Emergency Management Agency, Operations and Planning Division, Response and Recovery Directorate, 500 C Street, SW, Washington DC 20472. Copies of the minutes will be available upon request 30 days after the meeting.

Lacy E. Suiter,

Executive Associate Director, Response & Recovery Directorate.

[FR Doc. 98–3866 Filed 2–13–98; 8:45 am]

BILLING CODE 6718–02–P

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Policy Statement on External Auditing Programs of Banks and Savings Associations

AGENCY: Federal Financial Institutions Examination Council.

ACTION: Proposed policy statement; Request for comment.

SUMMARY: The Federal Financial Institutions Examination Council (FFIEC)[1] is requesting comments on a proposed Policy Statement on External Auditing Programs of Banks and Savings Associations (Policy Statement) which is intended to provide uniform guidance regarding independent external auditing programs. Because institutions with $500 million or more in total assets must have an annual audit performed by an independent public accountant in accordance with section 36 of the Federal Deposit Insurance Act (FDI Act), as implemented by 12 CFR part 363, this policy would apply only to institutions below that threshold that are not otherwise subject to audit requirements.

The Policy Statement expresses the banking agencies' belief that a well-planned external audit program, combined with a strong internal audit function, increases the ability of an institution to detect and correct any serious problems that exist. In this regard, the proposed guidance encourages each institution to adopt an external auditing program that includes an annual audit of its financial statements by an independent public accountant. If an institution's board of directors or audit committee determines that an audit is not appropriate for the institution, the proposal provides two alternative approaches for consideration. The alternatives, which should also be performed by an independent public accountant, consist of a report on the institution's balance sheet or an attestation report on internal control over specified schedules of its regulatory reports.

The proposed Policy Statement also encourages institutions to establish an audit committee consisting entirely of outside directors, if practicable.

DATES: Comments must be received by April 20, 1998.

ADDRESSES: Comments should be directed to Joe M. Cleaver, Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue, NW, Suite 200, Washington, DC 20037 (Fax number: (202) 634–6556). Comments will be available for public inspection during regular business hours at the above address. Appointments to inspect comments are encouraged and can be arranged by calling the FFIEC at (202) 634–6526.

FOR FURTHER INFORMATION CONTACT:

FDIC: Doris L. Marsh, Examination Specialist, Division of Supervision, (202) 898–8905, or A. Ann Johnson, Counsel, Legal Division, (202) 898–3573, FDIC, 550 17th Street, N.W., Washington, DC 20429.

FRB: Charles H. Holm, Project Manager, (202) 452–3502, or Arthur Lindo, Supervisory Financial Analyst, (202) 452–2695, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

OCC: Thomas Rees, Senior Accountant, Chief Accountant's office, Core Policy Division, (202) 874–5411, or Bill Morris, National Bank Examiner, Core Policy Division, (202) 874–4915, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, DC 20219.

OTS: Timothy J. Stier, Chief Accountant, Accounting Policy Division, (202) 906–5699, or Christine A. Smith, Policy Analyst, Accounting Policy Division, (202) 906–5740, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

An institution's internal auditing and external auditing programs are critical to its safety and soundness. When an institution lacks an internal auditing program or has weaknesses in an existing program, examiners often encourage the institution to obtain an independent external audit. Accordingly, many institutions now supplement their internal auditing programs by obtaining independent external audits, either voluntarily or as a result of the requirements of section 36 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831m) and its implementing regulation, 12 CFR part 363, the Securities and Exchange Act of 1934 (15 U.S.C. 78a), or the Federal Reserve bank holding company reporting requirements in the FR-Y–6 Annual Report of Bank Holding Companies. However, a number of institutions, particularly smaller institutions, do not have an external audit for various reasons.

Because the banking agencies believe that an independent external audit provides reasonable assurance that an institution's financial statements are prepared in accordance with generally accepted accounting principles (GAAP), the banking agencies encourage all institutions to obtain external audits. In an effort to provide more explicit guidance to institutions regarding external audits, the FFIEC is proposing to approve a uniform Policy Statement. Upon FFIEC approval, the FFIEC would recommend to the banking agencies that they individually adopt the policy. This proposal is generally consistent with the individual policies of the banking agencies.

Although some of the banking agencies have provided guidance on external audits to their supervised institutions, a uniform policy does not exist. For example, the OCC discusses its policies with regard to independent external audits for national banks in the Comptroller's Handbook for National Banks, Section 102, Internal and External Audits, and the Comptroller's Manual for Corporate Activities. The FDIC adopted similar guidance in its Policy Statement Regarding Independent External Auditing Programs of State Nonmember Banks on November 16, 1988, as published on November 28, 1988 (53 FR 47871), and amended on June 24, 1996, (61 FR 32438). The OTS's policy on independent external audits is discussed in the Thrift Activities Regulatory Handbook, Section 350, Independent Audits. The FRB sets forth its policy on external audits in the FR-Y–6'Annual Report of Bank Holding Companies and Section 1010, ''External Audits,'' of the Commercial Bank Examination Manual.

II. The Policy Statement

The following paragraphs describe the principal provisions of the proposed Policy Statement.

[1] The FFIEC consists of representatives from the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS) (referred to as the ''banking agencies''), and the National Credit Union Administration. However, this guidance is not directed to credit unions.

Board of Directors' Responsibilities

External Auditing Program

This section of the proposed Policy Statement expresses the banking agencies' belief that a well-planned external auditing program combined with a strong internal auditing function increases the ability of an institution to detect and correct any potentially serious problems. This section also emphasizes the importance to the institution's board of directors and management of establishing an effective internal control process to provide reasonable assurance that the institution achieves its objectives. The banking agencies believe that the board of directors should consider an external auditing program performed by an independent public accountant to be conducive to the safe and sound operation of the institution.

Audit Committee

This section encourages institutions to establish an audit committee consisting entirely of outside directors, if practicable. Among its duties, the audit committee should identify the areas of greatest risk affecting financial reporting in the institution's operations. In addition, this section states that an institution's board of directors or audit committee should consider the appropriateness of an external auditing program for the institution. This evaluation should address what form of external auditing program will best assist the board or audit committee in obtaining reasonable assurance that the institution's financial statements and regulatory reports are reliably prepared. The results of this evaluation should be documented.

Alternative External Auditing Programs

The proposal identifies the preferred external auditing program and two acceptable alternatives.[2]

Financial Statement Audit by an Independent Public Accountant

The proposal encourages each institution to adopt an external auditing program that includes an annual audit of its financial statements by an independent public accountant. The banking agencies believe that a financial statement audit benefits management in carrying out its control responsibilities.

Report on the Balance Sheet Audit

As an alternative to a financial statement audit, the proposed Policy Statement suggests that an institution consider engaging an independent public accountant to examine its assets, liabilities, and equity under generally accepted auditing standards (GAAS) and to opine on the fairness of the presentation on the balance sheet. Under this type of engagement, the accountant would not provide an opinion on the fairness of the presentation of the institution's income statement, statement of changes in equity capital, or statement of cash flows.

Attestation Report on Internal Control Assertion

Another alternative to a financial statement audit is to engage an independent public accountant to provide a report attesting to management's assertion concerning the effectiveness of internal control over financial reporting. The report would cover certain schedules of its regulatory reports, including those relating to loans and securities. Under this alternative, management would review its internal control over the preparation of these schedules and document this review. Management would then provide a written assertion stating whether it believes its internal control is effective. The independent public accountant would examine management's assertion and provide an appropriate attestation report.

The banking agencies believe that an institution's annual ongoing cost of an attestation report on internal control over certain schedules of its regulatory reports would be significantly less than the cost of an audit of its financial statements. However, the cost projections depend on the circumstances of each institution, and an institution may incur additional start-up costs to create the initial documentation of its internal control structure and procedures in the first year. This documentation is necessary to enable the independent public accountant to evaluate management's assertion on the effectiveness of internal control.

Holding Company Subsidiaries

The proposal describes the responsibilities of the board or audit committee of a subsidiary of a holding company with respect to the institution's external auditing program. Specifically, the proposal says that an institution which is a subsidiary of a holding company may find it appropriate to express the scope of its external auditing program in terms of its relationship to the consolidated group. However, the board or audit committee should determine whether the subsidiary's activities involve unusual risks that are not adequately covered within the scope of the audit of the consolidated financial statements. If so, the proposal suggests that the board or audit committee consider implementing an appropriate alternative external auditing program.

Other Matters Concerning an External Auditing Program

Timing and Experience

The proposed Policy Statement recommends that whatever external auditing program is adopted be performed at a quarter-end date that coincides with a regulatory report date. It states that the independent public accountant performing this program should be experienced in performing external auditing work for banks and savings associations.

Access to Regulatory Reports

The proposal explains that an independent public accountant should have access to examination reports, other documents, and reports of action related to the supervision of the institution by its appropriate federal or state banking agency.

Examiner Review of the External Auditing Program

The proposal explains that examiners should consider an institution's size, the nature and scope of its activities, and any compensating controls when determining the adequacy of the institution's external auditing program and making recommendations for improvement. Examiners should also consider whether the institution has undertaken a state-required auditing program (that differs from the programs set forth in this policy) when determining whether to make recommendations for improvements under this policy.

Notification and Submission of Reports

In general, each institution should furnish its appropriate supervisory office with a copy of external auditing reports issued by its independent public accountant. However, the proposal also addresses the submission of the independent public accountant's report by holding company subsidiaries. This guidance reflects the banking agencies' current approach to supervising banking organizations which own more than one depository institution. Because each banking agency designates one

[2] It is the understanding of the banking agencies that, under most state public accountancy laws, only an independent public accountant may perform a balance sheet audit or issue an attestation report on internal control.

supervisory office to manage the supervision of an entire banking organization, any reports from the independent public accountant should be sent to the appropriate supervisory office of each banking agency which supervises the entire banking organization.

Special Situations

Newly Insured Institutions

The proposed Policy Statement notes that the FDIC Statement of Policy on Applications for Deposit Insurance (57 FR 12822) requires newly insured institutions to adopt an appropriate external auditing program.

Institutions Presenting Supervisory Concerns

This section of the proposal lists some of the conditions in a problem institution which would warrant the inclusion of a requirement for a strong external auditing program.

Performance of Other Services

This section of the proposal explains that although each institution is encouraged to have an external auditing program performed by an independent public accountant, an institution may hire other firms for advisory and consulting services if it so desires.

Appendix A—Definitions

Appendix A defines the terms used throughout the proposed Policy Statement. The banking agencies have tried to achieve consistency in these definitions with current professional accounting and auditing literature. In addition, references are consistent with terminology in the report of the Committee of Sponsoring Organizations of the Treadway Commission (COSO Report), ''Internal Control—Integrated Framework,'' which is the standard by which the vast majority of institutions evaluate internal control.

III. Comments

The banking agencies encourage each institution to consider engaging an independent public accountant to perform an audit of its financial statements. If an institution's board or audit committee determines that an audit is not appropriate for the institution, the banking agencies encourage each institution to consider having one of the alternatives recommended in this proposal performed. Comments on the proposed Policy Statement are especially encouraged from any institution which has had its independent public accountant perform one of the alternatives (a report on the institution's balance sheet or an attestation report on internal control over specified schedules of its regulatory reports).

Some states have state-required external auditing programs (e.g., directors' examinations) that differ from the external auditing programs set forth in this policy statement. Accordingly, comments are requested on the amount of time those states might need if they wish to modify their directors' examination requirements to be consistent with this Policy Statement.

IV. Paperwork Reduction Act

As part of their continuing effort to reduce paperwork and respondent burden, the banking agencies invite the general public and other Federal agencies to take this opportunity to comment on proposed and/or continuing information collections, as required by the Paperwork Reduction Act of 1995. Currently, the banking agencies are soliciting comments concerning this proposed FFIEC policy statement, as there is a likelihood that each of the banking agencies will adopt it for their institutions. The banking agencies expect to submit the information collection to OMB for review in conjunction with FFIEC's approval of the final policy statement, and will invite public comment again in the **Federal Register** notice that publishes the final policy statement.

Written comments regarding the information collection aspects of the proposed policy statement should be submitted to any one or all of the addresses listed under the **ADDRESSES** section of this **Federal Register** notice. A copy of the comments may also be submitted to the OMB Desk Officer for the banking agencies: Alexander T. Hunt, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503.

Requests for information regarding the collections of information contained in the proposed policy statement may be sent to:

FDIC: Steven F. Hanft, FDIC Clearance Officer, (202) 898–8766, Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

FRB: Mary M. McLaughlin, Federal Reserve Board Clearance Officer (202) 452–3829, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551. Telecommunications Device for the Deaf (TDD) users may contact Diane Jenkins, (202) 452–3544, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

OCC: Jessie Gates, OCC Clearance Officer, (202) 874–5090, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

OTS: Christine Smith, Policy Analyst, (202) 906–5740, Timothy Stier, Chief Accountant, (202) 906–5699, Accounting Policy, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

Abstract

The title of this proposed information collection is ''External Auditing Programs (<$500MM).'' The information would be collected from all institutions with less than $500 million in total assets and consists of: (a) A recordkeeping requirement that institutions maintain management assertions regarding certain regulatory report schedules, and (b) reporting requirements that institutions submit to the appropriate supervisory office: (1) A notification when an independent public accountant is initially engaged to perform external auditing work and when a change in, or termination of, an independent public accountant occurs; and either (2) a copy of any reports by the independent public accountant pertaining to the external auditing program, including any management letters; or (3) when an institution's financial information is included in the audited consolidated financial statements of its parent company, a copy of the audited financial statements of the consolidated company, any other reports by the independent public accountant, and any notifications of changes in, or terminations of, the consolidated company's independent public accountant, with a transmittal letter identifying the institutions covered.

Type of Review: New collection.

Affected Public: Businesses or other for-profit.

Number of Respondents:

FDIC: 5,960.

FRB: 900.

OCC: 2,200.

OTS: 1,050.

Total Annual Respones: The banking agencies estimate 2 responses per respondent.

Frequency of Response: Annually and On occasion.

TOTAL ANNUAL BURDEN HOURS

FDIC	Recordkeeping Burden.	1,490 hours.
	Reporting Burden.	2,980 hours.
	Total Burden	4,470 hours.
FRB	Recordkeeping Burden.	225 hours.
	Reporting Burden.	450 hours.
	Total Burden	675 hours.
OCC	Recordkeeping Burden.	550 hours.
	Reporting Burden.	1,100 hours.
	Total Burden	1,650 hours.
OTS	Recordkeeping Burden.	263 hours.
	Reporting Burden.	525 hours.
	Total Burden	788 hours.

Comments

Comments submitted in response to this notice will be summarized and/or included in each agency's request for OMB approval. All comments will become a matter of public record. Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility;

(b) The accuracy of the agency's estimate of the burden of the collection of information;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or startup costs and costs of operation, maintenance, and purchase of services to provide the required information.

The text of the proposed Policy Statement follows:

Federal Financial Institutions Examination Council

Policy Statement On External Auditing Programs of Banks and Savings Associations [1]

Introduction

The banking agencies [2] believe that a well-planned annual external auditing program [3] is an important component of a bank's or savings association's (hereafter referred to as ''an institution'') risk management process. Furthermore, an external auditing program complements the internal auditing function of an institution by providing management and the board of directors with an independent and objective view of the reliability of the institution's financial statements. Additionally, an effective external auditing program contributes to the efficiency of the banking agencies' risk-focused examination process. By emphasizing the financial reporting aspects of the significant risk areas of an institution, an effective external auditing program may also reduce the examination time spent in these areas.

This policy statement outlines key elements of an effective external auditing program and describes how an institution's external auditing program will be reviewed by examiners. Specifically, this policy encourages institutions to adopt an external auditing program and establish an audit committee, and it describes some acceptable external auditing programs that institutions may consider. In addition, this policy statement provides guidance on external auditing for institutions that are subsidiaries of a holding company, newly insured institutions, and institutions presenting supervisory concerns.

Board of Directors' Responsibilities

External Auditing Program. The banking agencies encourage the board of directors of each institution to adopt an external auditing program. The banking agencies believe that the board of directors should consider an external auditing program performed by an independent public accountant to be conducive to the safe and sound operation of the institution. The board of directors should evaluate whether its external auditing program adequately addresses the financial reporting aspects of the significant risk areas of the institution's business. The ability to detect and correct potentially serious problems in these areas substantially improves the safety and soundness of an institution's operations and thereby lessens the risk the institution poses to the FDIC-administered insurance funds.

An external auditing program also gives the institution's management and board of directors information about the reliability of its financial statements and often provides information useful to them in discharging their responsibilities for effective internal control, such as safeguarding assets and identifying weaknesses in the internal control structure. In addition, an external auditing program may help directors exercise reasonable care in protecting the assets of the institution.

Audit Committee. The banking agencies also encourage the board of directors of each institution to establish an audit committee. Ideally, the audit committee should consist entirely of outside directors. However, if this is impracticable, the banking agencies believe that at least a majority of the audit committee members should be outside directors.

An audit committee or board of directors should periodically (at least annually) identify the risk areas of the institution's activities and assess the extent of external auditing involvement needed over each area. The audit committee or board should determine whether the institution's needs will best be met by an audit of its financial statements in accordance with generally accepted auditing standards (GAAS) or by an alternative external auditing program. (Recommended alternatives are described below.)

When evaluating the alternatives for the institution's external auditing program, the committee or board should consider the cost and potential benefits of an annual financial statement audit and ensure that the selected program provides sufficient coverage of the financial reporting aspects of the institution's significant risk areas and any other areas of concern. The committee or board also should consider how to best obtain reasonable assurance that the institution's financial

[1] Insured depository institutions covered by Section 36 of the Federal Deposit Insurance Act, as implemented by 12 CFR part 363, are required to have an external audit and an audit committee. Therefore, this guidance only applies to banks and savings associations which are not subject to part 363 (i.e., institutions with less than $500 million in total assets at the beginning of their fiscal year) or are not otherwise subject to audit requirements by agreement, statute, or agency regulations. Such banks and savings associations are referred to in this policy statement as ''institutions.''

[2] References to the banking agencies throughout this document mean the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

[3] Terms defined in Appendix A are italicized the first time they appear in this policy statement.

statements and regulatory reports are reliably prepared.

If the audit committee or board of directors decides to engage an independent public accountant to conduct an alternative external auditing program rather than an audit of the institution's financial statements, the reasons for that decision should be documented in its minutes.

Alternative External Auditing Programs

Financial Statement Audit by an Independent Public Accountant. The banking agencies encourage each bank and savings association to have its financial statements audited by an independent public accountant. Although other alternatives are acceptable, a financial statement audit provides the most comprehensive assurance about the fair presentation of an institution's financial statements.

In addition, an external audit provides information that benefits management in carrying out its control responsibilities. For example, an external audit may provide management with guidance on establishing or improving accounting and operating policies, recommendations on internal control (including internal auditing programs), and evaluations of management information systems necessary to ensure the fair presentation of the financial statements.

Report on the Balance Sheet. An institution's audit committee or board of directors may determine, based on its assessment of the institution's risk areas and scope of operations during a particular year, that a financial statement audit is not the institution's best alternative. In such cases, the institution may prefer to engage an independent public accountant to examine and *report on the balance sheet.* If this alternative is chosen, the balance sheet on which the accountant will report should be prepared in conformity with generally accepted accounting principles (GAAP). Furthermore, the independent public accountant should perform the engagement in accordance with GAAS.

Attestation Report on Internal Control Assertion.[4] Another alternative to a financial statement audit is to engage an independent public accountant to examine and report on management's assertion concerning the effectiveness of the institution's internal control over financial reporting in all or specified schedules of the institution's regulatory reports. A board or audit committee that elects this alternative should review and assess the institution's activities and determine its high risk areas with respect to financial reporting. In addition, management should evaluate and provide a written assertion about the effectiveness of the institution's internal control over financial reporting in the identified risk areas as of one designated regulatory report date. This assertion should specify the criteria on which management based its evaluation of internal control. Furthermore, management's evaluation should be adequately documented.

In most institutions, the lending and investment securities activities present the most significant risks that affect financial reporting. Therefore, management's assertion should generally cover the following regulatory report schedules every year:

Area	Reports of condition and income schedules	Thrift financial report schedules
Loans and Lease Financing Receivables	RC–C, Part I	SC, CF
Past Due and Nonaccrual Loans, Leases, and Other Assets	RC–N	PD
Allowance for Credit Losses	RI–B	SC, VA
Securities	RC–B	SC, SI, CF

If the board or audit committee determines that trading or off-balance sheet activities present material financial reporting risks to the institution, the regulatory report schedules for one or both of these areas should also be covered by management's assertion and the accountant's attestation:

Area	Reports of condition and income schedules	Thrift financial report schedules
Trading Assets and Liabilities	RC–D	SO, SI.
Off-Balance Sheet Items	RC–L	SI, CMR.

The regulatory report schedules listed in this policy statement address the most common high risk areas for financial reporting in institutions. However, these schedules do not address all possible risks in an institution. Therefore, each institution should review the risks inherent in its particular activities annually to determine whether to expand the scope of its external auditing program to include other financial reporting risk areas. For example, if an institution or its subsidiaries has significant real estate investments, insurance underwriting or sales activities, securities broker-dealer or similar activities (including securities underwriting and investment advisory services), loan servicing activities, or fiduciary activities, the institution should consider whether its external auditing program should cover these areas.

Holding Company Subsidiaries. When the audit committee or board of directors of any institution owned by another company (such as a holding company) considers its external auditing program, it may find it appropriate to address the scope of its program in terms of the institution's relationship to the consolidated group. The banking agencies do not expect an institution owned by another company to obtain a separate audit of its financial statements if the group's consolidated financial statements for the same fiscal year are audited. Nevertheless, the board of directors or audit committee of the subsidiary may determine that it has activities that involve risks which were not within the procedural scope of the audit of the financial statements of the consolidated entity. For example, the risks arising from some of the subsidiary's activities may be immaterial to the financial statements of the consolidated entity. Under such circumstances, the audit committee or board of the subsidiary institution should consider strengthening its internal auditing procedures to cover these activities or implementing an appropriate alternative external auditing program.

[4] An attestation engagement is not an audit. It is performed under different professional standards than an audit of an institution's financial statements or its balance sheet.

Other Matters Concerning an External Auditing Program

Timing. Whatever external auditing program an institution decides to implement, it preferably should be performed as of the institution's fiscal year-end. However, using a quarter-end date that coincides with a regulatory report date is also acceptable. Such an approach would permit the institution to use the audited financial statements to verify and, if appropriate, amend the regulatory report. In this regard, an institution may also find it cost-effective to have its financial statements audited during the accounting firm's off-peak period.

Experience. The banking agencies generally believe that the independent public accountant that an institution selects to perform its financial statement audit or its alternative external auditing program should be experienced in auditing the financial statements of banks and savings associations and knowledgeable about relevant laws and regulations.

Access to Regulatory Reports. Regardless of the external auditing approach chosen, management should inform the independent public accountant of, and provide the independent public accountant with access to, all examination reports and written communication between the institution and the banking agencies or state banking authorities since the last external auditing activity. The independent public accountant also should be provided access to any supervisory memoranda of understanding, written agreements, administrative orders, reports of action initiated or taken by a federal or state banking agency under section 8 of the Federal Deposit Insurance Act (or a similar state law), or civil money penalties assessed against the institution or an institution-related party, and any associated correspondence. The independent public accountant must maintain the confidentiality of examination reports and other confidential supervisory information.

Examiner Review of the External Auditing Program

A review of an institution's external auditing program will continue to be part of the banking agencies' examination procedures. An examiner's evaluation of and any recommendations for improvements in an institution's external auditing program will consider the institution's size, the nature and complexity of its business activities, its risk profile, any actions taken or planned by the institution to minimize or eliminate identified weaknesses, and any compensating controls that are in place.

Notification and Submission of Reports

Regardless of the type of external auditing program chosen, the banking agencies request that each institution furnish a copy of any reports[5] by the independent public accountant pertaining to the external auditing program, including any management letters, to its appropriate supervisory office in a timely manner.

In addition, the banking agencies request each institution to promptly notify its appropriate supervisory office when an independent public accountant is initially engaged to perform external auditing work and when a change in, or termination of, its independent public accountant occurs.

When an institution's financial information is included in the audited consolidated financial statements of its parent company, the institution may send its appropriate supervisory office one copy of the audited financial statements of the consolidated company, any other reports by the independent public accountant, and any notifications of changes in, or terminations of, the consolidated company's independent public accountant. If several institutions are owned by one parent company, a single copy of the reports and any notifications applicable to the consolidated company may be submitted to the appropriate supervisory office of each banking agency supervising one or more of the affiliated institutions and the holding company. A transmittal letter should identify the institutions covered.

Special Situations

Newly Insured Institutions. The FDIC Statement of Policy on Applications for Deposit Insurance requires an applicant for deposit insurance coverage to obtain an audit of its financial statements by an independent public accountant.

Institutions Presenting Supervisory Concerns. An independent external auditing program complements the banking agencies' supervisory process and the institution's internal auditing program by identifying or further clarifying issues of potential concern or exposure. It can also greatly assist management in taking corrective action, particularly when weaknesses are detected in internal control or management information systems. For these reasons, the banking agencies may require an annual audit of an institution's financial statements by an independent public accountant for an institution presenting supervisory concerns. However, if it is more appropriate, either (1) a report on the balance sheet; (2) an attestation report on management's assertions concerning internal control over financial reporting; (3) procedures agreed upon by the institution, independent public accountant, and appropriate banking agency; or (4) other engagements may be required if any of the following conditions exist:

(a) Internal control, including the internal auditing program, is inadequate;

(b) The board of directors is generally uninformed in the area of internal control;

(c) There is evidence of insider abuse;

(d) There are known or suspected defalcations;

(e) There is known or suspected criminal activity;

(f) It is probable that director liability for losses exists;

(g) Direct verification of loans or deposits is warranted;

(h) Questionable transactions with affiliates have occurred; or

(i) Other conditions exist that warrant improvements in the external auditing program.

Such an action may also require, among other things, that the institution provide its banking agency's supervisory office a copy of any reports, including management letters, issued by the independent public accountant. In addition, it may require the institution to notify the supervisory office prior to any meeting with the independent public accountant at which auditing findings are to be presented.

Performance of Other Services

This policy statement does not preclude institutions from engaging entities other than independent public accountants to perform advisory and other services that do not require licensing under applicable state public accountancy statutes. For example, an institution may hire individuals or firms who are not independent public accountants to provide independent loan reviews, give advice on consumer compliance issues, suggest improvements to increase operational efficiency in specific departments (e.g., information processing), or assist in areas of taxation or management information systems. In addition, if acceptable under applicable state laws, these firms may perform state-required directors' examinations; however, such services may not constitute or replace

[5] The institution's engagement letter is not expected to be submitted as a "report."

an external auditing program performed by an independent public accountant.

Appendix A—Definitions

Appropriate supervisory office. The regional or district office of the institution's primary federal banking agency which is responsible for supervising the institution, or, in the case of an institution that is part of a group of related insured institutions, the regional or district office of the institution's federal banking agency which is responsible for monitoring the group. If the institution is a subsidiary of a holding company, the term ''appropriate supervisory office'' also includes the federal banking agency responsible for supervising the holding company. In addition, if the institution is state-chartered, the term ''appropriate supervisory office'' includes the appropriate state bank or savings association regulatory authority.

Audit. An examination of the financial statements, accounting records, and other supporting evidence of an institution performed by an independent certified or licensed public accountant in accordance with generally accepted auditing standards (GAAS) and of sufficient scope to enable the independent public accountant to express an opinion on the institution's financial statements as to their presentation in accordance with generally accepted accounting principles (GAAP).

Audit Committee. A committee of the board of directors whose members should, to the extent possible, be knowledgeable about accounting and auditing. The committee should be responsible for reviewing and approving the institution's internal and external auditing programs or recommending adoption of these programs to the full board. Both the internal auditor and the independent public accountant should have unrestricted access to the audit committee without the need for any prior management knowledge or approval. Other duties of the audit committee may include reviewing the independence of the independent public accountant annually, consulting with management when management seeks a second opinion on an accounting issue, and overseeing the quarterly regulatory reporting process. The audit committee should report its findings periodically to the full board of directors.

Directors' Examination. An engagement performed by an independent third party that has been authorized by the institution's board of directors and is required by state law. (A directors' examinations is called an ''engagement audit'' or ''operational audit.'' Nevertheless, it is often not performed in accordance with GAAS nor do widely accepted national standards exist for its performance.)

External Auditing Program. The testing and evaluation of risk areas of an institution's business by an independent public accountant sufficient to enable the accountant to express an opinion on the financial statements or balance sheet. Under professional standards, this engagement should be performed in accordance with GAAS. Alternatively, an independent public accountant may attest to management's assertion concerning the effectiveness of the institution's internal control over financial reporting. Under professional standards, the independent public accountant is expected to perform this attestation engagement in accordance with the generally accepted standards for attestation engagements (GASAE).

Financial Statements. The statements of financial position (balance sheet), income, cash flows, and changes in equity together with related notes.

Independent Public Accountant. An accountant who is independent of the institution and registered or licensed to practice as a public accountant, and is 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 is located. No certified public accountant or public accountant will be recognized as independent who is not in fact independent. The independent public accountant also should comply with the American Institute of Certified Public Accountants' (AICPA) *Code of Professional Conduct* and any related guidance adopted by the banking agencies.

Internal auditing. An independent assessment function established within an institution to examine and evaluate its system of internal control and the efficiency with which the various units of the institution are carrying out their assigned tasks. The objective of internal auditing is to assist the management and directors of the institution in the effective discharge of their responsibilities. To this end, internal auditing furnishes management with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed.

Outside Directors. Members of an institution's board of directors who are not officers, employees, or principal stockholders of the institution, its subsidiaries, or its affiliates, and do not have any material business dealings with the institution, its subsidiaries, or its affiliates.

Regulatory Reports. These reports are the Reports of Condition and Income (Call Reports) for banks and Thrift Financial Reports (TFRs) for savings associations.

Report on the Balance Sheet. An examination of an institution's balance sheet performed and reported on by an independent public accountant in accordance with GAAS and of sufficient scope to enable the independent public accountant to express an opinion on the fairness of the balance sheet presentation in accordance with GAAP.

Risk Areas. Those particular activities of an institution that expose it to greater potential losses if problems exist and go undetected. The areas with the highest financial reporting risk in most institutions generally are their lending and investment securities activities.

Dated: February 5, 1998.

Joe M. Cleaver,

Executive Secretary, Federal Financial Institutions Examination Council.

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FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Uniform Interagency Trust Rating System

AGENCY: Federal Financial Institutions Examination Council.

ACTION: Notice and request for comment.

SUMMARY: The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) (collectively referred to as the federal supervisory agencies), under the auspices of the Federal Financial Institutions Examination Council (FFIEC) request comment on proposed changes to the Uniform Interagency Trust Rating System (UITRS), commonly referred to as the trust rating system. The proposed revisions update the rating system to reflect changes that have occurred in the fiduciary services industry and in supervisory policies and procedures since the rating system was first adopted in 1978. The proposed changes revise the numerical ratings to conform to the language and tone of the Uniform Financial Institution Rating System (UFIRS) rating definitions, commonly referred to as the CAMELS rating system; reformat and clarify the component rating descriptions; reorganize the account administration and conflicts of interest components