

# Draft Draft Draft

## **FEDERAL DEPOSIT INSURANCE CORPORATION**

### **12 CFR Parts 308 and 363**

#### **Annual Independent Audits and Reporting Requirements**

**AGENCY:** Federal Deposit Insurance Corporation (FDIC)

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** Section 36 of the Federal Deposit Insurance Act (FDI Act) and the FDIC's implementing regulations (part 363) are generally intended to facilitate early identification of problems in financial management at insured depository institutions with total assets above certain thresholds through annual independent audits, assessments of the effectiveness of internal control over financial reporting and compliance with designated laws and regulations, the establishment of independent audit committees, and related reporting requirements. The asset-size threshold for internal control assessments is \$1 billion and the threshold for the other requirements is \$500 million. Given changes in the industry; certain sound audit, reporting, and audit committee practices incorporated in the Sarbanes-Oxley Act of 2002 (SOX); and the FDIC's experience in administering part 363, the FDIC is proposing to amend part 363 of its regulations. These amendments are designed to further the objectives of section 36 by incorporating these sound practices into part 363 and to provide clearer and more complete guidance to institutions and independent public accountants concerning compliance with the requirements of section 36 and part 363. The most significant revisions included in the proposed amendments would: (1) require management and the independent public accountant to identify the

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internal control framework used to evaluate internal control over financial reporting and disclose all identified material weaknesses; (2) extend the time period for a non-public institution to file its Part 363 Annual Report by 30 days and replace the 30-day extensions of the filing deadline that may be granted if an institution (public or non-public) is confronted with extraordinary circumstances beyond its reasonable control with a late filing notification requirement that would have general applicability; (3) provide relief from the annual reporting requirements for institutions that are merged out of existence before the filing deadline; (4) provide relief from reporting on internal control over financial reporting for businesses acquired during the fiscal year; (5) require management's assessment of compliance with designated safety and soundness laws and regulations to state management's conclusion regarding compliance and disclose any noncompliance with such laws and regulations; (6) clarify the independence standards with which independent public accountants must comply and enhance the enforceability of compliance with these standards; (7) specify that the duties of the audit committee include the appointment, compensation, and oversight of the independent public accountant; (8) require audit committees to ensure that audit engagement letters do not contain unsafe and unsound limitation of liability provisions and require institutions to file copies of these letters; (9) require certain communications by independent public accountants to audit committees and establish retention requirements for audit working papers; (10) require boards of directors to adopt written criteria for evaluating an audit committee member's independence and provide expanded guidance for boards of directors to use in determining independence; (11) require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of

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the holding company's consolidated total assets in order for an institution to comply with part 363 at the holding company level; and (12) provide illustrative management reports to assist institutions in complying with the annual reporting requirements. As required by section 36, the FDIC has consulted with the other federal banking agencies.

The FDIC is also proposing to amend its rules and procedures (part 308, subpart U) for the removal, suspension, or debarment of accountants and accounting firms from performing audit services required by section 36 of the FDI Act by specifying where an accountant or accounting firm should file required notices of orders and actions with the FDIC.

**DATES:** Comments must be received on or before [INSERT DATE 90 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments by any of the following methods:

- Agency Web Site: <http://www.fdic.gov/regulations/laws/federal>. Follow instructions for submitting comments on the Agency Web Site.
- E-mail: [Comments@FDIC.gov](mailto:Comments@FDIC.gov). Include "Part 363 – Independent Audits and Reporting Requirements" in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

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- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal> including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226, between 9 a.m. and 5 p.m. on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

**FOR FURTHER INFORMATION CONTACT:** Harrison E. Greene, Jr., Senior Policy Analyst (Bank Accounting), Division of Supervision and Consumer Protection, at [hgreene@fdic.gov](mailto:hgreene@fdic.gov) or (202) 898-8905; or Michelle Borzillo, Counsel, Supervision and Legislation Section, Legal Division, at [mborzillo@fdic.gov](mailto:mborzillo@fdic.gov) or (202) 898-7400.

### **SUPPLEMENTARY INFORMATION:**

#### **I. Background**

Section 112 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) added section 36, “Early Identification of Needed Improvements in Financial

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Management,” to the FDI Act (12 U.S.C. 1831m). Section 36 is generally intended to facilitate early identification of problems in financial management at insured depository institutions above a certain asset size threshold (covered institutions) through annual independent audits, assessments of the effectiveness of internal control over financial reporting and compliance with designated laws and regulations, and related reporting requirements. Section 36 also includes requirements for audit committees at these insured depository institutions. Section 36 grants the FDIC discretion to set the asset size threshold for compliance with these statutory requirements, but it states that the threshold cannot be less than \$150 million. Sections 36(d) and (f) also obligate the FDIC to consult with the other federal banking agencies in implementing these sections of the FDI Act, and the FDIC has performed the required consultation.

Part 363 of the FDIC’s regulations (12 CFR part 363) implements section 36 of the FDI Act. When it adopted part 363 in 1993, the FDIC stated that it was setting the asset size threshold at \$500 million rather than the \$150 million specified in section 36 to mitigate the financial burden of compliance with section 36 consistent with safety and soundness. In selecting \$500 million in total assets as the size threshold, the FDIC noted that approximately 1,000 of the then nearly 14,000 FDIC-insured institutions would be subject to part 363. These covered institutions held approximately 75 percent of the assets of insured institutions at that time. By imposing the audit, reporting, and audit committee requirements of part 363 on institutions with this percentage of the industry’s assets, the FDIC intended to ensure that the Congress’s objectives for achieving sound financial management at insured institutions when it enacted section 36 would be focused

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on those institutions posing the greatest potential risk to the insurance funds then administered by the FDIC. Today, due to consolidation in the banking and thrift industry and the effects of inflation, approximately 1,300 of the more than 8,600 insured institutions have \$500 million or more in total assets and are therefore subject to part 363. These covered institutions hold approximately 91 percent of the assets of insured institutions.

Until its most recent amendments, part 363 required each covered institution to submit to the FDIC and other appropriate federal and state supervisory agencies an annual report comprised of audited financial statements, a statement of management's responsibilities, assessments by management of the effectiveness of internal control over financial reporting and compliance with designated laws and regulations, and an independent public accountant's attestation report on internal control over financial reporting. In addition, part 363 provided that each covered institution must establish an independent audit committee of its board of directors comprised of outside directors who are independent of management of the institution. Part 363 also includes Guidelines and Interpretations (Appendix A to part 363), which are intended to assist institutions and independent public accountants in understanding and complying with section 36 and part 363.

In November 2005, the FDIC amended its part 363 annual audit and reporting requirements and audit committee requirements. The amendments raised the asset-size threshold from \$500 million to \$1 billion for the assessments of internal control over

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financial reporting by management and the independent public accountant. All of the other audit and reporting requirements of part 363 continued to apply to all institutions with \$500 million or more in total assets. Also, for covered institutions with between \$500 million and \$1 billion in total assets, the amendments required only a majority, rather than all, of the members of the audit committee, who must be outside directors, to be independent of management.

### II. Discussion and Section-by-Section Analysis of Proposed Amendments

When it amended part 363 in November 2005, the FDIC noted that it had identified other aspects of part 363 that may warrant revision in light of changes in the industry and the passage of SOX.

Given the number of proposed changes to part 363 and its Guidelines and Interpretations and to enable readers and commenters to more easily understand the context of these proposed changes, this notice includes the entire text of part 363 as it is proposed to be amended, not just the text of proposed amendments. Also, the following “Table of Proposed Changes to Part 363 and Appendices” is intended to assist readers and commenters in determining which sections of part 363 would be affected by this proposal.

<b>Table of Proposed Changes to Part 363 and Appendices</b>				
	<b>Unchanged</b>	<b>Revised</b>	<b>New</b>	<b>Reserved</b>
<b>Part 363 – Annual Independent Audits and Reporting Requirements</b>				
<b>Table of Contents</b>		X		

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<b>Table of Proposed Changes to Part 363 and Appendices</b>				
	<b>Unchanged</b>	<b>Revised</b>	<b>New</b>	<b>Reserved</b>
<b>OMB Control Number</b> § 363.0	X			
<b>Scope</b> § 363.1(a) § 363.1(b)(1) § 363.1(b)(2) § 363.1(b)(3) § 363.1(c) § 363.1(d)	X	X X X	X X	
<b>Annual Reporting Requirements</b> § 363.2(a) § 363.2(b) § 363.2(b)(1) § 363.2(b)(2) § 363.2(b)(3) § 363.2(c)		X X X X X	X	
<b>Independent Public Accountant</b> § 363.3(a) § 363.3(b) § 363.3(c) § 363.3(d) § 363.3(e) § 363.3(f) § 363.3(g)	X  X	X	X X X X	
<b>Filing and Notice Requirements</b> § 363.4(a) § 363.4(b) § 363.4(c) § 363.4(d) § 363.4(e) § 363.4(f)	X  X	X  X	X X	
<b>Audit Committees</b> § 363.5(a) § 363.5(b) § 363.5(c)	X	X	X	
<b>Appendix A to Part 363 – Guidelines and Interpretations</b>				
<b>Table of Contents</b>		X		
<b>Introduction</b>	X			
<b>Scope (§ 363.1)</b> Guideline 1 Guideline 2 Guideline 3	X X	X		



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<b>Table of Proposed Changes to Part 363 and Appendices</b>				
	<b>Unchanged</b>	<b>Revised</b>	<b>New</b>	<b>Reserved</b>
Guideline 4		X		
Guideline 4A			X	
<b>Annual Reporting Requirements (§ 363.2)</b>				
Guideline 5		X		
Guideline 5A			X	
Guideline 6		X		
Guideline 7	X			
Guideline 8	X			
Guideline 8A			X	
Guideline 8B			X	
Guideline 9		X		
Guideline 10		X		
Guideline 11	X			
Guideline 12	X			
<b>Role of Independent Public Accountant (§ 363.3)</b>				
Guideline 13		X		
Guideline 14				X
Guideline 15		X		
Guideline 16				X
Guideline 17	X			
Guideline 18		X		
Guideline 19	X			
Guideline 20		X		
Guideline 21	X			
<b>Filing and Notice Requirements (§ 363.4)</b>				
Guideline 22				X
Guideline 23		X		
Guideline 24	X			
Guideline 25				X
Guideline 26		X		
<b>Audit Committees (§ 363.5)</b>				
Guideline 27		X		
Guideline 28		X		
Guideline 29				X
Guideline 30		X		
Guideline 31		X		
Guideline 32	X			
Guideline 33	X			
Guideline 34	X			
Guideline 35		X		
<b>Other</b>				
Guideline 36	X			

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<b>Table of Proposed Changes to Part 363 and Appendices</b>				
	<b>Unchanged</b>	<b>Revised</b>	<b>New</b>	<b>Reserved</b>
<b>Table 1 to Appendix A Designated Federal Laws and Regulations</b>		X		
<b>Appendix B – Illustrative Management Reports</b>			X	

### **A. Scope (§ 363.1 and Guidelines 1-4A)**

#### *1. Applicability*

The FDIC is proposing to amend § 363.1(a) to more clearly state that part 363 applies to any insured depository institution that has consolidated total assets of \$500 million or more at the beginning of its fiscal year. For example, if an institution has a December 31 fiscal year end and its consolidated total assets were \$600 million as January 1, 2007, the institution would be subject to the annual reporting requirements of part 363 and would have to file a Part 363 Annual Report for the fiscal year ending December 31, 2007.

Also, the institution would become subject to the other reporting requirements as well as the audit committee requirements of part 363 on January 1, 2007.

#### *2. Compliance by Subsidiaries of Holding Companies*

At present, an insured depository institution that is a subsidiary of a holding company may use consolidated holding company financial statements to satisfy the audited financial statements requirement of part 363 regardless of whether the assets of the insured depository institution subsidiary or subsidiaries of the holding company represent substantially all or only a minor portion of the holding company's consolidated total assets. When the assets of insured depository institution subsidiaries do not comprise a substantial portion of a holding company's consolidated total assets, the FDIC staff has

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found that the holding company's consolidated financial statements, including the accompanying notes to the financial statements, do not tend to provide sufficient information that is indicative of the financial position and results of operations of these institutions. Also, when the insured depository institution subsidiaries do not contribute significantly to the holding company's financial position and results of operations, the extent of audit coverage given to these institutions in the audit of the consolidated holding company may be limited. Such limited audit coverage would not be consistent with the purpose and intent of section 36 of the FDI Act, which focuses on insured depository institutions rather than holding companies. In this situation, the assurance that would be provided by an independent audit performed substantially at the level of the insured depository institution subsidiaries is not otherwise available.

Therefore, given the differing characteristics of the holding companies that own insured depository institutions as well as the relationship of an insured depository institution's total assets to the consolidated total assets of its parent holding company, and in keeping with the intent and purpose of section 36 of the FDI Act, the FDIC is proposing to amend §§ 363.1(b)(1) and (2) by revising the criteria for determining whether the audited financial statements requirement and the other requirements of part 363 may be satisfied at a holding company level. More specifically, to comply with the requirements of part 363 at the top-tier or any other mid-tier holding company level, the consolidated total assets of the insured depository institution (or the consolidated total assets of all insured depository institutions, regardless of size, if the top-tier or mid-tier holding company owns or controls more than one insured depository institution) would have to comprise

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75 percent or more of the consolidated total assets of the top-tier or mid-tier holding company. The FDIC believes that this percentage-of-assets threshold should ensure that the extent of independent audit work performed at the insured depository institution level is sufficient to satisfy the intent of section 36 of the FDI Act, that is, the early identification of needed improvements in financial management at insured institutions. At the same time, this threshold would continue to provide flexibility to the vast majority of covered institutions that are part of a holding company structure with respect to the level at which they may comply with part 363.

When determining an appropriate percentage-of-assets threshold for compliance with part 363 at a holding company level, the FDIC considered the range of percentage-of-assets ratios for insured institutions that are part of a holding company structure. The vast majority of insured institutions subject to part 363 that are in a holding company structure are subsidiaries of organizations where the assets of the insured depository institution subsidiaries of the holding company comprise 90 percent or more of the holding company's consolidated total assets. Of the remaining institutions subject to part 363 that are in a holding company structure, most are subsidiaries of organizations where the assets of the insured institutions comprise either between 75 and 90 percent or less than 25 percent of the top-tier parent company's consolidated total assets. Smaller numbers of institutions are subsidiaries of organizations where the assets of the insured institutions comprise from 25 to 50 percent or from 50 to 75 percent of the top-tier parent company's consolidated total assets. However, in a number of cases where the insured institution subsidiaries comprise less than 75 percent of the top-tier holding company's consolidated

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total assets, the insured institution subsidiaries that are subject to part 363 currently comply with the regulation at a mid-tier holding company level where the assets of the insured institution subsidiaries comprise 90 percent or more of the mid-tier holding company's consolidated total assets. Thus, these institutions would not need to change how they comply with part 363 in response to the establishment of the proposed 75 percent threshold, provided they continue to comply at the same mid-tier holding company level and this holding company continues to meet the 75 percent threshold.

The FDIC recognizes that those institutions currently complying with part 363 at the holding company level that will not meet the proposed 75 percent of consolidated total assets threshold will incur additional costs from having to comply with the regulation at the institution level or at a suitable mid-tier holding company level. Nevertheless, the FDIC believes that the introduction of this percentage-of-assets threshold strikes an appropriate balance between insured institution financial data and audit coverage and the cost of compliance with part 363.

As a related matter, guideline 3 to part 363, *Compliance by Holding Company Subsidiaries*, states that when a holding company submits audited consolidated financial statements and other reports or notices required by part 363 on behalf of any subsidiary institution, an accompanying cover letter should identify all subsidiary institutions to which the statements, reports, or other notices pertain. Because many cover letters received by the FDIC have not sufficiently identified these subsidiary institutions, the FDIC is proposing to amend guideline 3 to clarify what information should be included in

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the cover letter. For example, for a Part 363 Annual Report, the cover letter should identify the subsidiary institutions subject to part 363 included in the holding company's consolidated financial statements and state whether the other annual report requirements are being satisfied for these institutions at the holding company level or at the institution level.

### *3. Financial Reporting*

The FDIC is proposing to add a new § 363.1(c) and a new guideline 4A, *Financial Reporting*, to specify that “financial reporting” includes both financial statements prepared in accordance with generally accepted accounting principles and those prepared for regulatory reporting purposes. Also, as proposed, guideline 4A would clarify that financial statements prepared for regulatory reporting purposes consist of the schedules equivalent to the basic financial statements that are included in an institution's appropriate regulatory report and that financial statements prepared for regulatory reporting purposes do not include regulatory reports prepared by a non-bank subsidiary of a holding company or an institution. For example, if a bank holding company or an insured depository institution owns an insurance subsidiary, financial statements prepared for regulatory reporting purposes would not include any regulatory reports that the insurance subsidiary is required to submit to its appropriate insurance regulatory agency. These proposed amendments are consistent with explanatory guidance issued by the FDIC on this subject in December 1994 after reviewing the Part 363 Annual Reports

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submitted earlier that year, which was the first time these annual reports were required to be filed with the FDIC.<sup>1</sup>

### *4. Definitions*

The FDIC is proposing to add § 363.1(d), *Definitions*, to define several common terms used in part 363 and the guidelines.

## **B. Annual Reporting Requirements (§ 363.2 and Guidelines 5-12)**

### *1. Audited Financial Statements*

Consistent with sound management practices and the objective of internal control over financial reporting, the FDIC is proposing to amend § 363.2(a) to require that the annual financial statements reflect all material correcting adjustments identified by the independent public accountant. Financial statements issued by insured depository institutions that are public companies or by their parent holding companies that are public companies are already subject to such a requirement pursuant to section 401 of SOX. The FDIC believes this requirement should also apply to institutions subject to part 363 that are not public companies.

### *2. Management Report Contents*

Based on its review of management reports filed pursuant to part 363, the FDIC has noted differences in the content of these reports and insufficient information regarding the results of the assessments that management must perform. When management has

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<sup>1</sup> See FDIC Financial Institution Letter (FIL) 86-94, dated December 23, 1994.

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identified material weaknesses in internal control over financial reporting or noncompliance with designated safety and soundness laws and regulations, these weaknesses and noncompliance have not always been disclosed.

In addition, management's assessment of internal control over financial reporting has often failed to disclose the internal control framework used to perform the assessment of the effectiveness of these controls. It is not always evident from management's report whether controls over the preparation of the regulatory financial statements have been included within the scope of management's assessment. The omission of this information from an institution's management report reduces the usefulness of the report as a means of identifying needed improvements in financial management, which is the objective of section 36 of the FDI Act. The FDIC notes that the regulations adopted by the Securities and Exchange Commission (SEC) in 2003 implementing the requirement in section 404 of SOX for a management report on internal control over financial reporting requires the identification of the internal control framework management used to evaluate the effectiveness of these controls and the disclosure of any identified material weakness.

Accordingly, to provide clearer guidance on what should be included in the management report, the FDIC is proposing to expand § 363.2(b). As proposed, § 363.2(b) would require management's assessment of compliance with the designated safety and soundness laws and regulations to include a clear statement as to management's conclusion regarding compliance and disclose any noncompliance with such laws and



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regulations. In addition, amended § 363.2(b) would require management's assessment of internal control over financial reporting to identify the internal control framework that management used to make its evaluation, include a statement that the evaluation included controls over the preparation of regulatory financial statements, include a clear statement as to management's conclusion regarding the effectiveness of internal control over financial reporting, disclose all material weaknesses identified by management, and preclude management from concluding that internal control over financial reporting is effective if there are any material weaknesses.

Because part 363 and its guidelines provide only limited guidance concerning the contents of the management report and the related signature requirements for this report, institutions and auditors have expressed interest in examples of acceptable reports.

Therefore, to assist managements of insured depository institutions in complying with the annual reporting requirements of § 363.2, the FDIC is proposing to add "*Appendix B to Part 363 – Illustrative Management Reports.*" Proposed Appendix B would provide guidance regarding reporting scenarios that satisfy the annual reporting requirements of part 363, illustrative management reports, and an illustrative cover letter for use when an institution complies with the annual reporting requirements at the holding company level. The use of the wording in the illustrative management reports and cover letter would not be required.

Regarding management's responsibility for assessing compliance with the designated safety and soundness laws and regulations, the FDIC is proposing to revise and update

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Table 1 to Appendix A of part 363 to reflect changes in these safety and soundness laws and regulations that have occurred since this table was last revised in 1997.

### *3. Management Report Signatures*

Section 36(b)(2) of the FDI Act requires an institution's management report to be signed by the chief executive officer and the chief accounting officer or chief financial officer. In its reviews of management reports, the FDIC has encountered inconsistencies between the level at which the management report components are being satisfied (insured depository institution level versus holding company level) and the corporate level of the officers who are signing the management report. More specifically, management reports are often not signed by the officers at the appropriate corporate level when the audited financial statements requirement is satisfied at the holding company level or when one or more of the components of the management report is satisfied at the holding company level and the remaining components of the management report are satisfied at the insured depository institution level. As a result, the FDIC believes institutions would benefit from clearer guidance regarding who must sign the management report. Therefore, the FDIC is proposing to add § 363.2(c) to specify which corporate officers must sign the management report and also the level of the corporate signers (i.e., insured depository institution level or the holding company level).

### *4. Institutions Merged Out of Existence*

Currently, part 363 does not exempt an institution that is merged out of existence after the end of its fiscal year but before the deadline for filing its Part 363 Annual Report from

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filing an annual report. Such institutions typically submit a written request for relief from the annual report filing requirement and the request is approved by the FDIC. To reduce regulatory burden and provide certainty for merging institutions, the FDIC is proposing to add guideline 5A, *Institutions Merged Out of Existence*, to explicitly provide relief from filing a Part 363 Annual Report to an institution that is merged out of existence after the end of its fiscal year, but before the deadline for filing its Part 363 Annual Report. However, a covered institution that is acquired after the end of its fiscal year, but retains its separate corporate existence rather than being merged out of existence, would continue to be required to file a part 363 Annual Report for that fiscal year.

### *5. Management's Assessment of the Effectiveness of Internal Control Over Financial Reporting*

The FDIC has publicly advised institutions with \$1 billion or more in total assets that are public companies or subsidiaries of public companies that they have considerable flexibility in determining how best to satisfy the SEC's requirements for management's assessment of internal control over financial reporting which implement section 404 of SOX, and the FDIC's requirements in part 363.<sup>2</sup> The reporting flexibility available to institutions subject to both the section 404 and the part 363 requirements was initially described in the preamble to the SEC's section 404 final rule release (68 FR 36642, June 18, 2003). This final rule release explained that the flexible reporting approach described in the preamble had been developed by the SEC staff in consultation with the staff of the federal banking agencies. To codify this reporting flexibility in part 363, the FDIC is

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proposing to add guideline 8A, *Management's Assessment of the Effectiveness of Internal Control Over Financial Reporting*. For an institution with \$1 billion or more in total assets that is subject to both part 363 and the SEC's rules implementing section 404 of SOX (or whose parent holding company is subject to section 404 provided the condition in § 363.1(b)(2) is met), the proposed guideline describes two options for complying with the filing requirements regarding management's report on internal control over financial reporting. These options are to prepare (1) a separate report to satisfy the FDIC's part 363 requirements and prepare a separate report to satisfy the SEC's section 404 requirements, or (2) a single report that satisfies all of the FDIC's part 363 requirements and all of the SEC's section 404 requirements.

### *6. Internal Control Reports for Acquired Businesses*

Currently, under the reporting requirements of part 363, both management's and the related independent public accountant's evaluation of an institution's internal control over financial reporting must include controls at an institution in its entirety, including all of its consolidated businesses, including businesses that were recently acquired.

However, the FDIC recognizes that it may not always be possible for management to conduct an evaluation of the internal control over financial reporting of an acquired business in the period between the consummation date of the acquisition and the due date of management's internal control evaluation. For public companies subject to the internal control reporting requirements of section 404 of SOX, the SEC staff has also acknowledged that conducting an internal control evaluation of such an acquired business

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<sup>2</sup> 70 FR 71231, November 28, 2005; 70 FR 44295, August 2, 2005; FDIC Financial Institution Letter (FIL)

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may not always be possible. This led the SEC staff to provide guidance to public companies stating that the staff would not object to the exclusion of the acquired business from management's evaluation of internal control over financial reporting, provided certain disclosures are made and other conditions are met.<sup>3</sup> The FDIC has received several written requests from institutions subject to the internal control reporting requirements of part 363 concerning their ability to exclude recently acquired businesses from the scope of management's internal control evaluation as of the end of the year of the acquisition. The FDIC staff has granted such requests for relief subject to the same disclosure parameters and other conditions that are laid out in the SEC staff's guidance on this matter.

To reduce regulatory burden, including the burden of submitting written requests to the FDIC, and provide certainty to institutions, the FDIC is proposing to add guideline 8B, *Internal Control Reports for Acquired Businesses*, to explicitly provide relief from the reporting requirements regarding internal control over financial reporting related to business acquisitions made by an institution during its fiscal year. As proposed and consistent with the SEC staff's guidance, guideline 8B would permit management's evaluation of internal control over financial reporting to exclude internal control over financial reporting for the acquired business, provided management's report identifies the acquired business, states that the acquired business is excluded from management's evaluation of internal control over financial reporting, and indicates the significance of

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137-2004, December 21, 2004.

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the acquired business to the institution's consolidated financial statements. Also, proposed guideline 8B would clarify that if the acquired business is an insured depository institution that is subject to part 363 and it is not merged out of existence before the deadline for filing its Part 363 Annual Report, the acquired business (institution) must continue to comply with all of the applicable requirements of part 363.

### *7. Standards for Internal Control*

At present, guideline 10, *Standards for Internal Control*, provides that each institution should determine its own standards for establishing, maintaining, and assessing the effectiveness of its internal control over financial reporting. However, the guideline does not describe the characteristics of a suitable internal control framework. Accordingly, the FDIC is proposing to amend guideline 10 to provide guidance regarding the attributes of a suitable internal control framework to be used by management in its evaluation of an institution's internal control over financial reporting. Recognizing that a significant percentage of institutions subject to part 363 or their parent holding companies are also subject to the internal control reporting requirements of section 404 of SOX, the attributes described in amended guideline 10 are consistent with the attributes the SEC described in the preamble to the SEC's section 404 final rule release (68 FR 36648, June 18, 2003). The FDIC believes that a framework with these attributes is appropriate for all institutions whether or not they are public companies.

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<sup>3</sup> See Question 3 in the SEC staff's *Frequently Asked Questions on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports* at [www.sec.gov/info/accountants/controlfaq1004.htm](http://www.sec.gov/info/accountants/controlfaq1004.htm).

**C. Independent Public Accountant (§ 363.3 and Guidelines 13-21)**

*1. Internal Control Over Financial Reporting*

As with its experience in reviewing the portion of the management report in which management provides its assessment of the effectiveness of the institution's internal control over financial reporting, the FDIC has found some independent public accountants' internal control attestation reports to be less than sufficiently informative. Such attestation reports are, therefore, inconsistent with the objectives of section 36 of the FDI Act. As a consequence, the FDIC is proposing to amend § 363.3(b), which governs the independent public accountant's report on internal control over financial reporting, to specify that, consistent with generally accepted standards for attestation engagements, the Public Company Accounting Oversight Board's (PCAOB) auditing standards, and related PCAOB staff implementation guidance, the accountant's report must:

- Not be dated prior to the date of management's report on its assessment of the effectiveness of internal control over financial reporting;
- Identify the internal control framework that the accountant used to make the evaluation (which must be the same as the internal control framework used by management);
- Include a statement that the accountant's evaluation included controls over the preparation of regulatory financial statements;
- Include a clear statement as to the accountant's conclusion regarding the effectiveness of internal control over financial reporting;
- Disclose all material weaknesses identified by the accountant; and

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- Conclude that internal control is ineffective if there are any material weaknesses.

The FDIC is also proposing to amend guideline 18, *Attestation Report*, to be consistent with § 363.3(b)(2) by reiterating that the attestation report on internal control over financial reporting should include a statement as to regulatory reporting.

### 2. *Communications with Audit Committee*

According to section 204 of SOX, an accountant who audits a public company's financial statements should report on a timely basis to the company's audit committee: (1) all critical accounting policies, (2) alternative accounting treatments discussed with management, and (3) written communications provided to management, such as a management letter or schedule of unadjusted differences. These reporting requirements are intended to strengthen the relationship between the audit committee and the accountant. The FDIC has previously stated that effective communication between the accountant who audits the institution's financial statements and the institution's audit committee assists the audit committee in carrying out its responsibilities. For this reason, the FDIC encouraged institutions, regardless of whether they are public companies or not, to arrange with their accountant to institute these reporting practices.<sup>4</sup> Requirements that are similar, but not identical, to those set forth in section 204 apply to accountants who audit the financial statements of entities that are not public.<sup>5</sup> Therefore, consistent with current best practices and standards for audits of both public and non-public entities, the

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<sup>4</sup> See FDIC Financial Institution Letter (FIL) 17-2003, dated March 5, 2003.

<sup>5</sup> See Statement on Auditing Standards No. 114, *The Auditor's Communication With Those Charged With Governance*, December 2006.



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FDIC is proposing to amend part 363 by adding § 363.3(d), *Communications with audit committee*, to set a uniform minimum requirement for such communication. As proposed, § 363.3(d) would require the independent public accountant to report the information identified in section 204 of SOX to the audit committee.

### 3. *Retention of Working Papers*

Section 36(g)(3)(A) of the FDI Act states that an independent public accountant who performs audit services required by section 36 must agree to provide related working papers to the FDIC, any appropriate federal banking agency, and any state bank supervisor. However, when seeking to review audit working papers, the FDIC has previously encountered situations where the working papers had been retained for only a limited number of years. The SEC's rules and the PCAOB's auditing standards implementing sections 802 and 103 of SOX, respectively, now specify a 7-year retention period for audit working papers. The American Institute of Certified Public Accountants' (AICPA) auditing standards provide that the retention period for audit working papers should not be shorter than five years.<sup>6</sup> Since the retention period applicable to audits of public companies is seven years, the FDIC believes that a uniform retention period should apply to audits of all institutions subject to part 363. Accordingly, consistent with the current practices and professional standards for audits of both public and non-public entities, the FDIC is proposing to amend part 363 by adding § 363.3(e), *Retention of working papers*. As proposed, § 363.3(e) would require the independent public

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<sup>6</sup> See Statement on Auditing Standards No. 103, *Audit Documentation*, December 2006.

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accountant to retain the working papers related to its audit of the financial statements and, if applicable, its evaluation of internal control over financial reporting for seven years.

### *4. Independence*

Section 36 of the FDI Act states that an “independent public accountant” must perform the audit and attestation services required by section 36 but it does not define “independent,” leaving this to the FDIC’s rulemaking authority. As adopted by the FDIC in 1993, part 363 includes guideline 14, *Independence*, which identifies the independence standards applicable to accountants performing services under section 36 and part 363. In 2003, the agencies jointly issued rules of practice to implement the enforcement provisions of section 36(g)(4), which authorize the FDIC or an appropriate federal banking agency to remove, suspend, or bar an accountant, for good cause, from performing audit and attestation services for institutions subject to section 36 and part 363.<sup>7</sup> To enhance the enforceability of the independence standards with which an accountant must comply for purposes of part 363, the FDIC is proposing to move the independence requirements for independent public accountants from guideline 14, *Independence*, to new § 363.3(f), *Independence*. As proposed, § 363.3(f) would also clarify that the independent public accountant must comply with the independence standards and interpretations of the PCAOB that have been approved by the SEC in addition to the independence standards and interpretations of the AICPA and the SEC.

### *5. Peer Reviews*

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<sup>7</sup> 68 FR 48256, August 13, 2003.

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Section 36(g)(3)(A)(ii) of the FDI Act requires an independent public accountant to have received a peer review or be enrolled in a peer review program that meets acceptable guidelines. At present, guideline 15 to part 363 provides that to be acceptable, a peer review should, among other things, be generally consistent with AICPA standards. Since part 363 was originally adopted, the PCAOB has been created and conducts inspections of registered public accounting firms, some of which audit insured depository institutions subject to part 363 or their parent holding companies. These inspections serve a similar purpose as peer reviews. In addition, the PCAOB issues reports on its inspections of these accounting firms.

In response to this development and in light of the agencies' issuance of rules of practice implementing the enforcement provisions of section 36, as mentioned above, the FDIC is proposing to add new § 363.3(g) on peer reviews. The FDIC would move the requirements for peer reviews and retention of the peer review working papers from guideline 15, *Peer Reviews*, to § 363.3(g). In addition, the requirements for filing peer review reports would be moved to new § 363.3(g) from guideline 16, *Filing Peer Review Reports*. As proposed, § 363.3(g) would also clarify that acceptable peer reviews include peer reviews performed in accordance with the AICPA's Peer Review Standards and inspections conducted by the PCAOB. It would also provide that the FDIC would not make available for public inspection the portion of any peer review report and inspection report determined to be nonpublic by the AICPA and the PCAOB, respectively. Finally, the FDIC is proposing to revise guideline 15 to explain that a peer review, other than a PCAOB inspection, should be generally consistent with AICPA Peer Review Standards.

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### *6. Notice of Termination*

Guideline 26, *Notices Concerning Accountants*, permits an institution that is a public company or a subsidiary of a public company to satisfy the requirement for filing a notice of termination of its independent public accountant by using its current report (e.g., SEC Form 8-K) concerning a change in accountant to satisfy the similar notice requirements of part 363. To reduce regulatory burden and provide flexibility to the independent public accountant of such an institution, the FDIC is proposing to amend guideline 20, *Notice of Termination*, to permit the independent public accountant to satisfy the requirement to file a notice of termination of its services in a similar manner. As proposed, the independent public accountant generally could satisfy the part 363 notice requirement by (1) submitting the letter it provided to management to be filed with the institution's or the holding company's current report filed with the SEC or the appropriate federal banking agency or (2) relying on the institution's or the holding company's current report filed by management with the FDIC that includes the independent public accountant's notice of termination of its services, provided the independent public accountant confirms that management has filed a current report that includes the accountant's letter to satisfy the requirements of § 363.3(c).

### **D. Filing and Notice Requirements (§ 363.4 and Guidelines 22-26)**

#### *1. Annual Reporting*

Currently, the annual reporting requirements of part 363 require each insured depository institution to file its Part 363 Annual Report within 90 days after the end of its fiscal year.

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Part 363 also requires each institution to file the independent public accountant's report on the audited financial statements and, if applicable, the accountant's attestation report on management's assessment of internal control over financial reporting, both of which are components of the Part 363 Annual Report, within 15 days of receipt by the institution, which can present a conflict with the annual report filing requirement. The FDIC is also aware of the impact that earlier filing deadlines established by the SEC for annual reports filed by certain public companies under the federal securities laws (e.g., SEC Form 10-K) and more robust auditing standards related to internal control over financial reporting have had on the management of institutions, on the resources of independent public accountants, and on auditing costs. To reduce cost and burden, the FDIC is proposing to amend § 363.4(a) by extending the time period within which an insured depository institution that is not a public company or a subsidiary of a public company must file its Part 363 Annual Report from within 90 days to within 120 days after the end of its fiscal year. An insured depository institution that is a public company, or that is a subsidiary of a public company that meets certain criteria, would continue to be required to file its Part 363 Annual Report within 90 days after the end of its fiscal year, which is consistent with the maximum time frame that public companies have for filing annual reports under the federal securities laws. The FDIC would also eliminate the ambiguity in § 363.4 concerning the filing deadline for the components of the Part 363 Annual Report that are prepared by the independent public accountant.

An insured depository institution with consolidated total assets of less than \$1 billion that is a public company or a subsidiary of a public company is required to file management's

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assessment of the effectiveness of internal control over financial reporting with the SEC or the appropriate federal banking agency in accordance with the compliance dates of the SEC's rules implementing section 404 of SOX. Management's findings and conclusions with respect to internal control over financial reporting, as disclosed in the assessment that management files with the SEC or the appropriate federal banking agency, provide information that would aid in meeting the objective of section 36 of the FDI Act.

Therefore, the FDIC is proposing to add a provision to § 363.4(a) that would require an institution of this size to submit a copy of management's section 404 internal control assessment with its Part 363 Annual Report, but this assessment will not be considered part of the institution's Part 363 Annual Report.

### *2. Independent Public Accountant's Reports*

Section 36(h)(2)(A) of the FDI Act and § 363.4(c) require an institution to file a copy of any management letter or other report issued by its independent public accountant that pertains to the financial statement audit and the attestation on internal control over financial reporting within 15 days after receipt by the institution. The FDIC's experience in administering part 363 indicates that institutions are often uncertain as to which types of reports they receive from their independent public accountant must be submitted to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor pursuant to this filing requirement. As stated above, this uncertainty extends to this 15-day filing requirement and its relationship to the filing deadline for the Part 363 Annual Report. To clarify the requirements for the filing of accountants' reports, the FDIC is proposing to amend § 363.4(c), *Independent public accountant's letters and reports*, by

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providing examples of the types of reports issued by an institution's independent public accountant, except for the accountant's reports that are required to be included in the institution's Part 363 Annual Report, that are to be filed within 15 days after receipt. Guideline 25, *Independent Accountant's Reports*, would be deleted because it would be redundant and no longer needed.

In the *Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters*, the federal banking agencies expressed their concerns about limitation of liability provisions included in external audit engagement letters and advised institutions against entering into engagement letters containing such provisions.<sup>8</sup> To enable the FDIC to timely review institutions' engagement letters with their independent public accountants, the FDIC is also proposing to amend § 363.4(c) to require institutions to file copies of audit engagement letters, including any related agreements and amendments, with the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor within 15 days of acceptance by the institution.

### 3. *Notification of Late Filing*

Guideline 23, *Relief from Filing Deadlines*, currently provides that in the occasional event that an institution is confronted with extraordinary circumstances beyond its reasonable control that justifies an extension of the deadline for filing its Part 363 Annual Report or another required report or notice, the institution may submit a written request

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<sup>8</sup> 71 FR 6847, February 9, 2006.

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for an extension of the filing deadline of not more than 30 days that explains the reasons for the request. Such a request may be granted for good cause. Over the last several years, the reasons set forth in the requests for extensions of time for filing Part 363 Annual Reports that have been submitted to the FDIC generally did not represent extraordinary circumstances beyond the institution's reasonable control, the standard currently set forth in guideline 23. Also, several extension requests were repeats of requests from the same institutions from the previous year.

Based upon this experience and given the proposed amendment to § 363.4(a) to extend the filing deadline for Part 363 Annual Reports for non-public institutions from 90 to 120 days, the FDIC is proposing to replace the extensions of time for filing reports that are available only in extraordinary circumstances under guideline 23 with a new § 363.4(e), *Notification of late filing*. In place of filing extensions that have limited applicability, this new section would be applicable to all institutions and would require an institution that is unable to timely file all or any portion of its Part 363 Annual Report or any other report or notice to submit a written notice of late filing before the filing deadline for the report or notice. The late filing notice shall disclose the institution's inability to timely file all or specified portions of its Part 363 Annual Report or other report or notice, the reasons therefore in reasonable detail, and the date when the report or notice will be filed.

The FDIC is also proposing to amend guideline 23 by changing its focus from extension requests to late filing notices consistent with the approach taken in new § 363.4(e). Amended guideline 23 would explain that submitting a late filing notice would not cure



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the apparent violation of part 363 arising from an institution's failure to timely file a Part 363 Annual Report or any other required report or notice. The supervisory response to such an apparent violation would take into account the facts and circumstances surrounding an institution's delay in filing. As proposed, guideline 23 would also provide that, if the late filing applies to only a portion of the Part 363 Annual Report or any other report or notice, the components of the report or notice that have been completed should be filed within the prescribed filing period accompanied by either a cover letter that indicates which components are omitted or a combined late filing notice and cover letter.

### *4. Place for Filing*

Current guideline 22 identifies the office of the FDIC, the appropriate federal banking agency, and the appropriate state bank supervisor to which reports and notices (other than peer review reports) required by part 363 are to be filed. Nevertheless, the FDIC has found that some institutions submit required reports and notices to incorrect locations. The FDIC staff also receives questions from institutions asking where reports and notices should be filed. To make the information as to where Part 363 Annual Reports, written notices of late filing, and other reports and notices (except peer review reports) are to be filed more prominent, the FDIC is proposing to move this information from guideline 22, *Place for Filing*, to a new § 363.4(f), *Place for filing*.

## **E. Audit Committees (§ 363.5 and Guidelines 27-35)**

### *1. Composition*

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Section 36(g)(1) of the FDI Act and § 363.5(a) require each insured depository institution subject to part 363 to have an independent audit committee comprised entirely of outside directors. As defined in § 363.5(a)(3), in general, an outside director is a director who is not an officer or employee of the institution or any affiliate of the institution. In addition, the outside directors who serve on the audit committee must be “independent of management,” although a minority of the audit committee members of institutions with \$500 million or more but less than \$1 billion in total assets need not be “independent of management.” According to guideline 27, *Composition*, each institution’s board of directors is responsible for determining at least annually whether existing and potential audit committee members satisfy the requirements governing audit committee composition. Guidelines 28 and 29 set forth certain factors for boards of directors to consider in determining whether an outside director is “independent of management.”

In order for a board of directors to perform its evaluation of audit committee members in a consistent, effective, and reviewable manner, the FDIC believes the board should be guided by an approved policy or set of criteria that identifies the factors to be taken into account by the board. Accordingly, the FDIC is proposing to amend guideline 27 to state that an institution’s board of directors should maintain and use an approved set of written criteria for evaluating audit committee member independence and that the results of and basis for the board’s determination with respect to each existing and potential audit committee member should be recorded in the board’s minutes.

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Guideline 30, *Holding Company Audit Committees*, provides guidance for complying with the audit committee requirements of part 363 at the holding company level. The FDIC is proposing to amend guideline 30 for consistency with the proposed revisions to the holding company provisions of § 363.1(b) and to reflect the difference in the audit committee composition requirements in § 363.5(a) for institutions with more than and less than \$1 billion in total assets.

### 2. “Independent of Management” Considerations

Guideline 28, *“Independent of Management” Considerations*, identifies five factors for a board of directors to consider when determining the independence of an outside director.

Guideline 29, *Lack of Independence*, states that a director who owns or controls 10 percent or more of any class of the institution’s voting securities should not be considered “independent of management.” The FDIC has found that some of the factors in guideline 28 are so general that they fail to provide meaningful guidance to boards of directors. At the same time, many of the institutions subject to part 363 or their parent holding companies are public companies with securities listed on a national securities exchange. Under the SEC’s Rule 10A-3 (17 CFR § 240.10A-3), each audit committee member of a listed issuer must be a director of the issuer and must otherwise be independent. The listing standards of the national securities exchange must set forth the criteria for determining the independence of directors who are to serve on a listed issuer’s audit committee.

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Based on its review, the FDIC believes that the independence criteria for audit committee members included in the listing standards of the national securities exchanges, together with the FDIC's existing stock ownership criterion in guideline 29, represent an appropriate framework for determining whether an outside director is "independent of management" for purposes of part 363. Furthermore, for an institution whose audit committee members or whose parent holding company's audit committee members, if the holding company meets the holding company provisions of § 363.1(b), are subject to the listing standards of a national securities exchange, allowing the institution to use these standards for part 363 purposes will reduce the institution's burden.

Therefore, the FDIC is proposing to combine guidelines 28 and 29 and provide expanded guidance for an institution's board of directors to use in its assessment of an outside director's relationship to the institution for the purposes of making "independent of management" determinations regarding audit committee members. For example, the proposed amendment to guideline 28 includes a list of criteria that an institution's board of directors should consider when determining whether an outside director would be considered "independent of management." In developing the proposed list of criteria, the FDIC considered the portion of the listing standards of the national securities exchanges that apply to audit committees. An institution's board of directors may also conclude that it should consider additional criteria that may be appropriate in its particular circumstances. As an alternative to the listed criteria, proposed guideline 28 would permit an institution that is a public company or that is a subsidiary of a public company, when the holding company provisions of § 363.1(b) are met, to apply the audit committee

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provisions of the listing standards of the national securities exchange on which the public institution or its public parent company is listed for purposes of determining audit committee member independence. Similarly, all other institutions, including those that are not public companies, may elect to use the audit committee provisions of the listing standards of a national securities exchange or association for determining audit committee member independence.

### *3. Duties*

According to section 36(g)(1)(B) of the FDI Act and § 363.5(a), an audit committee's duties include reviewing the basis for the Part 363 Annual Report with both management and the independent public accountant. Guideline 31 further provides that the audit committee's duties should be appropriate to the size of the institution and the complexity of its operations and it identifies additional duties that could be appropriate for the audit committee. These additional duties include discussing with management the selection and termination of the institution's independent public accountant. In addition, guideline 26 provides that, before engaging an independent public accountant, an institution should review and satisfy itself that the accountant is in compliance with the required qualifications set forth in guidelines 13 through 15, including the accountant's independence and receipt of a peer review.

Under section 301 of SOX, the audit committee of each public company listed on a national securities exchange or association must be responsible for the appointment, compensation, and oversight of the accounting firm engaged to prepare or issue an audit

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report or perform related work. As the SEC noted when it adopted its final rule implementing section 301, “the auditing process may be compromised when a company’s outside auditors view their responsibility as serving the company’s management rather than its full board of directors or audit committee. This may occur if the auditor views management as the employer with hiring, firing and compensating powers. Under these conditions, the auditor may not have the appropriate incentive to raise concerns and conduct an objective review. . . . One way to help promote auditor independence, then, is for the auditor to be hired, evaluated and, if necessary, terminated by the audit committee.” Because the intent and purpose of section 36 of the FDI Act is the early identification of needed improvements in financial management, it is critical for the accountants that perform audit and attestation services for insured depository institutions subject to section 36 to have an appropriate incentive to raise concerns and conduct an objective review. In this regard, the FDIC believes it is a sound corporate governance practice for an institution’s audit committee, rather than its management, to be responsible for the appointment, compensation, and oversight of the accountant, regardless of whether the institution is a public company.

Therefore, the FDIC is proposing to amend § 363.5(a), *Composition and duties*, and guideline 31, *Duties*, to specify that, in addition to reviewing with management and the independent public accountant the basis for the reports issued under part 363, the duties of the audit committee include the appointment, compensation, and oversight of the independent public accountant who performs services required under part 363. In order to discharge these duties with respect to the independent public accountant, the audit

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committee should also review and satisfy itself as to the independent public accountant's compliance with the independence, peer review, and other qualifications under part 363. Additionally, the audit committee should be familiar with and ensure management's compliance with the requirement to file notices concerning the engagement, resignation, or dismissal of an independent public accountant. The FDIC is proposing to include these duties in guideline 31.

#### *4. Independent Public Accountant Engagement Letters*

In response to an observed increase in the types and frequency of provisions in financial institutions' external audit engagement letters that limit the auditors' liability, the federal banking agencies issued an *Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters* (Interagency Advisory) in February 2006.<sup>9</sup> When they issued the Interagency Advisory, the agencies stated their belief that when institutions agree to limit their external auditors' liability in provisions in engagement letters, such provisions may weaken the external auditors' objectivity, impartiality, and performance, which may reduce the reliability of audits and thereby raise safety and soundness concerns. The reliability of audits is central to achieving the intent and purpose of section 36 of the FDI Act. Therefore, the FDIC is proposing to add § 363.5(c), *Independent public accountant engagement letters*, and amend guideline 31, *Duties*, to incorporate the principal provisions of the Interagency Advisory.

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<sup>9</sup> See 71 FR 6847, February 9, 2006, and FDIC Financial Institution Letter (FIL) 13-2006, issued on the same date. The Federal Financial Institutions Examination Council on behalf of the agencies issued the Interagency Advisory in proposed form for public comment on May 10, 2005 (70 FR 24576).

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As proposed, § 363.5(c) and guideline 31 would require the audit committee to ensure that audit engagement letters and any related agreements with the independent public accountant for services to be performed under part 363 do not contain any limitation of liability provisions that: (1) indemnify the independent public accountant against claims made by third parties; (2) hold harmless or release the independent public accountant from liability for claims or potential claims that might be asserted by the client insured depository institution, other than claims for punitive damages; or (3) limit the remedies available to the client insured depository institution. Consistent with the Interagency Advisory, the proposed amendment would not preclude the use of alternative dispute resolution agreements and jury trial waivers.

### *5. Transition Period for Forming and Restructuring Audit Committees*

When an insured depository institution first exceeds the \$500 million total assets threshold and becomes subject to part 363, particularly an institution with few shareholders, the FDIC has observed that, in some cases, such an institution encounters difficulty in satisfying the requirements governing the composition of the independent audit committee. If the board of directors lacks a sufficient number of outside directors who are independent of management to serve on the audit committee, the board members must identify and attract qualified individuals in their community who would be willing to become directors and audit committee members and who would be “independent of management.” The lack of guidance in part 363 on the amount of time in which an institution must bring its audit committee into compliance with the requirements



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governing its composition when an institution first becomes subject to part 363 further complicates this process. This lack of guidance on the time frame for attaining compliance also affects the other two asset-size thresholds applicable to audit committee composition.

To provide both clarity and regulatory relief, the FDIC is proposing to replace outdated guideline 35, which dealt with compliance with the audit committee requirements of part 363 when the regulation took effect in 1993, with a revised guideline 35, “*Transition Period for Forming and Restructuring Audit Committees.*” As proposed, guideline 35 would provide a one-year transition period for forming or restructuring the audit committee when an institution first becomes subject to part 363, when an institution’s assets first reach the \$1 billion asset-size threshold, and when an institution’s assets first reach the \$3 billion asset-size threshold. The proposed revised guideline would state that, when an institution first crosses one of these three thresholds based on its total assets at the beginning of its fiscal year, no regulatory action would be taken if the institution forms or restructures its audit committee to comply with the applicable requirements governing the composition of the committee by the end of that fiscal year, provided the institution complied with any applicable audit committee requirements for its preceding fiscal year.

### **F. Other Changes to Part 363**

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The FDIC also proposes to make other changes to part 363 to improve its clarity, readability, and consistency of language, and to correct or eliminate outdated terms, references, and provisions in the regulation and appendix A.

### **G. Proposed Amendment to Part 308, Subpart U**

In August 2003, pursuant to section 36(g)(4) of the FDI Act, the FDIC and the other federal banking agencies jointly issued final rules governing their authority to take disciplinary actions against independent public accountants and accounting firms that perform audit and attestation services required by section 36.<sup>10</sup> Under the final rules, certain violations of law, negligent conduct, reckless violation of professional standards, or lack of qualifications to perform auditing services may be considered good cause to remove, suspend, or bar an accountant or firm from providing audit and attestation services for institutions subject to section 36. The rules also prohibit an accountant or accounting firm from performing these services if the accountant or firm has been removed, suspended, or debarred by one of the agencies, or if the SEC or PCAOB takes certain disciplinary actions against the accountant or firm. Additionally, the final rules require an accountant or an accounting firm to provide the agencies with written notification of the accountant's or firm's removal, suspension, or debarment. Part 308, subpart U, of the FDIC's rules and regulations implements the requirements of section 36(g)(4) of the FDI Act for institutions that are supervised by the FDIC. The FDIC is proposing to amend § 308.604(c) to identify the FDIC location where an accountant or

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<sup>10</sup> See 68 FR 48256, April 13, 2003, and the FDIC's Financial Institution Letter (FIL) FIL-66-2006, dated August 18, 2003.

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accounting firm should file required notices of orders and actions regarding removal, suspension, or debarment.

### **III. Request for Comments**

The FDIC welcomes comments on all aspects of this proposal. In particular, the FDIC invites comments on the following:

1. As proposed, the rule would require management's assessment of compliance with designated safety and soundness laws and regulations to include a clear statement as to management's conclusion regarding compliance and disclose any noncompliance with such laws and regulations. The designated safety and soundness laws and regulations relate to loans to insiders and dividend restrictions. Management's assessment of compliance is included in the management report within the Part 363 Annual Report, which is available for public inspection. Should the disclosure of instances of noncompliance with these designated laws and regulations be made available for public inspection or should the FDIC designate such disclosure as privileged and confidential and not available to the public?
2. As proposed, the rule would require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the holding company's consolidated total assets as of the beginning of its fiscal year in order for an institution to comply with part 363 at the holding company level. The holding company could be the institution's top-tier or any mid-tier holding

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company that meets the 75 percent threshold. Considering the costs and benefits of a threshold, is 75 percent or more of consolidated total assets an appropriate threshold? If not, what would be an appropriate threshold to use for compliance with part 363 at a holding company level?

### **IV. Solicitation of Comments on Use of Plain Language**

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. We invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?
- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- What else could we do to make the regulation easier to understand?

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### **V. Solicitation of Comments on Impact on Community Banks**

The FDIC seeks comments on the impact of this proposal on community banks. The FDIC recognizes that community banks operate with more limited resources than larger institutions and may present a different risk profile. Thus, the FDIC specifically requests comments on the impact of the proposal on community banks' current resources, including personnel, and whether the goals of the proposed rule could be achieved, for community banks, through an alternative approach.

### **VI. Regulatory Flexibility Act Analysis**

The Regulatory Flexibility Act (RFA) requires that each federal agency either certify that a proposed rule would not, if adopted in final form, have a significant economic impact on a substantial number of small entities or prepare an initial regulatory flexibility analysis (IRFA) of the proposal and publish the analysis for comment. See 5 U.S.C. 603, 605. The Small Business Administration (SBA) defines small banks as those with less than \$165 million in assets. Because this rule expressly exempts insured depository institutions having assets of less than \$500 million, it is inapplicable to small entities as defined by the SBA. Therefore, it is certified that this proposed rule would not have a significant economic impact on a substantial number of small entities.

### **VII. Paperwork Reduction Act**

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This proposed rule would revise a collection of information that has been reviewed and approved by the Office of Management and Budget (OMB) under control number 3064-0113, pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 et seq). The principal revisions that bear on the collection of information under part 363 are the extension of the filing deadline for the Part 363 Annual Report from 90 to 120 days after the end of the fiscal year for an institution that is not a public company or a subsidiary of a public company, the replacement of 30-day extension requests (when an institution is confronted with extraordinary circumstances beyond its reasonable control) with late filing notices (regardless of the reason), the modification of the criteria governing the acceptability of reports at the holding company level rather than at the institution level, the expanded guidance on the content of the management report and the independent public accountant's internal control attestation report, the board of directors' use of an approved set of written criteria for determining whether an audit committee member is an outside director and is "independent of management," and the new guidelines for institutions merged out of existence and for internal control reports for acquired businesses. It is anticipated that the overall effect of these changes will be a small burden increase for affected insured institutions. Comments are invited on: (a) Whether this collection of information is necessary for the proper performance of the FDIC's functions, including whether the information has practical utility; (b) the accuracy of the estimates of the burden of the information collection; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

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Comments should be addressed to Steven F. Hanft, Paperwork Clearance Officer, Room F-1062, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429, with copies to the OMB desk officer for the FDIC by mail to the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, New Executive Office Building, Room 10235, 725 17th Street, NW., Washington, DC 20503 or by fax to (202) 395-6974.

The paperwork burden associated with this rule was last reviewed in 2005. At that time, the FDIC estimated the burden of this information collection to be 65,612 hours for FDIC-supervised institutions. Before giving effect to the proposed amendments, the estimated burden would be 79,721 hours, an adjustment of 14,109 hours attributable to an increase in the number of FDIC-supervised institutions subject to part 363. If the revisions in this proposed rule are implemented, the resulting estimated reporting burden for the collection of information would be 83,599 hours, a program increase of 3,878 hours over the adjusted burden of 79,721 hours. The most significant component of the increase is attributable to the proposed revised requirements related to audit committee composition.

Number of Respondents: 5,230

Total Annual Responses: 16,231

Total Annual Burden Hours: 83,599

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## List of Subjects

### 12 CFR Part 308

Administrative practice and procedure, Bank deposit insurance, Banks, banking, Claims, Crime, Equal access to justice, Investigations, Lawyers, Penalties, State nonmember banks.

### 12 CFR Part 363

Accounting, Administrative practice and procedure, Banks, banking, Reporting and record keeping requirements.

For the reasons set forth in the preamble, the Board of Directors of the FDIC proposes to amend title 12, chapter III, of the Code of Federal Regulations as follows:

## **PART 308 – RULES OF PRACTICE AND PROCEDURE**

### **Subpart U – Removal, Suspension, and Debarment of Accountants From Performing Audit Services**

1. The authority citation for part 308 continues to read as follows:

**Authority:** 5 U.S.C. 504, 554-557; 12 U.S.C. 93(b), 164, 505, 1815(e), 1817, 1818, 1820, 1828, 1829, 1829b, 1831i, 1831m(g)(4), 1831o, 1831p-1, 1832(c), 1884(b), 1972, 3102, 3108(a), 3349, 3909, 4717; 15 U.S.C. 78(h) and (i), 78o-4(c), 78o-5, 78q-1, 78s, 78u, 78u-2, 78u-3 and 78w, 6801(b), 6805(b)(1); 28 U.S.C. 2461 note; 31 U.S.C. 330, 5321; 42 U.S.C. 4012a; Sec. 3100(s), Pub. L. 104-134, 110 Stat. 1321-358.



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2. Section 308.604(c) is amended to read as follows:

**§ 308.604 Notice of removal, suspension, or debarment.**

(c) *Timing and place of notice.* Written notice required by this paragraph shall be given no later than 15 calendar days following the effective date of an order or action, or 15 calendar days before an accountant or accounting firm accepts an engagement to provide audit services, whichever date is earlier. The written notice must be filed by the independent public accountant or accounting firm with the FDIC, Accounting and Securities Disclosure Section, 550 17th Street, NW., Washington, D.C. 20429.

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3. Part 363 is amended to read as follows:

**PART 363 – ANNUAL INDEPENDENT AUDITS AND REPORTING  
REQUIREMENTS**

Sec.

363.0 OMB control number.

363.1 Scope.

363.2 Annual reporting requirements.

363.3 Independent public accountant.

363.4 Filing and notice requirements.

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## 363.5 Audit committees.

### Appendix A to Part 363—Guidelines and Interpretations

### Appendix B to Part 363—Illustrative Management Reports

**Authority:** 12 U.S.C 1831m.

#### **§ 363.0 OMB control number.**

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

#### **§ 363.1 Scope and definitions.**

(a) *Applicability.* This part applies to any insured depository institution with respect to any fiscal year in which its consolidated total assets at the beginning of such fiscal year are \$500 million or more. The requirements specified in this part are in addition to any other statutory and regulatory requirements otherwise applicable to an insured depository institution.

(b) *Compliance by subsidiaries of holding companies.* (1) The audited financial statements requirement of § 363.2(a) for any fiscal year may be satisfied for an insured depository institution that is a subsidiary of a holding company by audited consolidated financial statements of the top-tier or any mid-tier holding company provided that the consolidated total assets of the insured depository institution (or the consolidated total assets of all insured depository institutions, regardless of size, if the holding company

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owns or controls more than one insured depository institution) comprise 75 percent or more of the consolidated total assets of the holding company at the beginning of its fiscal year.

(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 top-tier or any mid-tier holding company if the insured depository institution meets the criterion specified in § 363.1(b)(1) and 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.

(c) *Financial reporting.* For purposes of the management report requirement of § 363.2(b) and the internal control reporting requirement of § 363.3(b), "financial reporting" includes both financial statements prepared in accordance with generally accepted accounting principles and those prepared for regulatory reporting purposes.

(d) *Definitions.* For purposes of this part, the following definitions apply:

(1) *AICPA* means the American Institute of Certified Public Accountants.

(2) *GAAP* means generally accepted accounting principles.

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(3) *PCAOB* means the Public Company Accounting Oversight Board.

(4) *Public company* means an insured depository institution or other company that has a class of securities registered with the U.S. Securities and Exchange Commission or the appropriate federal banking agency under Section 12 of the Securities Exchange Act of 1934.

(5) *SEC* means the U.S. Securities and Exchange Commission.

(6) *SOX* means the Sarbanes-Oxley Act of 2002.

### **§ 363.2 Annual reporting requirements.**

(a) *Audited financial statements.* Each insured depository institution shall prepare annual financial statements in accordance with GAAP, which shall be audited by an independent public accountant. The annual financial statements must reflect all material correcting adjustments identified by the 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 that must contain the following:

(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 that are designated by the FDIC and the appropriate federal banking agency;

(2) An assessment by management of the insured depository institution's compliance with such laws and regulations during such fiscal year. The assessment must state

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management's conclusion as to whether the insured depository institution has complied with the designated safety and soundness laws and regulations during the fiscal year and disclose any noncompliance with these laws and regulations; and

(3) For an insured depository institution with consolidated 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 that must include the following:

(i) A statement identifying the internal control framework<sup>11</sup> used by management to evaluate the effectiveness of the insured depository institution's internal control over financial reporting;

(ii) A statement that the assessment included controls over the preparation of regulatory financial statements in accordance with regulatory reporting instructions including identification of such regulatory reporting instructions; and

(iii) A statement expressing management's conclusion as to whether the insured depository institution's internal control over financial reporting is effective. Management must disclose all material weaknesses in internal control over financial reporting, if any, that it has identified. Management is precluded from concluding that the insured depository institution's internal control over financial reporting is effective if there are one or more material weaknesses.

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<sup>11</sup> In the United States, the Committee of Sponsoring Organizations (COSO) of the Treadway Commission has published *Internal Control – Integrated Framework*, including an addendum on safeguarding assets. Known as the COSO report, this publication provides a suitable and available framework for purposes of management's assessment.

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(c) *Management report signatures.* Subject to the criteria specified in § 363.1(b):

(1) If the audited financial statements requirement specified in § 363.2(a) is satisfied at the insured depository institution level and the management report requirement specified in § 363.2(b) is satisfied in its entirety at the insured depository institution level, the management report must be signed by the chief executive officer and the chief accounting officer or chief financial officer of the insured depository institution;

(2) If the audited financial statements requirement specified in § 363.2(a) is satisfied at the holding company level and the management report requirement specified in § 363.2(b) is satisfied in its entirety at the holding company level, the management report must be signed by the chief executive officer and the chief accounting officer or chief financial officer of the holding company; and

(3) If the audited financial statements requirement specified in § 363.2(a) is satisfied at the holding company level and (a) the management report requirement specified in § 363.2(b) is satisfied in its entirety at the insured depository institution level or (b) one or more of the components of the management report specified in § 363.2(b) is satisfied at the holding company level and the remaining components of the management report are satisfied at the insured depository institution level, the management report must be signed by the chief executive officers and the chief accounting officers or chief financial officers of both the holding company and the insured depository institution and the management report must clearly indicate the level (institution or holding company) at which each of its components is being satisfied.

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### **§ 363.3 Independent public accountant.**

(a) *Annual audit of financial statements.* Each insured depository institution shall engage an independent public accountant to audit and report on its annual financial statements in accordance with GAAP 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 GAAP.

(b) *Internal control over financial reporting.* For each insured depository institution with total assets of \$1 billion or more at the beginning of the institution's fiscal year, the independent public accountant who audits the institution's financial statements shall examine, attest to, and report separately on, the assertion of management concerning the effectiveness of the institution's internal control structure and procedures for financial reporting. The attestation and report shall be made in accordance with generally accepted standards for attestation engagements or the PCAOB's auditing standards, if applicable. The accountant's report must not be dated prior to the date of the management report and management's assessment of the effectiveness of internal control over financial reporting. The accountant's report must include the following:

- (1) A statement identifying the internal control framework used by the independent public accountant, which must be the same as the internal control framework used by management, to evaluate the effectiveness of the insured depository institution's internal control over financial reporting;
- (2) A statement that the independent public accountant's evaluation included controls over the preparation of regulatory financial statements in accordance with regulatory

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reporting instructions including identification of such regulatory reporting instructions;  
and

(3) A statement expressing the independent public accountant's conclusion as to whether the insured depository institution's internal control over financial reporting is effective.

The report must disclose all material weaknesses in internal control over financial reporting that the independent public accountant has identified. The independent public accountant is precluded from concluding that the insured depository institution's internal control over financial reporting is effective if there are one or more material weaknesses.

(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. The written notice shall be filed at the place identified in § 363.4(f).

(d) *Communications with audit committee.* The independent public accountant must report the following on a timely basis to the audit committee:

- (1) all critical accounting policies used by the insured depository institution,
- (2) alternative accounting treatments the independent public accountant has discussed with management, and
- (3) other written communications the independent public accountant has provided to management, such as a management letter or schedule of unadjusted differences.

(e) *Retention of working papers.* The independent public accountant must retain the working papers related to the audit of the insured depository institution's financial



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statements and, if applicable, the evaluation of the institution's internal control over financial reporting for seven years, unless a longer period of time is required by law.

(f) *Independence.* The independent public accountant must comply with the independence standards and interpretations of the AICPA, the SEC, and the PCAOB.

(g) *Peer reviews.* (1) Prior to commencing any services for an insured depository institution under this part, the independent public accountant must have received a peer review, or be enrolled in a peer review program, that meets acceptable guidelines.

Acceptable peer reviews include peer reviews performed in accordance with the AICPA's Peer Review Standards and inspections conducted by the PCAOB.

(2) Within 15 days of receiving notification that a peer review has been accepted or a PCAOB inspection report has been issued, or before commencing any audit under this part, whichever is earlier, the independent public accountant must file two copies of the most recent peer review report and the most recent PCAOB inspection report, if any, accompanied by any letters of comments, response, and acceptance, with the FDIC, Accounting and Securities Disclosure Section, 550 17th Street NW., Washington, DC 20429, if the report has not already been filed. Except for the portions of any peer review report and inspection report determined to be nonpublic by the AICPA and the PCAOB, respectively, the report will be made available for public inspection by the FDIC.

### **§ 363.4 Filing and notice requirements.**

(a) *Part 363 Annual Report.* (1) 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 its Part 363 Annual Report. A Part 363 Annual Report must

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contain audited comparative annual financial statements, the independent public accountant's report thereon, a management report, and, if applicable, the independent public accountant's attestation report on management's assessment 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.

(2) Subject to the criteria specified in § 363.1(b), each insured depository institution with consolidated total assets of less than \$1 billion as of the beginning of its fiscal year that is required to file, or whose parent holding company is required to file, management's assessment of the effectiveness of internal control over financial reporting with the SEC or the appropriate federal banking agency in accordance with section 404 of SOX must submit a copy of such assessment to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor with its Part 363 Annual Report as additional information. This assessment will not be considered part of the institution's Part 363 Annual Report.

(3) (i) Each insured depository institution that is neither a public company nor a subsidiary of a public company that meets the criterion specified in § 363.1(b)(1) shall file its Part 363 Annual Report within 120 days after the end of its fiscal year.

(ii) Each insured depository institution that is a public company or a subsidiary of public company that meets the criterion specified in § 363.1(b)(1) shall file its Part 363 Annual Report within 90 days after the end of its fiscal year.

(b) *Public availability.* The annual report in paragraph (a)(1) of this section shall be available for public inspection.

(c) *Independent public accountant's letters and reports.* (1) Except for the independent

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public accountant's reports that are included in its Part 363 Annual Report, 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 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.

Such reports include, but are not limited to:

- (i) any written communication regarding matters that are required to be communicated to the audit committee (for example, critical accounting policies, alternative accounting treatments discussed with management, and any schedule of unadjusted differences),
- (ii) any written communication of significant deficiencies and material weaknesses in internal control required by the AICPA's or the PCAOB's auditing standards;
- (iii) for institutions with total assets of less than \$1 billion as of the beginning of their fiscal year that are public companies or subsidiaries of public companies that meet the criterion specified in § 363.1(b)(1), any independent public accountant's report on the audit of internal control over financial reporting required by section 404 of SOX and the PCAOB's auditing standards; and
- (iv) for all institutions that are public companies or subsidiaries of public companies that meet the criterion specified in § 363.1(b)(1), any independent public accountant's written communication of all deficiencies in internal control over financial reporting that are of a lesser magnitude than significant deficiencies required by the PCAOB's auditing standards.

(2) Each insured depository institution shall file with the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor, a copy of any audit

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engagement letter, including any related agreements and amendments, within 15 days of acceptance by the institution.

(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 resignation or dismissal in reasonable detail.

(e) *Notification of late filing.* No extensions of time for filing reports required by § 363.4 shall be granted. An insured depository institution that is unable to timely file all or any portion of its Part 363 Annual Report or any other report or notice required by § 363.4 shall submit a written notice of late filing to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor. The notice shall disclose the institution's inability to timely file all or specified portions of its Part 363 Annual Report or any other report or notice and the reasons therefore in reasonable detail. The late filing notice shall also state the date when the report or notice will be filed. The written notice shall be filed on or before the deadline for filing the Part 363 Annual Report or any other report or notice, as appropriate.

(f) *Place for filing.* The Part 363 Annual Report, any written notification of late filing, and any other report or notice required by § 363.4 should be filed as follows:

(1) FDIC: Appropriate FDIC Regional or Area Office (Division of 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

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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.

(2) Office of the Comptroller of the Currency (OCC): Appropriate OCC Supervisory Office.

(3) Federal Reserve: Appropriate Federal Reserve Bank.

(4) Office of Thrift Supervision (OTS): Appropriate OTS District Office.

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

### **§ 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. The duties of the audit committee shall include the appointment, compensation, and oversight of the independent public accountant who performs services required under this part, and 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

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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's audit committee shall not include any members who are large customers of the subsidiary institution.

(c) *Independent public accountant engagement letters.* (1) In performing its duties with respect to the appointment of the institution's independent public accountant, the audit committee shall ensure that engagement letters and any related agreements with the independent public accountant for services to be performed under this part do not contain any limitation of liability provisions that:

(i) Indemnify the independent public accountant against claims made by third parties;

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(ii) Hold harmless or release the independent public accountant from liability for claims or potential claims that might be asserted by the client insured depository institution, other than claims for punitive damages; or

(iii) Limit the remedies available to the client insured depository institution.

(2) Alternative dispute resolution agreements and jury trial waiver provisions are not precluded provided that they do not incorporate any limitation of liability provisions set forth in paragraph (c)(1) of this section.

### **Appendix A to Part 363 – Guidelines and Interpretations**

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## **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.

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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

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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 that are submitted by a holding company for any subsidiary institution should be accompanied by a cover letter identifying all subsidiary institutions subject to part 363 that are included in the holding company's submission. When submitting a Part 363 Annual Report, the cover letter should identify all subsidiary institutions subject to part 363 included in the consolidated financial statements and state whether the other annual report requirements (i.e., management's statement of responsibilities, management's assessment of compliance with designated safety and soundness laws and regulations, and, if applicable,

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management's assessment of the effectiveness of internal control over financial reporting and the independent public accountant's attestation report on management's internal control assessment) are being satisfied for these institutions at the holding company level or at the institution level. An institution filing holding company consolidated financial statements as permitted by § 363.1(b)(1) also may report on changes in its independent public accountant on a holding company basis. An institution that does not meet the criteria in § 363.1(b)(2) must satisfy the remaining provisions of this part on an individual institution basis and maintain its own audit committee. Subject to the criteria in §§ 363.1(b)(1) and (2), a multi-tiered holding company may satisfy all of the requirements of this part at the top-tier or any mid-tier holding company 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 management's assessment of compliance with the Designated Laws defined in guideline 12 and, if applicable, management's assessment of the effectiveness of internal control over financial reporting based on information concerning the relevant activities and operations of those subsidiary institutions within the scope of the Rule.

4A. *Financial Reporting.* (a) For purposes of this part, "financial reporting" includes financial statements prepared under GAAP and those prepared for regulatory reporting

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purposes. Financial statements prepared for regulatory reporting purposes consist of the schedules equivalent to the basic financial statements that are included in an institution's appropriate regulatory report, e.g., the bank Consolidated Reports of Condition and Income (Call Report) and the Thrift Financial Report (TFR).

(b) Financial statements prepared for regulatory reporting purposes do not include regulatory reports prepared by a non-bank subsidiary of a holding company or an institution. For example, if a bank holding company or an insured depository institution owns an insurance subsidiary, financial statements prepared for regulatory reporting purposes would not include any regulatory reports that the insurance subsidiary is required to submit to its appropriate insurance regulatory agency.

### **Annual Reporting Requirements (§ 363.2)**

5. *Annual Financial Statements.* Each institution should prepare comparative annual consolidated financial statements (balance sheets and statements of income, changes in equity capital, and cash flows, with accompanying footnote disclosures) in accordance with 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.

5A. *Institutions Merged Out of Existence.* An institution that is merged out of existence after the end of its fiscal year, but before the deadline for filing its Part 363 Annual Report (120 days after the end of its fiscal year for an institution that is neither a public company nor a subsidiary of a public company that meets the criterion specified in

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§ 363.1(b)(1), and 90 days after the end of its fiscal year for an institution that is a public company or a subsidiary of public company that meets the criterion specified in § 363.1(b)(1)), is not required to file a Part 363 Annual Report for the last fiscal year of its existence.

6. *Holding Company Statements.* Subject to the criterion specified in § 363.1(b)(1), subsidiary institutions may file copies of their holding company's audited financial statements filed with the SEC or prepared for their FR Y-6 Annual Report under the Bank Holding Company Act of 1956 to satisfy the audited financial statements requirement of § 363.2(a).

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:

(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

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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.

*8A. Management's Assessment of the Effectiveness of Internal Control over Financial Reporting.* An institution with \$1 billion or more in total assets as of the beginning of its fiscal year that is subject to both part 363 and the SEC's rules implementing section 404 of SOX (as well as a public holding company permitted under the holding company exception in § 363.1(b)(2) to file an internal control report on behalf of a subsidiary institution or institutions with \$1 billion or more in total assets) can choose either of the following two options for filing management's report on internal control over financial reporting.

- (i) Management can prepare two separate reports on the institution's or the holding company's internal control over financial reporting to satisfy the FDIC's part 363 requirements and the SEC's section 404 requirements; or
- (ii) Management can prepare a single report on internal control over financial reporting provided that it satisfies all of the FDIC's part 363 requirements and all of the SEC's section 404 requirements.

*8B. Internal Control Reports for Acquired Businesses.* Generally, the FDIC expects management's and the related independent public accountant's report on an institution's internal control over financial reporting to include controls at an institution in its entirety, including all of its consolidated entities. However, it may not always be possible for

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management to conduct an assessment of the internal control over financial reporting of an acquired business in the period between the consummation date of the acquisition and the due date of management's internal control assessment.

(a) In such instances, the acquired business's internal control structure and procedures for financial reporting may be excluded from management's assessment report and the accountant's attestation report on internal control over financial reporting. However, the FDIC expects management's assessment report to identify the acquired business, state that the acquired business is excluded, and indicate the significance of this business to the institution's consolidated financial statements. Notwithstanding management's exclusion of the acquired business's internal control from its assessment, management should disclose any material change to the institution's internal control over financial reporting due to the acquisition of this business. Also, management may not omit the assessment of the acquired business's internal control from more than one annual part 363 assessment report on internal control over financial reporting. When the acquired business's internal control over financial reporting is excluded from management's assessment, the independent public accountant may likewise exclude this acquired business's internal control over financial reporting from the accountant's evaluation of internal control over financial reporting.

(b) If the acquired business is or has a consolidated subsidiary that is an insured depository institution subject to part 363 and the institution is not merged out of existence before the deadline for filing its Part 363 Annual Report (120 days after the end of its fiscal year for an institution that is neither a public company nor a subsidiary of a public company that meets the criterion specified in § 363.1(b)(1), and 90 days after the end of



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its fiscal year for an institution that is a public company or a subsidiary of public company that meets the criterion specified in § 363.1(b)(1)), the acquired institution must continue to comply with all of the applicable requirements of part 363, including filing its Part 363 Annual Report.

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 and auditing 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.<sup>12</sup>

10. *Standards for Internal Control.* The management of each insured depository institution with \$1 billion or more in total assets as of the beginning of its fiscal year should base its assessment of the effectiveness of the institution’s internal control over financial reporting on a suitable, recognized control framework established by a body of experts that followed due-process procedures, including the broad distribution of the

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<sup>12</sup> It 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.

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framework for public comment. In addition to being available to users of management's reports, a framework is suitable only when it:

- Is free from bias;
- Permits reasonably consistent qualitative and quantitative measurements of an insured depository institution's internal control over financial reporting;
- Is sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of an insured depository institution's internal control over financial reporting are not omitted; and
- Is relevant to an evaluation of internal control over financial reporting.

In the United States, *Internal Control – Integrated Framework*, including its addendum on safeguarding assets, which was published by the Committee of Sponsoring Organizations of the Treadway Commission, and is known as the COSO report, provides a suitable and recognized framework for purposes of management's assessment. Other suitable frameworks have been published in other countries or may be developed in the future. Such other suitable frameworks may be used by management and the institution's independent public accountant in assessments, attestations, and audits of internal control over financial reporting.

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.

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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 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 working papers, policies, and procedures relating to services performed under this part.

14. [Reserved.]

15. *Peer Review 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 (other than a PCAOB inspection) should be generally consistent with AICPA Peer Review Standards; and
- (c) The review should include, if available, at least one audit on an insured depository institution or consolidated depository institution holding company.

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16. [Reserved.]

17. *Information to be Provided to the 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 and Management Report.* The independent public accountant should provide the institution with any management letter and, if applicable, an internal control attestation report (as required by section 36(c)(1)) at the conclusion of the audit. The independent public accountant's attestation report on internal control over financial reporting must specifically include a statement as to regulatory reporting. 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 of termination 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

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discloses all relevant reasons for the accountant's termination. Subject to the criteria specified in § 363.1(b)(1) regarding compliance with the audited financial statements requirement at the holding company level, the independent public accountant for an insured depository institution that is a public company and files reports with its appropriate federal banking agency, or is a subsidiary of a public company that files reports with the SEC, may submit the letter it furnished to management to be filed with the institution's or the holding company's current report (*e.g.*, SEC Form 8-K) concerning a change in accountant to satisfy the notice requirements of § 363.3(c).

Alternatively, if the independent public accountant confirms that management has filed a current report (*e.g.*, SEC Form 8-K) concerning a change in accountant that satisfies the notice requirements of § 363.4(d) and includes an independent public accountant's letter that satisfies the requirements of § 363.3(c), the independent public accountant may rely on the current report (*e.g.*, SEC Form 8-K) filed with the FDIC by management concerning a change in accountant to satisfy the notice requirements of § 363.3(c).

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.

### **Filing and Notice Requirements (§ 363.4)**

22. [Reserved.]

23. *Notification of Late Filing.* (a) An institution's submission of a written notice of late filing does not cure the requirement to timely file the Part 363 Annual Report or other

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reports or notices required by § 363.4. An institution's failure to timely file is considered an apparent violation of part 363.

(b) If the late filing notice submitted pursuant to § 363.4(e) relates only to a portion of a Part 363 Annual Report or any other report or notice, the insured depository institution should file the other components of the report or notice within the prescribed filing period together with a cover letter that indicates which components of its Part 363 Annual Report or other report or notice are omitted. An institution may combine the written late filing notice and the cover letter into a single notice that is submitted together with the other components of the report or notice that are being timely filed.

24. *Public Availability.* Each institution's Part 363 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 Part 363 Annual Report to any person who requests it. The Part 363 Annual Report should remain available to the public until the Part 363 Annual Report for the next year is available. An institution may use its Part 363 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. [Reserved.]

26. *Notices Concerning Accountants.* With respect to any selection, change, or termination of an independent public accountant, an institution's management and audit committee should be familiar with the notice requirements in § 363.4(d) and guideline 20, and management should send a copy of any notice required under § 363.4(d) to the independent public accountant when it is filed with the FDIC. An insured depository

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institution that is a public company and files reports required under the federal securities laws with its appropriate federal banking agency, or is a subsidiary of a public company that files such reports with the SEC, may use its current report (*e.g.*, SEC Form 8-K) concerning a change in accountant to satisfy the notice requirements of § 363.4(d) subject to the criterion of § 363.1(b)(1) regarding compliance with the audited financial statements requirement at the holding company level.

### **Audit Committees (§ 363.5)**

*27. Composition.* The board of directors of each institution should determine whether each existing or potential audit committee member meets the requirements of section 36 and this part. To do so, the board of directors should maintain an approved set of written criteria for determining whether a director who is to serve on the audit committee is an outside director (as defined in § 363.5(a)(3)) and is independent of management. At least annually, the board of each institution should apply these criteria and determine whether each existing or potential audit committee member is an outside director. In addition, 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.” The minutes of the board of directors should contain the results of and the basis for its determinations with respect to each existing and potential audit committee member.

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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.* It is not possible to anticipate, or explicitly provide for, all circumstances that might signal potential conflicts of interest in, or that might bear on, an outside director's relationship to an insured depository institution and whether the outside director should be deemed “independent of management.” When assessing an outside director's relationship with an institution, the board of directors should consider the issue not merely from the standpoint of the director himself or herself, but also from the standpoint of persons or organizations with which the director has an affiliation. These relationships can include, but are not limited to, commercial, banking, consulting, charitable, and family relationships. The board of directors should apply its approved set of written criteria for determining whether existing and potential members of the audit committee are outside directors and whether they are “independent of management.” To assist boards of directors in fulfilling this requirement, paragraphs (a) through (d) of this guideline provide guidance for determining whether audit committee members are “independent of management.”

(a) Notwithstanding the criteria set forth in paragraphs (b), (c), and (d) of this guideline, if an outside director, either directly or indirectly, owns or controls, or has owned or controlled within the preceding fiscal year, 10 percent or more of any outstanding class of



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voting securities of the institution, the outside director will not be considered “independent of management.”

(b) The following list sets forth additional criteria, that, at a minimum, a board of directors should consider when determining whether an outside director is “independent of management.” The board of directors may conclude that additional criteria are also relevant to this determination in light of the particular circumstances of its institution.

Accordingly, an outside director will not be considered “independent of management” if:

- (1) The director serves, or has served within the last three years, as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of or to the institution or its affiliates.
- (2) The director has been, within the last three years, an employee of the institution or any of its affiliates or an immediate family member is, or has been within the last three years, an executive officer of the institution or any of its affiliates.
- (3) The director has participated in the preparation of the financial statements of the institution or any of its affiliates at any time during the last three years.
- (4) The director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$60,000 in direct or indirect compensation from the institution or any of its affiliates other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service). Direct compensation also would not include compensation received by the director for former service as an interim chairman or interim chief executive officer. Indirect compensation includes payments to spouses and children as well as organizations that provide financial

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services to the institution or any of its affiliates in which the director is a partner or principal.

(5) The director or an immediate family member is a current partner of a firm that performs internal or external auditing services for the institution or any of its affiliates; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance, or tax compliance practice; or the director or an immediate family member was within the last three years (but no longer is) a partner or employee of such a firm and personally worked on the audit of the insured depository institution or any of its affiliates within that time.

(6) The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another entity where any of the present executive officers of the institution or any of its affiliates at the same time serves or served on that entity's compensation committee.

(7) The director is a current employee, or an immediate family member is a current executive officer, of an entity that has made payments to, or received payments from, the institution or any of its affiliates for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$200 thousand, or 5 percent of such entity's consolidated gross revenues. This would include payments made by the institution or any of its affiliates to not-for-profit entities where the director is an executive officer or where an immediate family member of the director is an executive officer.

(8) For purposes of paragraph (b) of this guideline, the following definitions apply:

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- (i) An “immediate family member” includes a person’s spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person’s home.
- (ii) The term affiliate of, or a person affiliated with, a specified person, means a person or entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
- (c) An insured depository institution that is a public company and a listed issuer (as defined in Rule 10A-3 of the Securities Exchange Act of 1934 (Exchange Act)), or is a subsidiary of a public company that meets the criterion specified in § 363.1(b)(1) and is a listed issuer, may use the definition of audit committee member independence set forth in the listing standards applicable to the public institution or its public company parent.
- (d) All other insured depository institutions may use the definition of audit committee member independence set forth in the listing standards of a national securities exchange that is registered with the SEC pursuant to section 6 of the Exchange Act or a national securities association that is registered with the SEC pursuant to section 15A(a) of the Exchange Act.

29. [Reserved.]

30. *Holding Company Audit Committees.* (a) When an insured depository institution satisfies the requirements for the holding company exception specified in §§ 363.1(b)(1) and (2), the audit committee requirement of this part may be satisfied by the audit committee of the top-tier or any mid-tier holding company. Members of the audit committee of the holding company should meet all the membership requirements applicable to the largest subsidiary depository institution subject to part 363 and should

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perform all the duties of the audit committee of a subsidiary institution subject to part 363, even if the holding company directors are not directors of the institution.

(b) When an insured depository institution subsidiary with total assets of \$1 billion or more as of the beginning of its fiscal year does not meet the requirements for the holding company exception specified in §§ 363.1(b)(1) and (2) or maintains its own separate audit committee to satisfy the requirements of this part, the members of the audit committee of the top-tier or any mid-tier holding company may serve on the audit committee of the subsidiary institution if they are otherwise independent of management of the subsidiary institution, and, if applicable, meet any other requirements for a large subsidiary institution covered by this part.

(c) When an insured depository institution with total assets of \$500 million or more but less than \$1 billion as of the beginning of its fiscal year does not meet the requirements for the holding company exception specified in §§ 363.1(b)(1) and (2) or maintains its own separate audit committee to satisfy the requirements of this part, the members of the audit committee of the top-tier or any mid-tier holding company may serve on the audit committee of the subsidiary institution provided a majority of its audit committee members are independent of management of the subsidiary institution.

(d) Officers and employees of a top-tier or any mid-tier holding company may not serve on the audit committee of its subsidiary institutions.

31. *Duties.* The audit committee should perform all duties determined by the institution's board of directors and it should maintain minutes and other relevant records of its meetings and decisions. The duties of the audit committee should be appropriate to the size of the institution and the complexity of its operations, and, at a minimum, should

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include (1) the appointment, compensation, and oversight of the independent public accountant; (2) 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); (3) reviewing and satisfying itself as to the independent public accountant's compliance with the required qualifications for independent public accountants set forth in §§ 363.3(f) and (g) and guidelines 13 through 16; (4) ensuring that audit engagement letters comply with the provisions of § 363.5(c) before engaging an independent public accountant; (5) being familiar with the notice requirements in § 363.4(d) and guideline 20 regarding the selection, change, or termination of an independent public accountant; and (6) ensuring that management sends a copy of any notice required under § 363.4(d) to the independent public accountant when it is filed with the FDIC. 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 effectiveness of internal control over financial reporting, and the resolution of identified material weaknesses and significant deficiencies in internal control over financial reporting, including the prevention or detection of management override or compromise of the internal control system;
- (c) Reviewing with management the institution's compliance with the designated laws and regulations identified in guideline 12;

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(d) Discussing with management and the independent public accountant any significant disagreements between management and the independent public accountant; and

(e) Overseeing the internal audit function.

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

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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. Transition Period for Forming and Restructuring Audit Committees.*

(a) When an insured depository institution's total assets at the beginning of its fiscal year are \$500 million or more for the first time and it thereby becomes subject to part 363, no regulatory action will be taken if the institution forms or restructures its audit committee to comply with § 363.5(a)(2) by the end of that fiscal year.

(b) When an insured depository institution's total assets at the beginning of its fiscal year are \$1 billion or more for the first time, no regulatory action will be taken if the institution forms or restructures its audit committee to comply with § 363.5(a)(1) by the end of that fiscal year, provided that the composition of its audit committee meets the requirements specified in § 363.5(a)(2) at the beginning of that fiscal year, if such requirements were applicable.

(c) When an insured depository institution's total assets at the beginning of its fiscal year are \$3 billion or more for the first time, no regulatory action will be taken if the institution forms or restructures its audit committee to comply with § 363.5(b) by the end of that fiscal year, provided that the composition of its audit committee meets the requirements specified in § 363.5(a)(1) at the beginning of that fiscal year, if such requirements were applicable.

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### 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 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					
		<b>National banks</b>	<b>State member banks</b>	<b>State non-member banks</b>	<b>Savings associations</b>
<b>Insider Loans—Parts and/or Sections of Title 12 of the United States Code</b>					
375a	Loans to Executive Officers of Banks	√	√	(A)	(A)
375b	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Banks	√	√	(A)	(A)
1468(b)	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders				√
1828(j)(2)	Extensions of Credit to Officers, Directors, and Principal Shareholders			√	
1828(j)(3)(B)	Extensions of Credit to Officers, Directors, and Principal Shareholders	(B)		(C)	



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<b>Parts and/or Sections of Title 12 of the Code of Federal Regulations</b>					
31	Extensions of Credit to Insiders	√			
32	Lending Limits	√			
215	Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks	√	√	(D)	(E)
337.3	Limits on Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Insured Nonmember Banks			√	
563.43	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders				√
<b>Dividend Restrictions--Parts and/or Sections of Title 12 of the United States Code</b>					
56	Prohibition on Withdrawal of Capital and Unearned Dividends	√	√		
60	Dividends and Surplus Fund	√	√		
1467a(f)	Declaration of Dividend				√
1831o(d)(1)	Prompt Corrective Action - Capital Distributions Restricted	√	√	√	√
<b>Parts and/or Sections of Title 12 of the Code of Federal Regulations</b>					
5 Subpart E	Payment of Dividends	√			
6.6	Prompt Corrective Action - Restrictions on Undercapitalized Institutions	√			
208.5	Dividends and Other Distributions		√		
208.45	Prompt Corrective Action - Restrictions on Undercapitalized Institutions		√		
325.105	Prompt Corrective Action - Restrictions on Undercapitalized Institutions			√	

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563 Subpart E	Capital Distributions				√
565.6	Prompt Corrective Action - Restrictions on Undercapitalized Institutions				√

- A. Subsections (g) and (h) of section 22 of the Federal Reserve Act [12 U.S.C. 375a, 375b]
- B. Applies only to insured federal branches of foreign banks.
- C. Applies only to insured state branches of foreign banks.
- D. See 12 CFR § 337.3.
- E. See 12 CFR § 563.43.

### **Appendix B to Part 363 – Illustrative Management Reports**

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1. General
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Responsibilities, Management’s Assessment of Compliance with Laws and  
Regulations, and Management’s Assessment of the Effectiveness of Internal Control  
Over Financial Reporting
7. Illustrative Cover Letter – Compliance by Holding Company Subsidiaries

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1. *General.* The reporting scenarios, illustrative management reports, and the cover letter (when complying at the holding company level) in Appendix B to part 363 are intended to assist managements of insured depository institutions in complying with the annual reporting requirements of § 363.2 and guideline 3, *Compliance by Holding Company Subsidiaries*, of Appendix A to part 363. However, use of the wording in the illustrative management reports and cover letter is not required. The managements of insured depository institutions are encouraged to tailor their management reports and cover letters to fit their particular circumstances and avoid the use of “boilerplate” language. Terms that are not explained in Appendix B have the meanings given them in part 363, the FDI Act, or professional accounting and auditing literature. Instructions to the preparer of the management reports are shown in brackets within the illustrative reports.

### 2. *Reporting Scenarios for Institutions that are Holding Company Subsidiaries .*

(a) Subject to the criteria specified in § 363.1(b), an insured depository institution that is a subsidiary of a holding company has flexibility in satisfying the reporting requirements of part 363. When reporting at the holding company level, the management report should identify those subsidiary institutions that are subject to part 363 and the extent to which they are included in the scope of the management report. The following reporting scenarios reflect how an insured depository institution that meets the criteria set forth in § 363.1(b) could satisfy the annual reporting requirements of § 363.2. Other reporting scenarios are possible.

(i) An institution that is a subsidiary of a holding company may satisfy the requirements for audited financial statements, management’s statement of responsibilities,

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management's assessment of the institution's compliance with laws and regulations, management's assessment of the effectiveness of internal control over financial reporting (if applicable), and the independent public accountant's attestation on management's assertion as to the effectiveness of internal control over financial reporting (if applicable) at the insured depository institution level.

(ii) An institution that is a subsidiary of a holding company may satisfy the requirements for audited financial statements, management's statement of responsibilities, management's assessment of the institution's compliance with laws and regulations, management's assessment of the effectiveness of internal control over financial reporting (if applicable), and the independent public accountant's attestation on management's assertion as to the effectiveness of internal control over financial reporting (if applicable) at the holding company level.

(iii) An institution that is a subsidiary of a holding company may satisfy the requirement for audited financial statements at the holding company level and may satisfy the requirements for management's statement of responsibilities, management's assessment of the institution's compliance with laws and regulations, management's assessment of the effectiveness of internal control over financial reporting (if applicable), and the independent public accountant's attestation on management's assertion as to the effectiveness of internal control over financial reporting (if applicable) at the insured depository institution level.

(iv) An institution that is a subsidiary of a holding company may satisfy the requirements for audited financial statements, management's statement of responsibilities, and management's assessment of the institution's compliance with laws and regulations at the

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insured depository institution level and may satisfy the requirements for the assessment by management of the effectiveness of internal control over financial reporting (if applicable), and the independent public accountant's attestation on management's assertion as to the effectiveness of internal control over financial reporting (if applicable) at the holding company level.

(b) For an institution with total assets of \$1 billion or more as of the beginning of its fiscal year, the assessment by management of the effectiveness of internal control over financial reporting and the independent public accountant's attestation on management's assertion as to the effectiveness of internal control over financial reporting (if applicable) must both be performed at the same level, i.e., either at the insured depository institution level or at the holding company level.

(c) Financial statements prepared for regulatory reporting purposes encompass the schedules equivalent to the basic financial statements in an institution's appropriate regulatory report, e.g., the bank Consolidated Reports of Condition and Income (Call Report) and the Thrift Financial Report (TFR). When internal control assessments and attestations are performed at the holding company level, the FDIC believes that holding companies have flexibility in interpreting "financial reporting" as it relates to "regulatory reporting" and has not objected to several reporting approaches employed by holding companies to cover "regulatory reporting." Certain holding companies have had management's assessment and the accountant's attestation cover the schedules equivalent to the basic financial statements that are included in the appropriate regulatory report, e.g., Call Report and the TFR, of each subsidiary institution subject to part 363. Other holding companies have had management's assessment and the accountant's attestation

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cover the schedules equivalent to the basic financial statements that are included in the holding company's year-end regulatory report (FR Y-9C report) to the Federal Reserve Board.

3. *Illustrative Management Report – Statement of Management's Responsibilities.* The following illustrative statements of management's responsibilities satisfy the requirements of § 363.2(b)(1).

(a) Statement Made at Insured Depository Institution Level

To: The Board of Directors and Audit Committee

ABC Depository Institution

Re: Statement of Management's Responsibilities

The management of ABC Depository Institution (the "Institution") is responsible for preparing the Institution's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions]; and for complying with laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable].

ABC Depository Institution

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\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(b) Statement Made at Holding Company Level

To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Statement of Management's Responsibilities

The management of BCD Holding Company (the "Company") is responsible for preparing the Company's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions]; and for complying with laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable]. The following subsidiary institutions of the Company that are subject to Part 363 are included in the scope of this management report: [Identify the subsidiary institutions.]

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BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

*4. Illustrative Management Report – Management’s Assessment of Compliance with Laws and Regulations.* The following illustrative reports of management’s assessment of compliance with laws and regulations satisfy the requirements of § 363.2(b)(2).

(a) Statement Made at Insured Depository Institution Level – Compliance

To: The Board of Directors and Audit Committee

ABC Depository Institution

Re: Management’s Assessment of Compliance with Laws and Regulations

The management of ABC Depository Institution (the “Institution”) has assessed the Institution’s compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. Based upon its assessment, management has concluded that the Institution complied with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX.



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ABC Depository Institution

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(b) Statement Made at Insured Depository Institution Level – Noncompliance

To: The Board of Directors and Audit Committee

ABC Depository Institution

Re: Management’s Assessment of Compliance with Laws and Regulations

The management of ABC Depository Institution (the “Institution”) has assessed the Institution’s compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. Because of the noncompliance during the fiscal year that ended on December 31, 20XX, with the laws and regulations relating to safety and soundness noted below, management has determined that the Institution did not comply with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX.

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[Identify and describe the instance or instances of noncompliance with the laws and regulations relating to safety and soundness.]

ABC Depository Institution

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(c) Statement Made at Holding Company Level – Compliance

To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Management’s Assessment of Compliance with Laws and Regulations

The management of BCD Holding Company (the “Company”) has assessed the Company’s compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. Based upon its assessment, management has concluded that the Company complied with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. The following subsidiary institutions of the Company that are

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subject to Part 363 are included in the scope of management’s assessment of compliance with laws and regulations: [Identify the subsidiary institutions.]

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(d) Statement Made at Holding Company Level – Noncompliance

To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Management’s Assessment of Compliance with Laws and Regulations

The management of BCD Holding Company (the “Company”) has assessed the Company’s compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. The following subsidiary institutions of the Company that are subject to Part 363 are included in the scope of management’s assessment of compliance with laws and regulations: [Identify the subsidiary institutions.]

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Because of the noncompliance during the fiscal year that ended on December 31, 20XX, with the laws and regulations relating to safety and soundness noted below, management has determined that the Company did not comply with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX.

[Identify and describe the instance or instances of noncompliance with the laws and regulations relating to safety and soundness.]

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

*5. Illustrative Management Report – Management’s Assessment of Internal Control Over Financial Reporting.* The following illustrative reports of management’s assessment of internal control over financial reporting satisfy the requirements of § 363.2(b)(3).

(a) Statement Made at Insured Depository Institution Level – No Material Weaknesses

To: The Board of Directors and Audit Committee

ABC Depository Institution

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Re: Management's Assessment of Internal Control Over Financial Reporting

ABC Depository Institution's (the "Institution") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Institution; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Institution are being made only in accordance with authorizations of management and directors of the Institution; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Institution's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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Management assessed the effectiveness of the Institution’s internal control over financial reporting, including controls over preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on that assessment, management concluded that, as of December 31, 20XX, the Institution’s internal control over financial reporting, including controls over preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], is effective based on the criteria established in Internal Control – Integrated Framework.

Management’s assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

ABC Depository Institution

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

## Draft Draft Draft

(b) Statement Made at Insured Depository Institution Level – One or More Material Weaknesses

To: The Board of Directors and Audit Committee

ABC Depository Institution

Re: Management's Assessment of Internal Control Over Financial Reporting

ABC Depository Institution's (the "Institution") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Institution; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Institution are being made only in accordance with authorizations of management and directors of the Institution; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Institution's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Because of the material weakness (or weaknesses) noted below, management determined that the Institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], was not effective as of December 31, 20XX.

[Identify and describe the material weakness or weaknesses.]

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting



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instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

ABC Depository Institution

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(c) Statement Made at Holding Company Level – No Material Weaknesses

To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Management's Assessment of Internal Control Over Financial Reporting

BCD Holding Company's (the "Company") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of

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financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on that assessment, management concluded that, as of December 31, 20XX, the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], is effective based on the criteria established in Internal Control – Integrated Framework.

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The following subsidiary institutions of the Company that are subject to Part 363 are included in the scope of this assessment of internal control over financial reporting:

[Identify the subsidiary institutions.]

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(d) Statement Made at Holding Company Level – One or More Material Weaknesses

To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Management's Assessment of Internal Control Over Financial Reporting

BCD Holding Company's (the "Company") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial

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reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting

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instructions], as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Because of the material weakness (or weaknesses) noted below, management determined that the Company’s internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], was not effective as of December 31, 20XX. The following subsidiary institutions of the Company that are subject to Part 363 are included in the scope of this assessment of internal control over financial reporting: [Identify the subsidiary institutions.]

[Identify and describe the material weakness or weaknesses.]

Management’s assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

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Date: \_\_\_\_\_

\_\_\_\_\_  
Jane Doe, Chief Financial Officer

*6. Illustrative Management Report – Combined Statement of Management’s Responsibilities, Management’s Assessment of Compliance with Laws and Regulations, and Management’s Assessment of the Effectiveness of Internal Control Over Financial Reporting*, if applicable. The following illustrative management reports satisfy the requirements of §§ 363.2(b)(1), (2), and (3).

(a) Management Report Made at Insured Depository Institution Level – Compliance with Laws and Regulations and No Material Weaknesses in Internal Control Over Financial Reporting

To: The Board of Directors and Audit Committee

ABC Depository Institution

Re: Management Report

## Statement of Management’s Responsibilities

The management of ABC Depository Institution (the “Institution”) is responsible for preparing the Institution’s annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the

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preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions]; and for complying with laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable].

### Management's Assessment of Compliance with Laws and Regulations

Management of ABC Depository Institution (the "Institution") has assessed the Institution's compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. Based upon its assessment, management has concluded that the Institution complied with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency (specify the appropriate federal banking agency, if applicable) during the fiscal year that ended on December 31, 20XX.

### Management's Assessment of Internal Control Over Financial Reporting

ABC Depository Institution's (the "Institution") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting

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principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Institution; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Institution are being made only in accordance with authorizations of management and directors of the Institution; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Institution's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, based on the framework set forth by the



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Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on that assessment, management concluded that, as of December 31, 20XX, the Institution’s internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], is effective based on the criteria established in Internal Control – Integrated Framework.

Management’s assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

ABC Depository Institution

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

(b) Management Report Made at Holding Company Level – Compliance with Laws and Regulations and No Material Weaknesses in Internal Control Over Financial Reporting

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To: The Board of Directors and Audit Committee

BCD Holding Company

Re: Management Report

### Statement of Management's Responsibilities

The management of BCD Holding Company (the "Company") is responsible for preparing the Company's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions]; and for complying with laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable]. The following subsidiary institutions of the Company that are subject to Part 363 are included in the scope of this management report, management's assessment of compliance with laws and regulations, and management's assessment of internal control over financial reporting: [Identify the subsidiary institutions.]

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### Management's Assessment of Compliance with Laws and Regulations

Management of BCD Holding Company (the "Company") has assessed the Company's compliance with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify the appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX. Based upon its assessment, management has concluded that the Company complied with the laws and regulations relating to safety and soundness that are designated by the FDIC and the appropriate federal banking agency [specify appropriate federal banking agency, if applicable] during the fiscal year that ended on December 31, 20XX.

### Management's Assessment of Internal Control Over Financial Reporting

BCD Holding Company's (the "Company") internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, including those prepared for regulatory reporting purposes [specify the regulatory reports]. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of

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financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on that assessment, management concluded that, as of December 31, 20XX, the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], is effective based on the criteria established in Internal Control – Integrated Framework.

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Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for regulatory reporting [specify the regulatory reporting instructions], as of December 31, 20XX, has been audited by [name of auditing firm], an independent public accounting firm, as stated in their report dated March XX, 20XX.

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

John Doe, Chief Executive Officer

\_\_\_\_\_

Date: \_\_\_\_\_

Jane Doe, Chief Financial Officer

*7. Illustrative Cover Letter – Compliance by Holding Company Subsidiaries.* The following illustrative cover letter satisfies the requirements of guideline 3, *Compliance by Holding Company Subsidiaries*, of Appendix A to part 363.

To: (Appropriate FDIC Regional or Area Office)

Division of Supervision and Consumer Protection, FDIC, and

(Appropriate District or Regional Office of the Primary Federal Regulator(s), if not the FDIC), and

(Appropriate State Bank Supervisor(s), if applicable)

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Dear [Insert addressees]:

BCD Holding Company (the “Company”) is filing two copies of the Part 363 Annual Report for the fiscal year ended December 31, 20XX, on behalf of its insured depository institution subsidiaries listed in the chart below that are subject to Part 363. The Part 363 Annual Report contains audited comparative annual financial statements, the independent public accountant’s report on the audited financial statements, management’s statement of responsibilities, management’s assessment of compliance with laws and regulations, and [if applicable] management’s assessment of and the independent public accountant’s attestation report on internal controls over financial reporting. The chart below also indicates the level (institution or holding company) at which the requirements of Part 363 are being satisfied. The Company’s insured depository institution subsidiary that complies with all of the Part 363 annual reporting requirements at the institution level has filed [or will file] its Part 363 Annual Report separately.

Institutions Subject to Part 363	Audited Financial Statements	Management’s Statement of Responsibilities	Management’s Assessment of Compliance with Laws and Regulations	Management’s Internal Control Assessment	Independent Auditor’s Internal Control Attestation Report
ABC Depository Institution	HC Level	HC Level	HC Level	HC Level	HC Level
DEF Depository Institution	HC Level	Institution Level	Institution Level	Institution Level	Institution Level

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If you have any questions regarding the annual report [or reports] of the Company's insured depository institution subsidiaries subject to Part 363 or if you need any further information, you may contact me at 987-654-3210.

BCD Holding Company

\_\_\_\_\_

Date: \_\_\_\_\_

[Insert officer's name and title.]

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By order of the Board of Directors.

Dated at Washington, D. C., this \_\_ day of \_\_\_\_\_, 2007.

Federal Deposit Insurance Corporation,

Robert E. Feldman

Executive Secretary

(SEAL)