.61	Payment of dividends; capital limitations	✓			
5.62	Payment of dividends; earnings limitation	✓			
6.6	Prompt Corrective Action--Dividend Restrictions	✓			
7.6120	Dividends Payable in Property Other Than Cash	✓			
208.19	Payments of Dividends		✓		
208.35	Prompt Corrective Action		✓		
				✓	

325.105	Prompt Corrective Action	
563.134	Capital Distributions	✓
565	Prompt Corrective Action	✓

¹Subsections (g) and (h) only.

²Applies only to insured federal branches of foreign banks.

³Applies only to insured state branches of foreign banks. {{12-30-05 p.3162.10}}

⁴See 12 CFR parts 337.3 and 349.3.

⁵See 12 CFR part 563.43.

[Codified to 12 C.F.R. Part 363, Appendix A]

[Appendix A to Part 363 amended at 61 Fed. Reg. 6494, February 21, 1996, effective April 1, 1996; 62 Fed. Reg. 63259, November 28, 1997, effective January 1, 1998; 70 Fed. Reg. 71232, November 28, 2005, effective December 28, 2005 and applies to part 363 annual reports with a filing deadline (90 days after the end of an institution's fiscal year) on or after the effective date of these amendments]

NOTE

Preamble to Part 363

III. Background

In September 1992, the FDIC proposed regulations (57 FR 42516, Sept. 15, 1992) to implement the provisions of section 112 of FDICIA, entitled "Independent Annual Audits of Insured Depository Institutions." The requirements of section 112 apply to fiscal years of insured depository institutions that begin after December 31, 1992.

The new statutory provision, contained in section 36, requires the FDIC, in consultation with the appropriate federal banking agencies, to promulgate regulations requiring institutions over a certain asset size to have an annual independent audit of their financial statements in accordance with generally accepted auditing standards and section 37 of the FDI Act, and the institution's independent public accountant to notify the FDIC upon termination of services. Section 36 also requires the federal banking agencies jointly to issue rules of practice governing enforcement actions against independent public accountants.

IV. Discussion of Final Rule and Public Comments

Section 36 requires the FDIC, in consultation with the other appropriate federal banking agencies, to prescribe regulations concerning only a few specified provisions of the statute. It also permits, but does not require, the FDIC to undertake rulemaking pursuant to its general rulemaking authority concerning other provisions of the statute.

The FDIC has elected to limit, with few exceptions, its rulemaking to a final rule to implement those provisions of section 36 which specifically require rulemaking. It is persuaded that the approach is consistent with the letter and spirit of the law and with comments received, with which the FDIC concurs, that the final rule not impose unnecessary regulatory burdens, provide appropriate flexibility, and be reasonably cost-effective.

Accordingly, the final rule implements the "Annual Independent Audits of Financial Statements" requirement of section 36(d)(1) of the FDI Act and the "Notice by Accountant of Termination of Services" requirement of section 36(g)(5). The FDIC anticipates that, jointly with the other appropriate federal banking agencies, it promptly will issue rules of practice with respect to removal, suspension or bar of an independent public accountant from performing audit services for insured depository institutions as required by section 36(g)(4).

The final rule also restates, by way of emphasis, selective provisions of the statute. That is not intended, however, to imply that the FDIC does not expect affected insured depository institutions to comply with all provisions of the statute. Instead, it makes clear that the final rule does not expand the scope of interpretation of the statutory requirements.

The FDIC received over 305 comment letters concerning the proposed rule. The largest group of comments, approximately 120, was from banks, about eight percent of which were institutions that were exempt from proposed Part 363. Another 23 percent were from bank holding companies, including most of the 25 largest in the United States. Twenty-two letters were from thrifts, four of which are among the ten largest in the country.

The FDIC has reviewed the proposal in light of these comments. The majority of the commenters criticized the proposed requirements, and the cost to comply with the proposed rule. The comments are discussed below.

A. Scope.

Section 36 left to the FDIC's discretion whether to exempt institutions having total assets in excess of \$150 million. The FDIC has exercised its discretion to mitigate the financial burden of compliance by raising

{{10-31-07 p.3162.11}} the threshold from \$150 million to \$500 million, thereby exempting from the final rule approximately two-thirds of institutions that would have been subject to section 36, but which pose less of a risk to the deposit insurance funds, while bringing approximately 75 percent of the banking assets in the U.S. within the scope of the regulation.

More than 96 percent of institutions with \$500 million or more in total assets report they already engage an independent public accountant to perform an annual audit of their financial statements or that their parent company engages an independent public accountant to do the same for its consolidated statements. All of the remaining institutions in this asset range engage an independent public accountant to provide some audit services. Many of these institutions or their holding companies also have audit committees that comply with the final rule. These facts suggest the final rule will not impose unacceptable burdens on affected institutions.

Compliance by Subsidiaries of Holding Companies

The requirements for an independent audit may be satisfied for subsidiaries of holding companies by an independent audit of the holding company. The other requirements of section 36 may be satisfied for

subsidiaries if "services and functions" comparable to those required by the statute are provided at the holding company level, and, either the institution has total assets, as of the beginning of each fiscal year, of less than \$5 billion; or, total assets between \$5 billion and \$9 billion, and it received a CAMEL (or comparable) rating of one or two at its most recent examination.

If a subsidiary meets the foregoing criteria, an independent public accountant may examine and attest to the subsidiary's assertions on the consolidated entity's internal control system, and would not be required to examine and attest to the systems of each subsidiary.

B. Reporting Requirements

1. Definitions

Definitions in the proposed rule have been eliminated in the final rule. Certain relevant terms are already defined in the FDI Act and professional accounting and auditing literature.

2. Annual Report

The final rule requires each covered institution to prepare an annual report containing financial statements prepared in accordance with generally accepted accounting principles (GAAP) that have been audited by an independent public accountant, and to file such report within 90 days after the end of each fiscal year. The FDIC has adopted commenters' suggestions that the language of the final rule more closely track the statute.

The proposal that institutions may use Call Report items or an audit of the Call Report schedules has been deleted as being unnecessarily confusing, and because such schedules do not comply with GAAP. In addition, a proposed provision on consolidation has been eliminated.

Many commenters requested that the FDIC delete the proposed provision requiring an audited reconciliation of an institution's capital reported under GAAP with the capital calculated under regulatory capital standards. Because this reconciliation is not specifically required by the statute, the FDIC eliminated it from the final rule.

3. Management Report

Internal controls for financial reporting. Section 36 requires that each institution prepare an annual report containing a statement of management's responsibility for establishing and maintaining an adequate internal control structure and an assessment of the effectiveness of internal controls for financial reporting.

To comply with the reporting and attestation requirements of the final rule, both management and the independent public accountant should refer to terms, including "internal control structure" and "control procedures," in professional accounting and auditing literature.

The FDIC sought comment on whether it should leave the development of internal control criteria to institutions. After careful consideration, the FDIC has decided that each institution should determine its own standard for an internal control structure and procedures for financial reporting, but that any assessment by management should include sufficient information to enable the independent public accountant separately to examine and report on management's assessment.

In response to a number of suggestions, the FDIC has removed the proposed requirement that "material matters" be as-

sesssed. Nevertheless, an assessment must include all significant items.

Compliance with laws and regulations. Section 36 requires management to assess its own compliance with designated laws and regulations, and to evaluate the effectiveness of the operation of its internal control structure and procedures for compliance with such laws and regulations.

The final rule also requires that a covered institution engage an independent public accountant to report on procedures for compliance with designated laws and regulations. In response to requests from many commenters the proposed requirement that management provide a description of its handling of material weaknesses and inadequacies and other reportable conditions was deleted. Commenters correctly pointed out that these matters should be resolved by the independent public accountant and management working together to determine the appropriate action to correct any deficiency. The proposal that institutions submit the names and occupations of audit committee members also was deleted because this information is available to examiners.

Many commenters addressed the proposal that an independent public accountant provide negative assurance that an institution has complied with FDIC assessment requirements. They noted section 36 does not require this, and that to require FDIC assessment auditors and independent public accountants to review the assessment calculations is duplicative and would result in unjustifiable additional expense. Accordingly, the FDIC has eliminated the requirement in the final regulation.

Many commenters requested that the accountant's management letter be eliminated from the filing requirement. However, section 36 specifically requires that the management letter, audit report, and any other report provided by the independent public accountant during the year be filed within 15 days of its receipt.

In the final rule, the proposed requirement that institutions retain workpapers documenting management's review of its statements in the management report has been eliminated because it is not required by section 36, and is not essential to the rule.

Notice of engagement or change of accountants. The final rule establishes notice requirements for institutions whenever there is a change of accountant. Several commenters questioned whether institutions had to notify the FDIC and appropriate federal banking agency immediately after the final rule is effective. Those institutions that have already notified the FDIC and the appropriate federal banking agency of their accountant's identity need make no additional notification until there is a change in accountant.

C. Independent Public Accountant Reporting and Notice Requirements

1. Internal Control Attestation

The final rule requires institutions to engage an independent public accountant to perform an examination level attestation and report separately on the assertions contained in management's report regarding management's assessment of the effectiveness of the institution's internal control structure and procedures for financial reporting. The attestation should be as of the date of management's assertions and should be in accordance with generally accepted standards for attestation engagements.

2. Compliance With Laws and Regulations Attestation

The final rule requires that each institution engage an independent public accountant to test the institution's compliance with designated laws and regulations through the performance of agreed upon procedures. The Guidelines set forth such procedures.

3. Other Duties of Independent Public Accountants

The proposal required the independent public accountant to inform the appropriate federal banking agency of any apparent criminal violation if management had not already done so. A number of commenters objected to this requirement because it is not specifically mandated by section 36, and it does not allow time for the institution to investigate the alleged violation before it must be reported to regulators. The comments are valid and the provision has been deleted.

4. Notice by Accountant of Termination of Services

The FDIC could not adopt the suggestion of some commenters that the accountant notice provisions be deleted. Section 36 requires such notice. However, the final rule extends from five days to 15 days the period of time within which an independent public accountant must file a termination of services report.

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D. Audit Committees

Section 36 requires that each institution have an independent audit committee entirely made up of outside directors who are independent of the institution. For large institutions, as defined in the final rule, there are additional criteria: The large institution's audit committee must include members with banking or related management experience, have access to its own outside counsel, and not include any large customers of the institution.

The final rule reiterates the requirements of the statute, but does not include specific definitions of "independent person," "large customer," and "banking and financial management expertise". The FDIC expects boards of directors to determine if an outside director meets audit committee requirements. Such a determination will be subject to review by examiners.

The FDIC requested comment on its proposed definition of "large institution". A large majority of commenters recommended that the proposed large institution asset threshold be increased. After careful consideration, the FDIC has adopted an asset threshold of \$3 billion. With this threshold, fewer than 2 percent of the nation's institutions will be defined as "large", yet more than half of the assets insured by the Bank Insurance Fund and the Savings Association Insurance Fund will receive the additional protection afforded by the presence of independent directors who have banking or financial management expertise, and are not large customers of the institution.

E. Insured Branches of Foreign Banks

A few commenters noted that the proposal did not separately address the responsibilities of insured branches of foreign banks. Application of section 36 statutory requirements to such branches is complicated because, unlike other institutions, they are not separately incorporated or capitalized. The Guidelines facilitate compliance by such branches.

[The page following this is 3165.]

¹It is management's responsibility to establish policies concerning underwriting and asset management and to make credit decisions. The auditor's role is to test compliance with management's policies relating to financial reporting. [Go Back to Text](#)

²In considering what information is needed on safeguarding of assets and standards for internal controls, management may review guidelines provided by its primary federal regulator; the FDIC's Division of Supervision and Consumer Protection (DSC) Risk Management Manual of Examination Policies; the Federal Reserve Board's Commercial Bank Examination Manual and other relevant regulations; the Office of Thrift Supervision's Thrift Activities Handbook; the Comptroller of the Currency's Handbook for National Bank Examiners; and standards published by professional accounting organizations, such as the American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards No. 55, "Consideration of the Internal Control Structure in a Financial Statement Audit," as amended by Statement of Auditing Standards No. 78; the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's *Internal Control--Integrated Framework*, including its addendum on safeguarding of assets; and other internal control standards published by the AICPA, other accounting or auditing professional associations, and financial institution trade associations. [Go Back to Text](#)

³These would include Standards for Performing and Reporting on Peer Reviews, codified in the *SEC Practice Section Reference Manual*, and Standards for Performing and Reporting on Peer Reviews, contained in Volume 2 of the AICPA's *Professional Standards*. [Go Back to Text](#)

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