

Proposed Rules

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FARM CREDIT ADMINISTRATION

12 CFR Parts 611, 619, 620, 621, 624, 627, and 630

RIN 3052-AC11

Organization; Definitions; Disclosure to Shareholders; Accounting and Reporting Requirements; Regulatory Accounting Practices; Title IV Conservators, Receivers, and Voluntary Liquidations; and Disclosure to Investors in System-Wide and Consolidated Bank Debt Obligations of the Farm Credit System

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) is proposing to amend our disclosure and reporting regulations for Farm Credit System (System) institutions by clarifying and enhancing existing disclosures and reporting to System shareholders and investors. The rule would provide “real time” disclosures to shareholders, investors, and the public by accelerating the time period for filing annual and quarterly reports. The Federal Farm Credit Banks Funding Corporation (Funding Corporation) would have to adopt policies and procedures for issuing interim reports, improving the timely and accurate distribution of System-wide financial information. The proposed rule would also enhance financial accuracy certifications in periodic reports for all System institutions, requiring the Funding Corporation and larger System institutions (with over \$500 million in assets) to review and report on internal controls. Further, the proposed rule would create a regulatory section on the independence of external auditors, adding restrictions on non-audit services and conflicts of interest, as well as requiring auditor rotation.

DATES: You may send comments on or before June 12, 2006.

ADDRESSES: Comments may be sent by electronic mail to reg-comm@fca.gov,

through the Pending Regulations section of our Web site at <http://www.fca.gov>, or through the Government-wide <http://www.regulations.gov> portal. You may also send written comments to Gary Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, Virginia 22102-5090, or by facsimile transmission to (703) 734-5784.

You may review copies of all comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select “Legal Info,” and then select “Public Comments.” We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove electronic-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Update our financial disclosure and reporting requirements for System institutions by incorporating recent changes in industry practices;
- Augment existing reporting timeframes with “real time disclosure” principles to improve shareholders, investors, and public access to material financial information for informed investment decisionmaking;
- Strengthen the independence of System financial audits;
- Streamline the financial reporting certification requirements to make them easier to understand and use; and
- Enhance shareholders’ and investors’ understanding of, and confidence in, the System’s operations through improved transparency.

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II. Background

The Farm Credit Amendment Act of 1985 (1985 Amendments)¹ added provisions to the Farm Credit Act of 1971, as amended (Act),² requiring FCA to regulate the disclosure and reporting practices of System institutions. The 1985 Amendments require each System institution to prepare and publish annual financial reports to its shareholders as prescribed by us. The 1985 Amendments also require that annual reports contain financial statements prepared in accordance with generally accepted accounting principles (GAAP) and be audited by an independent public accountant. To implement the 1985 Amendments, we issued regulations at part 620—Disclosure to Shareholders and part 621—Accounting and Reporting Requirements. These regulations establish the requirements for financial reports from Farm Credit banks and associations. When developing part 620, we primarily relied on the disclosure and reporting requirements of the Securities and Exchange Commission (SEC) in existence at the time, adapting SEC requirements to the cooperative nature and unique structure of the System before issuing the rule. Part 621 contains requirements that System institutions adhere to GAAP when preparing financial disclosures and reports to shareholders, as well as establishes accounting and performance requirements for classification of high-risk assets and loan performance. This part of our regulations also requires each institution’s financial statements and related disclosures be audited annually by a qualified public accountant (auditor).

In 1994, we extended the requirements of part 621 to the Funding Corporation and issued additional disclosure and reporting requirements at part 630 for System-wide reporting to investors. When developing part 630, we incorporated many of the System practices in use at the time, especially with regard to the Funding Corporation’s disclosure and reporting practices. Our regulations on the System-wide reporting responsibilities of the Funding Corporation, contained in part 630, additionally address the maintenance of internal controls over

¹ Pub. L. 99-205, Dec. 23, 1985.

² Pub. L. 92-181, Dec. 10, 1971.

System-wide financial disclosures and reporting.

Our existing regulations require each System institution to prepare annual and quarterly reports, making quarterly reports available to shareholders but requiring distribution of annual reports. Our regulations identify the minimum informational requirements of the reports and include general prohibitions against making incomplete, inaccurate, or misleading disclosures. Our existing regulations also set forth reporting timeframes and signatory requirements for periodic reports. We adopted these regulations to enhance the integrity of the System's published financial reports and to ensure full and adequate disclosure to shareholders and other investors in System obligations. The regulations were intended to ensure that System institutions provide timely and reliable financial information to multiple audiences, including borrowers, shareholders, investors and the public.

Our reporting and disclosure regulations at part 620 and 630 were last comprehensively revised in 1991 (56 FR 29412, June 27, 1991) and 1994 (59 FR 46742, September 12, 1994), respectively. At the time, the rules were considered comprehensive up-to-date financial disclosure and reporting requirements. However, public sector disclosure and reporting practices have recently undergone significant changes that we believe necessitate updates to our regulations.

In the course of developing this proposed rule, we looked extensively at the disclosure and reporting practices of publicly traded companies, reporting changes of the Federal Deposit Insurance Corporation (FDIC) and other federal banking regulatory agencies, and the financial reporting and disclosure provisions of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and the SEC implementing regulations.³ We also considered studies and public statements of individuals and organizations with knowledge and expertise in financial disclosure and reporting practices. Throughout this process we evaluated the proposed changes to our rules against our role as the safety and soundness regulator of the System and the System's cooperative structure.

We believe transparency in System operations strengthens board and management accountability to System shareholders and increases investor confidence in the accuracy of System financial disclosures and reports. We believe all the proposed changes in this

rule will ensure that shareholders in the System and investors in System-wide obligations continue to receive material and relevant information about the financial condition and results of operations of individual System institutions and of the entire System on a combined basis.

III. Comments Received

We received comments on our existing regulations prior to developing these proposed rules. The comments were in an August 9, 2005, letter from the Funding Corporation on behalf of System institutions. The letter recommended we issue regulations that were flexible in application, rather than detailed and prescriptive. The letter further explained that judgment is an important element in determining the appropriate financial reporting and disclosure treatments in accordance with GAAP as well as rapid changes in the current financial reporting environment. The Funding Corporation attached to the letter a list of recommended regulation changes.

We evaluated the recommendations in recognition of existing law and policy considerations, other regulator's disclosure rules, the differences in size and complexity among System institutions, and the cooperative nature of the System. We address the recommendations falling within the scope of this proposed rule, incorporating those achieving one or more of the stated objectives. The other recommendations will be considered for future rulemaking.

IV. Section-by-Section Analysis

A. Definition of Qualified Public Accountant [New § 619.9270 and § 621.2(i)]

We propose to move the existing definition of qualified public accountant from § 621.2(i) to part 619 to clarify that it applies to all our rules. In addition, we propose to further explain the meaning of "independent" in the definition. We are proposing that a qualified public accountant is not independent if he or she functions in the role of management, audits his or her own work, or serves as an advocate for the System audit client. We believe the proposed change facilitates preventing fundamental conflicts of interest between the qualified public accountant and a System institution. An external auditor who assumes or carries out the responsibility of providing a justification for a particular accounting practice in use by the client serves in an advocacy role. Supporting the appropriate use of any accounting

practice is clearly the responsibility of the client's management. When an external auditor assumes or carries out this responsibility, conflicts arise that compromise who is held responsible for the accounting practices used to present the financial statements. The client should be held responsible, not the auditor. We believe this prohibition against external auditors serving in an advocacy role will prevent such conflicts and ensure System management's understanding that they are solely responsible for the accounting practices in use by their institution.

The proposed § 619.9270 would apply the definition of qualified public accountant to all our regulations, unless otherwise noted. We also propose clarifying that we mean a qualified public accountant when using the term "external auditor." In conformance with this proposed change, we propose removing the § 621.2(i) definition reference in §§ 611.1250(a)(3), 611.1255(a)(3), 620.5(m)(1), and 630.20(l).

B. Certification and Submission of Financial Reports [§§ 620.2, 620.3, 627.2785(d), 630.3, 630.4 and 630.5]

We propose removing the requirement contained in §§ 620.2(a) and 630.3(h) that multiple copies of reports be sent to us. We also propose removing the specificity of where reports are sent from §§ 620.2(a), 630.3(f) and 630.3(h). We believe these changes will reduce an administrative burden on the System and allow flexibility in reporting locations.

We also propose moving Farm Credit banks' and associations' financial report certification requirements from § 620.2(b) and (c) to § 620.3. We propose amendments to the certification requirements to establish separate components for signatory, certification of financial accuracy, and internal controls. A similar amendment is proposed to move the parallel requirements for the System-wide report from § 630.3(h) to § 630.5. We explain these changes more fully below.

We propose conforming technical changes to require all reports, regardless of the recipient, to comply with §§ 620.3 and 630.5. We also propose technical changes to § 630.20(h) and (i) to correct cross references to the regulatory sections containing report availability and signatures.

1. Signatures on Financial Reports [§§ 620.3(b) and 630.5(b)]

The proposed rule would move the signature requirements of § 620.2(b) to § 620.3(b) and change them to require the Chief Executive Officer (CEO), the

³Pub. L. 107-204, July 30, 2002.

Chief Financial Officer (CFO), and a board member sign all financial reports. The rule would require that the officer responsible for preparing financial reports must sign when an institution has no formally identified CFO. The rule would also require that the board member signing the report be formally designated by the entire board as the responsible signatory, with authority to sign as the representative of each individual board member. The rule would keep the existing requirement that if any of the signatories refused to sign a report, the person and reason for the refusal must be disclosed in the report. We also propose moving the System-wide report signature requirements from § 630.3(h) to § 630.5(b), with similar proposed changes to the signatory requirements for the System-wide report. We do not propose including the CFO's signature designation for System-wide reports, instead we propose that an officer in charge of preparing the financial reports be one of the signatories. We make this distinction out of consideration for the fact that the Funding Corporation does not attribute or designate its CFO as the official responsible for preparation of the System's report to investors. We believe adding the CFO or responsible financial officer to the list of individuals signing financial reports would be appropriate given that this officer is most closely associated with the preparation of the financial reports. Moreover, this requirement is consistent with the industry practices of public companies.

Our proposed changes would require a board member signing the report to be formally designated by the entire board as the responsible signatory, with authority to sign as the representative of each individual board member. This would apply the existing quarterly reporting requirements to annual reports, no longer requiring the entire board sign the annual report. We believe the proposed change simplifies the process for obtaining signatures by reducing the burden on System institutions in obtaining every board member's signature for the annual report and makes the signatory requirements for all reports submitted to the FCA consistent.

2. Certification of Financial Reports Accuracy [§§ 620.3(c), 620.5, 630.4 and 630.5(c)]

The proposed rule would require those officers and directors signing periodic reports to certify the financial accuracy of the reports. The rule would move the existing certification requirements of § 620.2(b) to § 620.3(c)

and add a requirement that the signatories state in the certification that they have reviewed the reports. The rule would also require the certification to be included in all reports, regardless of who is the recipient. The rule would keep the existing requirement that if any of the signatories refused to certify a report, the person and reason for the refusal must be disclosed in the report. We are proposing these same changes to the certification requirements for System-wide reports, moving them from § 630.3(h) to § 630.5(c).

We believe having the signatories state they reviewed the report they are signing enhances shareholder and investor confidence in the institution's financial reporting procedures by clearly establishing management's and board's responsibility for the accuracy of the published reports. We believe that such a certification of financial accuracy is considered valuable by shareholders and investors and is in line with the industry practices of disclosures to shareholders of public companies.

As a conforming technical change, we are proposing to remove § 620.5(m)(2), which requires signatures and certifications on financial statements. The proposed changes to § 620.3 would make this requirement unnecessary. For the same reason, we propose removing the requirement in § 630.4(c)(5) for banks to provide a separate certification to the Funding Corporation. We instead propose replacing § 630.4(c)(5) with a requirement that reporting submissions to the Funding Corporation comply with proposed § 620.3. We propose adding a requirement in redesignated § 630.4(c)(1) that financial information provided by associations to their funding bank comply with proposed § 620.3.

3. Assessment of Internal Controls [§§ 620.3(d) and 630.5(d)]

We are proposing the addition of an internal controls assessment to the periodic reports of those institutions with total assets over \$500 million as of the end of the previous fiscal year. The rule would require these institutions to report that internal controls are in place and reviewed during the reporting period, stating that the results of the review were reported to the board of directors. The rule would also require the internal controls assessment to contain a statement on the conclusions reached from the review. The proposed rule does not specify who must conduct the review, leaving that to the institution's discretion. We are proposing similar requirements for the Funding Corporation in a new § 630.5(d) with an additional requirement

involving the external auditor that is discussed in section IV.A.4. of this preamble.

We believe this assessment provision will enhance the objectives of § 618.8430, which requires each Farm Credit institution's board of directors to adopt an internal control policy that includes adoption of internal audit and control procedures that evidence responsibility for review and maintenance of comprehensive and effective internal controls. We also believe the assessment provision is valuable to disclose to System shareholders, investors, and potential investors that the larger System institutions' internal control procedures are periodically reviewed. Management's responsibility for creating and maintaining adequate internal controls over financial reporting and their assessment of the effectiveness of those controls serves to enhance the quality of reporting, identify prospective damaging practices within the institution, and increase shareholder and investor confidence in the reports. To mitigate any perceived burden for smaller institutions, the proposed regulation would provide an exemption for institutions with assets at or below \$500 million, a practice analogous to exemptions currently permitted by the SEC for smaller institutions under its oversight.

We are not proposing prescriptive requirements for the conduct of the internal controls assessment. We believe practices for the conduct of an internal controls assessment are evolving, thus the proposed rule would allow System institutions the flexibility to change the conduct of their internal controls assessment as industry practices evolve. Nevertheless, we would expect the assessments made for the annual reports to include a fairly comprehensive review of the internal controls over the preparation of the financial information and disclosures contained in those reports. We would expect each quarterly assessment to be more limited, focusing more on testing changes to the internal controls that have occurred since the completion of the comprehensive annual assessment. We encourage System institutions to follow good judgment in the determination of the scope and conduct of the assessments.

Since most institutions already plan to prepare such assessments in conjunction with the preparation of the System's report to investors; we do not believe our proposal would be overly burdensome. Various members of the System have informed us that most System associations will provide an internal controls certification to their

funding bank and the banks will provide an internal controls certification on a district-wide basis to the Funding Corporation as a means of facilitating the implementation of an internal control certification process on a System-wide basis for the report to investors.

4. Auditor Attestation of System-Wide Internal Controls [§ 630.5(d)]

We propose adding in § 630.5(d) a requirement for the Funding Corporation to obtain from its external auditor an attestation of, and a report on, the effectiveness of management's internal control systems and procedures for the financial reporting of the System-wide combined financial statements. The attestation must be included in the annual report to investors. We patterned this proposed requirement after section 404 of Sarbanes-Oxley to enhance the transparency and maintain investor confidence in System-issued debt obligations. We believe that an attestation provision in the System-wide report to investors would provide the users an independent source as to the status of internal controls used in the preparation of the System-wide report. We believe this independent assurance serves as an essential external control of the preparation of the System's financial report to investors.

We are not proposing an attestation provision at the bank and association level because an external auditor attestation of internal controls at the System-wide level will accomplish, at substantially less cost, many of the same objectives as an attestation requirement at the association and bank level. Further, the Funding Corporation informed us that it already has plans to require its external auditor to review the System-wide internal controls assessment and provide an attestation report for inclusion in the System-wide annual report, which should also reduce any burden this proposed provision may create.

C. Timing of Periodic Reports to Shareholders and Investors

1. Annual and Quarterly Report Filing Deadlines [§§ 620.4(a), 620.10(a) and 630.3(a)]

We propose reducing to 40 calendar days both the existing 60-day System-wide quarterly reporting deadline and the 45-day Farm Credit bank and association quarterly reporting deadline. We also propose that all annual reports be filed within 75 calendar days of the end of an institution's fiscal year, instead of the existing 90-day deadline. We believe significant technological

advances have occurred in the last 10 years that have both increased the market's demand for more timely information and improved the ability of institutions to capture, process, and disseminate this information. We also believe accelerating the time to report the financial condition of a System institution to shareholders, investors, and the general public improves information flow and facilitates shareholder and investor decisionmaking.

We considered proposing further reductions in filing deadlines based on those used by SEC-accelerated filers⁴ and the practices of most corporate and financial entities, but viewed our proposed timeframe as appropriate considering the cooperative nature and structure of the System. We also considered the fact that some System institutions may not have the support structure in place to accommodate shorter timeframes. We recognize that sufficient time must be provided for the System-wide reports to investors because these reports are dependent on information provided from the banks and associations and, as a result, gathering and consolidating this information takes additional time. We consider these proposed timeframes as a reasonable compromise between industry practices and the unique cooperative structure of the System.

2. System-Wide Interim Reports [New § 630.3(a)]

The proposed rule would add a new § 630.3(a)(3), requiring the Funding Corporation to have written policies and procedures in place for disclosing significant events or material changes in System-wide operations occurring after publication of a quarterly or annual System-wide report to investors. The value of System-wide debt is subject to change based on information in the marketplace and, in keeping with section 409 ("real time issuer disclosures")⁵ of Sarbanes-Oxley, we believe it appropriate to propose requiring the Funding Corporation to develop and maintain policies and procedures for the issuance of interim reports on the System-wide financial condition. We would expect the policies and procedures to incorporate appropriate best industry practices, taking into consideration the

⁴ Accelerated SEC filers must submit annual reports within 60 days of the end of the fiscal year and quarterly reports within 40 days of the quarter's end.

⁵ Public companies disclose "on a rapid and current basis" material information regarding changes in a company's financial condition or operations.

cooperative nature and unique structure of the System. We determined that, because the value of equity held by System stockholders is not subject to changes based on information disseminated in the marketplace, there was no need to require similar policies and procedures for interim reports from banks and associations. However, we expect System banks and associations to comply with redesignated § 630.4(b) and (c) that requires them to provide information to the Funding Corporation necessary for preparation of reports to System investors.

D. Auditor Independence [§ 621.4(b) and New §§ 621.30, 621.31, and 621.32]

We are proposing new requirements in part 621 to facilitate auditor independence within the System. We are proposing a new subpart F, which would require each System institution ensure the independence of all external auditors conducting the institution's audit by establishing and maintaining policies and procedures governing the engagement of auditors. We believe that the proposed provision will strengthen auditor independence by alleviating circumstances where conflicts of interests may arise or impair an auditor's independence.

As a conforming change, we are proposing to revise § 621.4(b) to require that a qualified public accountant comply with the provisions of the new subpart F of this chapter when retained by a System institution to audit financial reports.

1. Prohibited Non-Audit Services [New § 621.31]

We propose adding a new § 621.31 prohibiting external auditors of System institutions from providing certain non-audit services. Our proposed rule identifies seven specific non-audit services that would be prohibited, including bookkeeping, valuation services, financial information system design, and management services. These prohibited non-audit services are currently recognized within the accounting industry as exposing external auditors to a high risk for conflicts of interest with respect to their audit of a client's financial information. For instance, it is doubtful an auditor can maintain independence in conducting an audit of an information system the auditor helped design and implement. We believe clearly identifying a list of prohibited non-audit services would enhance the independent relationship between System institutions and their external auditors as well as provide stockholders, investors and the general

public assurances that audited reports have not been significantly impacted by auditor conflicts of interest. We consider this especially important in the current business climate, where qualified public accountants are subject to strict conflict-of-interest rules when auditing publicly traded company financial reports. We are also convinced that limitations on non-audit services improve the safety and soundness of System institutions.

As a conforming change, we propose removing from redesignated § 630.4(b)(4) and (c)(2) the requirement that banks and associations include a provision in their audit engagement letters, authorizing the external auditors to respond to questions from funding banks and the Funding Corporation. We consider removal of this provision necessary to conform our rules to the expectations discussed in our proposed financial reporting certification requirements for System institutions. We strongly believe that each bank and association should be able to respond to questions on the contents of their own financial reports. We have proposed certification requirements for System institution officers and directors to state they have reviewed the financial reports and that the reports are accurate. These certifying officials, in order to make the certification, should be able to explain the financial reports to their funding bank or the Funding Corporation. We also believe this requirement must be removed to enable external auditors to comply with our proposed prohibitions on auditor services, including serving as an advocate of an institution.

2. Permitted Non-Audit Services [§§ 620.30, New 621.31 and 630.6]

We propose, in new § 621.31(b), requiring System institutions to obtain their audit committee's approval prior to contracting for permissible non-audit services from the auditor. The proposed rule recognizes that the external auditor may provide additional permissible services than those required to perform a financial statement audit pursuant to generally accepted auditing standards. We believe requiring audit committee approval of non-audit services will help prevent conflicts of interest from arising between the qualified public accountant and management by providing a level of board oversight. We also consider the involvement of an institution's audit committee in the non-audit duties of a qualified public accountant is necessary given the audit committee's responsibility for selecting and hiring an external auditor to perform the institution's financial audit.

The proposed rule would also amend the authorities of the audit committees in § 620.30(d)(2) to specifically include approval of non-audit services and add a new § 630.6(a)(4)(ii)(C) that imposes the same requirement on the System Audit Committee. The proposed rule would also require audit committees to comply with the independent auditor provisions proposed at part 621 and that approved non-audit services be reported in the annual report.

3. Auditor Conflicts of Interest and Rotation [New § 621.32]

We are proposing a new § 621.32 prohibiting a System institution from engaging the audit services of a qualified public accountant if the accountant, an accounting partner or concurring partner, or lead audit team member was an employee, officer or director of the System in the 12 months prior to contracting for audit services. The proposed rule would further prohibit an institution from making employment offers to an external auditor, accounting firm partner, concurring partner, or lead audit team member during the audit, or within 1 year of its conclusion. We believe creating a 1-year "cooling-off" period for former professional relationships will preserve the independent judgment of audit staff, helping to ensure it is not impaired, either through appearance or actuality.

We also propose prohibiting a System institution from engaging the audit services of a qualified public accountant, or the lead and reviewing audit partner, after 5 consecutive years of service to that institution. The proposed rule would require the institution ensure the lead audit and reviewing partners assigned to the institution's audit team are rotated out of the audit team for a 5-year "time-out" period. After the end of 5 years, the institution would again be authorized to engage the audit services of those audit partners. We believe that requiring the rotation of the lead and reviewing auditing partners after 5 consecutive years provides borrowers, shareholders and investors assurances that a "fresh look" is given to the accounting and auditing issues confronting the institution.

We applied the "time-out" on an individual institution basis, instead of a System-wide basis, due to the separate status of each institution. We recognize that the System issues System-wide debt and may therefore be viewed by some investors as a single entity, however, each institution has a separate charter and issues individual quarterly and annual reports. It is these reports that

the external auditors review, so permitting rotation by institution does not impinge on the independence of the auditor for that institution.

E. Contents of Farm Credit Banks and Associations Periodic Reports [§ 620.5]

1. Description of Property [§ 620.5(b)]

We propose removing the requirement at § 620.5(b) that Farm Credit banks and associations describe, in their annual reports, the terms and condition of agreements involving institution property subject to major encumbrances. The Funding Corporation suggested we delete the last sentence of this section of the rule as it asks for too much information. We have determined the provision is duplicative of requirements contained elsewhere in this section of the rule. However, we remind institutions that our existing regulations require disclosure of additional information necessary to enhance an understanding of the institution's financial condition or to keep the information that has been disclosed from being misleading.

2. Legal Proceedings and Enforcement [§ 620.5(c)]

We propose removing that portion of § 620.5(c)(1) requiring banks and associations to provide filing information on court proceedings, including a description of factual allegations, in annual reports. The Funding Corporation stated that our existing rule goes beyond the scope of GAAP contingency requirements, asking us to remove the last sentence requiring disclosure of information normally not disclosed under GAAP, unless the information was material to an understanding of the litigation.

While we do not agree with the Funding Corporation's reasons for seeking removal of the language, we have identified other reasons for proposing its removal. While the requirements may go beyond the scope of GAAP for disclosure of contingencies, GAAP was never intended to address all disclosure issues. Disclosure of items important to shareholder decisions or determination of an entity's financial condition are reason enough to require disclosures beyond GAAP. Further, our existing requirement to disclose such matters in the narrative portion of the annual report is consistent with the requirements of other regulators. Nevertheless, because this section of our existing rule already requires a brief discussion of material pending legal proceedings, we are proposing the removal of the last sentence of this section. We make this proposal with the

expectation that System institutions understand that the remaining materiality requirement means information must be provided to enable readers to understand a material pending legal proceeding. We also reiterate that System institutions must continue to make the detailed disclosures required in § 620.5(c)(2) for enforcement actions.

3. Selected Financial Data and Management Discussion & Analysis (MD&A) [§ 620.5(f) and (g)]

We propose clarifying in § 620.5(f), (g)(l)(iii)(A) and (g)(l)(iv)(E) that disclosure of selected financial data, loan purchases and sales involving the Federal Agricultural Mortgage Corporation (FAMC), and risk exposure need only be reported if they are material. The Funding Corporation requested we limit certain financial disclosure to material information, remarking that it would be appropriate to have some flexibility as to what is disclosed, as long as all material information is provided. The Funding Corporation stated that a materiality threshold would also eliminate immaterial data from the annual report, such as loan sale disclosures for institutions with smaller transactions. We believe that banks and associations need not disclose information that may not be relevant and meaningful to shareholders and investors. We continue to believe that shareholders and investors have the right to receive material and relevant information that could have an impact on the financial condition and results of operations of an institution and the System. As a related technical amendment, we are proposing to remove the reference in § 620.5(g)(1)(iv)(E) to section 8.7 of the Act because section 8.7 of the Act was repealed.

We also propose removing the required discussion of the adequacy of loan loss allowances for absorbing inherent portfolio risks in § 620.5(g)(l)(iv)(B). The Funding Corporation asked us to remove the last portion of this paragraph of the section to accommodate best practices. We believe this requirement is duplicative of information already provided in this section and should be amended to reflect current best practices. We remind System institutions that we discuss our expectations for disclosures in this area in our April 26, 2004 Bookletter, "Adequacy of Farm Credit System Institutions' Allowance for Loan Losses and Risk Funds" (BL-049) and our April 26, 2004 Informational Memorandum, "Adequacy of Farm Credit System Institutions' Allowance

for Loan Losses and Risk Funds." BL-049 provides guidance to System institutions on principles for maintenance of an adequate level of the allowances for loan losses (ALL) to ensure prudent risk funds management. BL-049 explains the acceptable minimum criteria to determine the adequacy of an institution's ALL and risk funds, while the companion Informational Memorandum contains more specificity on the ALL analysis through incorporating current best practices. The federal banking regulatory agencies issued similar policy statements intended to clarify their expectations regarding methodologies and documentation support for the ALL and the SEC-issued parallel guidance in a Staff Accounting Bulletin.

4. Fees to Qualified Public Accountants [§ 620.5(l)]

We are proposing a new reporting requirement at § 620.5(l), disclosing the fees paid by System institutions to their qualified public accountants. System institutions would annually report the fees paid for audit, tax, and non-audit services and indicate the audit committee's approval of the non-audit services. We believe disclosing the fees paid to qualified public accountants will improve the shareholders and investors understanding of the services performed and help shareholders and investors assess the independence of the institution's qualified public accountant.

5. Selected Financial Data [§ 630.20(f)]

We propose clarifying that § 630.20(f) requires only material combined financial data for 5 years, not all financial data. The Funding Corporation requested we limit certain financial disclosure to material information. We believe that System-wide reports need not disclose information that may not be relevant and meaningful to investors, potential investors, and the public. The Funding Corporation also asked that we remove the requirement to report all other property owned on a System-wide basis for each of the last 5 fiscal years. We believe the proposed clarification that § 630.20(f) requires only material combined financial data for 5 years be disclosed will address this issue. Thus, we do not propose removing other property owned from the list of financial data. We believe this clarification will not compromise the information provided to investors since the Funding Corporation must still report all additional information necessary to enhance an understanding of the System's financial condition or to

keep the information that has been disclosed from being misleading.

F. Miscellaneous and Technical Changes

1. Financial Assistance Corporation [§§ 630.2, 630.4, and 630.20(b)]

We propose removing references to the Financial Assistance Corporation (FAC) from the definition of "disclosure entity" in § 630.2(c) and remove §§ 630.4(b) and 630.20(b)(3), which outline the reporting requirements of the FAC. Having fulfilled its statutory responsibilities in accordance with section 6.31 of the Act,⁶ the activities of the FAC will be terminated. Since the FAC will no longer exist as a corporate entity, we believe it necessary to remove any reference to the FAC in these regulations.

2. Regulatory Accounting Practices [Part 624]

On October 13, 1988, we adopted part 624 to allow the use of specific regulatory accounting practices (RAP) by Farm Credit institutions and to implement provisions of the Agricultural Credit Act of 1987.⁷ Part 624 authorized System institutions to use RAP to defer certain interest costs and portions of the provision for loan losses. The Act and part 624 authorized each institution to defer costs it incurred until the calendar year end 1992. The regulations further allowed System institutions to amortize those costs over a period of not more than 20 years, or until calendar year end 2012. Because no System institution currently uses the provisions of this part, we believe it appropriate to remove part 624, in its entirety.

3. Other Issues Not Resulting in Proposed Changes

We received recommended changes to regulations covered by this rulemaking that we are not making and explain our reasons below.

a. Developments Impacting Earnings and Interest Rates [§ 620.5(a)(4)]

The Funding Corporation asked that we move the § 620.5(a)(4) requirement to discuss the impact of business developments on earnings and interest rates to § 620.5(g), Management Discussion and Analysis (MD&A). The

⁶ Under section 6.31 of the Act, the Financial Assistance Corporation and the authority provided to such Corporation by the Act is to terminate on the complete discharge by the Financial Assistance Corporation of its responsibilities under section 6.9(e) and section 6.26, but in no event later than 2 years following the maturity and full payment of all debt obligations issued under section 6.26(a).

⁷ See 53 FR 40049 (October 13, 1988).

Funding Corporation stated that § 620.5(a)(4) should be used to provide information material to an understanding of the general development of the business, not a discussion on the impact of earnings and interest rates. Existing § 620.5(a)(4) requires a brief discussion of significant developments within the last 5 years that had or could have a material impact on earnings or interest rates to borrowers. If this discussion is integral to the MD&A disclosure as suggested by the Funding Corporation, it may be incorporated by reference in the MD&A section without a regulatory change. Our existing rule at § 620.2(e) clearly states that information in any part of the report may be referenced or incorporated in answer or partial answer to any other item of the report. Section 620.2(h) provides further that each Farm Credit institution shall present its reports in a manner that provides the most meaningful disclosure to shareholders.

b. Business Concentration Disclosure [§ 630.20(a)]

The Funding Corporation asked us to remove the § 630.20(a)(1)(v) requirement for a brief discussion of any business concentrations of more than 10 percent because a table is included in the MD&A setting forth this information. We continue to believe that the information required to be discussed in § 630.20(a)(1)(v) is necessary for the reader to have a complete understanding of the business and customers of the System. Further, the Funding Corporation may refer the reader to the disclosures made in the MD&A in satisfaction of § 630.20(a)(1)(v) without a regulatory change. Our existing rule at § 630.3(e) clearly states that information in any part of the report may be referenced or incorporated in answer or partial answer to any other item of the report. Section 630.3(e) further states that information required by this part may be presented in any order deemed suitable by the Funding Corporation.

c. Reporting on Young, Beginning and Small Farmers [§§ 614.4165(c), 620.5(n) and 630.20(p)]

The Funding Corporation asked us to reduce regulatory burden by restricting the young, beginning and small farmers (YBS) reporting requirement to association annual reports. The Funding Corporation stated that this change would eliminate the need to disclose this information in the annual reports of Farm Credit banks, district-wide reports, and System-wide reports. Additionally, the Funding Corporation asked that part

of § 614.4165(c) be deleted, stating that only a description and disclosure of key components and material information in serving YBS farmers should be required.

We are proposing no changes to §§ 620.5(n) and 630.20(p), which require annual reports to shareholders and investors include information on YBS lending activities. Section 4.19 of the Act requires Farm Credit banks to submit an annual report to FCA summarizing the YBS operations and achievements of their affiliated associations. We continue to believe reporting to shareholders and the public on the YBS mission underscores the importance of the System's public purpose mission and the YBS mission, resulting in greater transparency to the public on the System's accomplishment in this area. Further, we do not believe the consolidated YBS reporting requirements impose a regulatory burden on System institutions. The rule requires the banks to include in their annual reports to shareholders a summary report of YBS quantitative data received from their affiliated associations. This quantitative data must already be submitted to us in each bank's annual YBS year-end report so it is not significantly more burdensome for the banks to include this same data in their annual reports to shareholders.

4. Implementation Date

We recognize that some System institutions may have to modify their annual and quarterly reports to satisfy certain provisions of the proposed rule. Therefore, we are proposing a delay in the implementation of the rule. Compliance with all provisions must be achieved by the start of the fiscal year immediately following the effective date of the final rule, unless the start of that fiscal year is within 3 months or less of the effective date. In that case, we propose that full compliance with all provisions be delayed until the start of the next full fiscal year.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

List of Subjects

12 CFR Part 611

Agriculture, Banks, banking, Rural areas.

12 CFR Part 619

Agriculture, Banks, banking, Rural areas.

12 CFR Part 620

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 621

Accounting, Agriculture, Banks, banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 624

Accounting, Agriculture, Banks, banking, Rural areas.

12 CFR Part 627

Agriculture, Banks, banking, Claims, Rural areas.

12 CFR Part 630

Accounting, Agriculture, Banks, banking, Organization and functions (Government agencies), Reporting and recordkeeping requirements, Rural areas.

For the reasons stated in the preamble, parts 611, 619, 620, 621, 624, 627 and 630 of chapter VI, title 12 of the Code of Federal Regulations are proposed to be amended as follows:

PART 611—ORGANIZATION

1. The authority citation for part 611 continues to read as follows:

Authority: Secs. 1.3, 1.4, 1.13, 2.0, 2.1, 2.10, 2.11, 3.0, 3.2, 3.21, 4.12, 4.15, 4.20, 4.21, 5.9, 5.10, 5.17, 6.9, 6.26, 7.0–7.13, 8.5(e) of the Farm Credit Act (12 U.S.C. 2011, 2013, 2021, 2071, 2072, 2091, 2092, 2121, 2123, 2142, 2183, 2203, 2208, 2209, 2243, 2244, 2252, 2278a–9, 2278b–6, 2279a–2279f–1, 2279aa–5(e)); secs. 411 and 412 of Pub. L. 100–233, 101 Stat. 1568, 1638; secs. 409 and 414 of Pub. L. 100–399, 102 Stat. 989, 1003, and 1004.

Subpart P—Termination of System Institution Status

§ 611.1250 [Amended]

2. In subpart P, § 611.1250(a)(3) is amended by removing the words "as defined in § 621.2(i) of this chapter" from the end of the second sentence.

§ 611.1255 [Amended]

2a. Section 611.1255(a)(3) is amended by removing the words "as defined in § 621.2(i) of this chapter" from the end of the second sentence.

PART 619—DEFINITIONS

3. The authority citation for part 619 is revised to read as follows:

Authority: Secs. 1.4, 1.7, 2.1, 2.4, 2.11, 3.2, 3.21, 4.9, 5.9, 5.12, 5.17, 5.18, 5.19, 6.22, 7.0, 7.1, 7.6, 7.7, 7.8, 7.12 of the Farm Credit Act (12 U.S.C. 2011, 2015, 2072, 2075, 2092, 2123, 2142, 2160, 2243, 2244, 2252, 2253, 2254, 2278b–2, 2279a, 2279a–1, 2279b, 2279b–1, 2279b–2, 2279f).

4. Amend part 619 by adding a new § 619.9270 to read as follows:

§ 619.9270 Qualified Public Accountant or External Auditor.

A qualified public accountant or external auditor is a person who:

(a) Holds a valid and unrevoked certificate, issued to such person by a legally constituted State authority, identifying such person as a certified public accountant;

(b) Is licensed to practice as a public accountant by an appropriate regulatory authority of a State or other political subdivision of the United States;

(c) Is in good standing as a certified and licensed public accountant under the laws of the State or other political subdivision of the United States in which is located the home office or corporate office of the institution that is to be audited;

(d) Is not suspended or otherwise barred from practice as an accountant or public accountant before the Securities and Exchange Commission (SEC) or any other appropriate Federal or State regulatory authority; and

(e) Is independent of the institution that is to be audited. For the purposes of this definition the term “independent” has the same meaning as under the rules and interpretations of the American Institute of Certified Public Accountants (AICPA). At a minimum, an accountant hired to audit a System institution is not independent if he or she functions in the role of management, audits his or her own work, or serves in an advocacy role for the institution.

PART 620—DISCLOSURE TO SHAREHOLDERS

5. The authority citation for part 620 is revised to read as follows:

Authority: Secs. 4.19, 5.9, 5.17, 5.19, 8.11 of the Farm Credit Act (12 U.S.C. 2207, 2243, 2252, 2254, 2279aa–11).

Subpart A—General

6. Amend § 620.2 as follows:

- a. Remove paragraphs (b) and (c);
- b. Add new paragraph (b);
- c. Redesignate paragraphs (d) through (j) as paragraphs (c) through (i), consecutively; and

d. Revise paragraphs (a) and newly redesignated paragraph (c).

The additions and revisions read as follows:

§ 620.2 Preparing and filing the reports.

For the purposes of this part, the following shall apply:

(a) Copies of each report required by this part, including financial statements and related schedules, exhibits, and all other papers and documents that are a part of the report must be sent to the Farm Credit Administration according to our instructions to you. Submissions must comply with the requirements of § 620.3 of this part. The Farm Credit Administration must receive the report within the period prescribed under applicable subpart sections.

(b) The reports must be available for public inspection at the issuing institution and the Farm Credit Administration office with which the reports are filed. Bank reports must also be available for public inspection at each related association office.

(c) The reports sent to shareholders must comply with the requirements of § 620.3 of this part. Shareholders must agree to electronic disclosures of reports required by this part.

* * * * *

7. Revise § 620.3 to read as follows:

§ 620.3 Accuracy of reports and internal controls.

(a) *Prohibition against incomplete, inaccurate, or misleading disclosures.* No institution and no employee, officer, director, or nominee for director of the institution shall make any disclosure to shareholders or the general public concerning any matter required to be disclosed by this part that is incomplete, inaccurate, or misleading. When any such person makes disclosure that, in the judgment of the Farm Credit Administration, is incomplete, inaccurate, or misleading, whether or not such disclosure is made in disclosure statements required by this part, such institution or person shall make such additional or corrective disclosure as is necessary to provide shareholders and the general public with a full and fair disclosure.

(b) *Signatures.* The name and position title of each person signing the report must be printed beneath his or her signature. If any person required to sign the report has not signed the report, the name and position title of the individual and the reasons such individual is unable or refuses to sign must be disclosed in the report. All reports must be dated and signed on behalf of the institution by:

(1) The chief executive officer (CEO);

(2) The chief financial officer (CFO), or if the institution has no CFO, the officer responsible for preparing financial reports; and

(3) A board member formally designated by action of the board to certify reports of condition and performance on behalf of individual board members.

(c) *Certification of financial accuracy.* The report must be certified as financially accurate by the signatories to the report. If any signatory is unable to or refuses to certify the report, the institution must disclose the individual’s name and position title and the reasons such individual is unable or refuses to certify the report. At a minimum, the certification must include a statement that:

(1) The signatories have reviewed the report,

(2) The report has been prepared in accordance with all applicable statutory or regulatory requirements, and

(3) The information is true, accurate, and complete to the best of signatories’ knowledge and belief.

(d) *Internal controls assessment.* The annual and quarterly reports of those institutions with over \$500 million in assets (at the end of the prior fiscal year) must include an assessment of the internal financial controls of the institution. At a minimum, the assessment must:

(1) Affirmatively state internal controls are in place,

(2) Declare the internal controls have been reviewed during the reporting period,

(3) Indicate that the details of the internal controls review were reported to the institution’s board of directors, and

(4) Include a conclusion on the effectiveness of the internal controls.

Subpart B—Annual Report to Shareholders**§ 620.4 [Amended]**

8. Amend § 620.4(a) by removing the word “shall” and adding in its place, the word “must”; and by removing the reference “90” and adding in its place, the reference “75 calendar”.

9. Amend § 620.5 as follows:

a. Remove the word “shall” and add in its place, the word “must” in paragraph (a) introductory text;

b. Remove the last sentence in paragraphs (b) and (c)(1);

c. Add the words “, if material” at the end of paragraph (f) introductory text;

d. Add the word “material” before the word “participation” in paragraph (g)(1)(iii)(A);

e. Remove the words “to absorb the risk inherent in the institution’s loan

portfolio" at the end of paragraph (g)(1)(iv)(B);

f. Add the word "material" before the word "obligations" and before the word "contributions" in the first sentence of paragraph (g)(1)(iv)(E) and remove the words "pursuant to section 8.7 of the Act" at the end of the first sentence;

g. Revise paragraph (l); and

h. Remove the words "as defined in § 621.2(i) of this chapter," in paragraph (m)(1); remove existing paragraph (m)(2) and redesignate paragraph (m)(3) as new paragraph (m)(2).

The revision reads as follows:

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(l) *Relationship with qualified public accountant.*

(1) If a change or changes in qualified public accountants have taken place since the last annual report to shareholders or if a disagreement with a qualified public accountant has occurred that the institution would be required to report to the Farm Credit Administration under part 621 of this chapter, the information required by § 621.4(c) and (d) of this chapter must be disclosed.

(2) Disclose the total fees, by the category of services provided, paid during the reporting period to the qualified public accountant or accounting firm. At a minimum, identify fees paid for audit services, tax services, and non-audit related services. The types of non-audit services must be identified and indicate audit committee approval of the services.

* * * * *

Subpart C—Quarterly Report

§ 620.10 [Amended]

10. Amend § 620.10(a) by removing the word "shall" and adding in its place, the word "must" and by removing the reference "45" and adding in its place, the reference "40 calendar".

Subpart F—Bank and Association Audit and Compensation Committees

11. Amend § 620.30 by adding new paragraphs (d)(2)(iii) and (iv) to read as follows:

§ 620.30 Audit committees.

(d) * * *

(2) * * *

(iii) Give prior approval for any non-audit services performed by the external auditor, except those non-audit services specifically prohibited by FCA regulation; and

(iv) Comply with the auditor independence provisions of part 621 of this chapter.

* * * * *

PART 621—ACCOUNTING AND REPORTING REQUIREMENTS

12. The authority citation for part 621 is revised to read as follows:

Authority: Secs. 5.17, 8.11 of the Farm Credit Act (12 U.S.C. 2252, 2279aa-11); sec. 514 of Pub. L. 102-552.

Subpart A—Purpose and Definitions

13. Amend § 621.2 by removing paragraph (i); and by redesignating paragraph (j) as (i).

Subpart B—General Rules

14. Amend § 621.4 by revising paragraph (b) to read as follows:

§ 621.4 Audit by qualified public accountant.

* * * * *

(b) The qualified public accountant's opinion of each institution's financial statements must be included as a part of each annual report to shareholders. The accountant must comply with the auditor independence provisions of subpart F of this part.

* * * * *

15. Add a new subpart F, consisting of §§ 621.30, 621.31, and 621.32, to read as follows:

Subpart F—Auditor Independence

Sec.

621.30 General.

621.31 Non-audit services.

621.32 Conflicts of interest and rotation.

Subpart F—Auditor Independence

§ 621.30 General.

System institutions must ensure the independence of all qualified public accountants conducting the institution's audit by establishing and maintaining policies and procedures governing the engagement of external auditors. The policies and procedures must incorporate the provisions of this section and § 612.2260 of this chapter.

§ 621.31 Non-audit services.

Non-audit services are any professional services provided by a qualified public accountant during the period of an audit engagement which are not connected to an audit or review of an institution's financial statements.

(a) A qualified public accountant engaged to conduct a System institution's audit may not perform the following non-audit services for that institution:

(1) Bookkeeping,

(2) Financial information systems design,

(3) Appraisal and valuation services,

(4) Actuarial services,

(5) Internal audit outsourcing services,

(6) Management or human resources functions,

(7) Legal and expert services unrelated to the audit, and

(8) Advocating an institution's interests in litigation, regulatory or administrative investigations and proceedings.

(b) A qualified public accountant engaged to conduct a System institution's audit may only perform non-audit services, not otherwise prohibited in this section, if the institution's audit committee pre-approves the services and the services are fully disclosed in the annual report.

§ 621.32 Conflicts of interest and rotation.

(a) *Conflicts of interest.* (1) A System institution may not engage a qualified public accountant to conduct the institution's audit if the accountant uses a partner, concurring partner, or lead member in the audit engagement team who was a director, officer or employee of the System institution within the past year.

(2) A System institution may not make an employment offer to a partner, concurring partner, or lead member serving on the institution's audit engagement team during the audit or within 1 year of the conclusion of the audit engagement.

(b) *Rotation.* Each institution may engage the same lead and reviewing audit partners of a qualified public accountant to conduct the institution's audit for no more than 5 consecutive years. The institution must then require the lead audit and reviewing partners assigned to the institution's audit team to rotate out of the audit team for 5 years. At the end of 5 years, the institution may again engage the audit services of those lead and reviewing audit partners.

PART 624—[REMOVED AND RESERVED]

16. Remove and reserve part 624.

PART 627—TITLE IV CONSERVATORS, RECEIVERS, AND VOLUNTARY LIQUIDATIONS

17. The authority citation for part 627 continues to read as follows:

Authority: Secs. 4.2, 5.9, 5.10, 5.17, 5.51, 5.58, 5.61 of the Farm Credit Act (12 U.S.C. 2183, 2243, 2244, 2252, 2277a, 2277a-7, 2277a-10).

Subpart C—Conservators and Conservatorships

18. Amend § 627.2785 by revising paragraphs (b) and (d) as follows:

§ 627.2785 Inventory, examination, audit, and reports to stockholders.

* * * * *

(b) The institution in conservatorship shall be examined by the Farm Credit Administration in accordance with section 5.19 of the Act. The institution must also be audited by a qualified public accountant in accordance with part 621 of this chapter.

* * * * *

(d) Each institution in conservatorship must prepare and issue published financial reports in accordance with provisions of part 620 of this chapter, and the certifications and signatures of the board of directors or management provided for in § 620.3 must be provided by the conservator of the institution.

PART 630—DISCLOSURE TO INVESTORS IN SYSTEM-WIDE AND CONSOLIDATED BANK DEBT OBLIGATIONS OF THE FARM CREDIT SYSTEM

19. The authority citation for part 630 continues to read as follows:

Authority: Secs. 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2252, 2254).

Subpart A—General

20. Amend § 630.2 by revising paragraph (c) to read as follows:

§ 630.2 Definitions.

* * * * *

(c) *Disclosure entity* means any Farm Credit bank and the Federal Farm Credit Banks Funding Corporation (Funding Corporation).

* * * * *

21. Amend § 630.3 by revising paragraphs (a), (f) and (h) as follows:

§ 630.3 Publishing and filing the report to investors.

(a) The disclosure entities shall jointly publish the following reports in order to provide meaningful information pertaining to the financial condition and results of operations of the System to investors and potential investors in FCS debt obligations and other users of the report:

(1) An annual report to investors within 75 calendar days after the end of each fiscal year;

(2) A quarterly report to investors within 40 calendar days after the end of each quarter, except for the quarter that coincides with the end of the fiscal year.

(3) Interim reports, as required by the Funding Corporation's written policies and procedures, disclosing significant events or material changes in information occurring since the most recently published report to investors.

* * * * *

(f) Information in documents prepared for investors in connection with the offering of debt securities issued through the Funding Corporation may be incorporated by reference in the annual and quarterly reports in answer or partial answer to any item required in the reports under this part. A complete description of any offering documents incorporated by reference must be clearly identified in the report (e.g., Federal Farm Credit Banks Consolidated System-wide Bonds and Discount Notes—Offering Circular issued on [insert date]). Offering documents incorporated by reference in either an annual or quarterly report prepared under this part must be filed with the Farm Credit Administration according to our instructions to you either prior to or at the time of submission of the report under paragraph (h) of this section. Any offering document incorporated by reference is subject to the delivery and availability requirements set forth in § 630.4(a)(5) and (a)(6).

* * * * *

(h) Complete copies of the report must be filed with the Farm Credit Administration according to our instructions to you. All copies must comply with the requirements of § 630.5 of this part.

22. Amend § 630.4 as follows:

- a. Revise paragraph (a)(4);
- b. Remove paragraph (b);
- c. Redesignate paragraphs (c) and (d) as (b) and (c);
- d. Revise newly redesignated paragraphs (b)(4), (b)(5), and (c).

§ 630.4 Responsibilities for preparing the report to investors.

(a) * * *

(4) File the reports with the FCA in accordance with § 630.3(f) and (h) and § 630.5.

* * * * *

(b) * * *

(4) Respond to inquiries from the Funding Corporation relating to preparation of the report.

(5) Certify to the Funding Corporation that all information needed for preparation of the report to investors has been submitted in accordance with the instructions of the Funding Corporation and the information submitted complies with § 620.3.

(c) *Responsibilities of associations.* Each association must:

(1) Provide its related bank with the information necessary to allow the bank to provide accurate and complete information regarding the bank and its related associations to the Funding Corporation for preparation of the report. The financial information provided by the association to its related bank must comply with § 620.3.

(2) Respond to inquiries of the related bank pertaining to preparation of the combined financial data of the association and its related bank.

23. Revise § 630.5 to read as follows:

§ 630.5 Accuracy of reports and internal controls.

(a) *Prohibition against incomplete, inaccurate, or misleading disclosure.* Neither the Funding Corporation, nor any institution supplying information to the Funding Corporation under this part, nor any employee, officer, director, or nominee for director of the Funding Corporation or of such institutions, shall make or cause to be made any disclosure to investors and the general public required by this part that is incomplete, inaccurate, or misleading. When any such institution or person makes or causes to be made disclosure under this part that, in the judgment of the FCA, is incomplete, inaccurate, or misleading, whether or not such disclosure is made in published statements required by this part, such institution or person shall promptly furnish to the Funding Corporation, and the Funding Corporation shall promptly publish, such additional or corrective disclosure as is necessary to provide full and fair disclosure to investors and the general public. Nothing in this section shall prevent the FCA from taking additional actions to enforce this section pursuant to its authority under title V, part C of the Act.

(b) *Signatures.* The name and position title of each person signing the report must be printed beneath his or her signature. If any person required to sign the report has not signed the report, the name and position title of the individual and the reasons such individual is unable or refuses to sign must be disclosed in the report. All reports must be dated and signed on behalf of the Funding Corporation by:

- (1) The chief executive officer (CEO);
- (2) The officer in charge of preparing financial statements; and

(3) A board member formally designated by action of the board to certify reports of condition and performance on behalf of individual board members.

(c) *Certification of financial accuracy.* The report must be certified as financially accurate by the signatories to

the report. If any signatory is unable to or refuses to certify the report, the institution must disclose the individual's name and position title and the reasons such individual is unable or refuses to certify the report. At a minimum, the certification must include a statement that:

(1) The signatories have reviewed the report,

(2) The report has been prepared in accordance with all applicable statutory or regulatory requirements, and

(3) The information is true, accurate, and complete to the best of signatories' knowledge and belief.

(d) *Internal controls assessment.* (1) Annual and quarterly reports must include an assessment of the internal financial controls of the Funding Corporation over the Report to Investors. At a minimum, an assessment must:

(i) Affirmatively state internal controls are in place,

(ii) Declare the internal controls were reviewed during the reporting period,

(iii) Indicate that the details of the internal controls review were reported to the Funding Corporation's board of directors and the System Audit Committee, and

(iv) Include a conclusion on the effectiveness of internal controls.

(2) The qualified public accountant must, at a minimum, review, attest, and report on whether the internal controls are sufficient to reasonably ensure that the System-wide financial statements published by the Funding Corporation do not contain material misstatements. The accountant's report must be included in the annual report to investors.

24. Amend § 630.6 by revising paragraph (a)(4)(ii) to read as follows:

§ 630.6 Funding Corporation committees.

(a) * * *

(4) * * *

(ii) *External auditors.* The external auditor must report directly to the SAC. The SAC must:

(A) Determine the appointment, compensation, and retention of external auditors issuing System-wide audit reports;

(B) Review the external auditor's work;

(C) Give prior approval for any non-audit services performed by the external auditor, except those non-audit services specifically prohibited by FCA regulation; and

(D) Comply with the auditor independence provisions of part 621 of this chapter.

* * * * *

Subpart B—Annual Report to Investors

25. Amend § 630.20 as follows:

- a. Remove paragraph (b)(3); and
- b. Revise the introductory text, paragraphs (f) introductory text, (h)(1), (i), (k), and (l) introductory text to read as follows:

§ 630.20 Contents of the annual report to investors.

The annual report must contain the following:

* * * * *

(f) *Selected financial data.* At a minimum, furnish the following combined financial data of the System in comparative columnar form for each of the last 5 fiscal years, if material.

* * * * *

(h) Directors and management.

(1) *Board of directors.* Briefly describe the composition of boards of directors of the disclosure entities. List the name of each director of such entities, including the director's term of office and principal occupation during the past 5 years, or state that such information is available upon request pursuant to § 630.4(a)(5) and (a)(6).

(2) * * *

(i) *Compensation of directors and senior officers.* State that information on the compensation of directors and senior officers of System banks is contained in each bank's annual report to shareholders and that the annual report of each bank is available to investors upon request pursuant to § 630.4(a)(5) and (a)(6).

* * * * *

(k) Relationship with qualified public accountant.

(1) If a change in the qualified public accountant who has previously examined and expressed an opinion on the System-wide combined financial statements has taken place since the last annual report to investors or if a disagreement with a qualified public accountant has occurred that the Funding Corporation would be required to report to the FCA under part 621 of this chapter, disclose the information required by § 621.4(c) and (d).

(2) Disclose the total fees paid during the reporting period to the qualified public accountant or accounting firm by the category of services provided. At a minimum, identify fees paid for audit services, tax services, and non-audit related services. The types of non-audit services must be identified and indicate audit committee approval of the services.

(l) *Financial statements.* Furnish System-wide combined financial statements and related footnotes prepared in accordance with GAAP, and

accompanied by supplemental information prepared in accordance with the requirements of § 630.20(m). The System-wide combined financial statements shall provide investors and potential investors in FCS debt obligations with the most meaningful presentation pertaining to the financial condition and results of operations of the System. The System-wide combined financial statement and accompanying supplemental information shall be audited in accordance with generally accepted auditing standards by a qualified public accountant. The System-wide combined financial statements shall include the following:

* * * * *

Dated: March 8, 2006.

Roland E. Smith,

Secretary, Farm Credit Administration Board.

[FR Doc. 06-2382 Filed 3-13-06; 8:45 am]

BILLING CODE 6705-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 2001-NM-387-AD]

RIN 2120-AA64

Airworthiness Directives; McDonnell Douglas Model DC-9-81 (MD-81), DC-9-82 (MD-82), DC-9-83 (MD-83), DC-9-87 (MD-87), and MD-88 Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Supplemental notice of proposed rulemaking; reopening of comment period.

SUMMARY: This document revises an earlier proposed airworthiness directive (AD), applicable to certain McDonnell Douglas airplane models, that would have required a one-time inspection for chafing or signs of arcing of the wire bundle for the auxiliary hydraulic pump, and other specified and corrective actions, as applicable. This new action revises the proposed rule by proposing that certain airplanes be required to install additional protective sleeving on the upper portion of the auxiliary hydraulic pump wire assembly. The proposed AD results from reports of shorted wires and evidence of arcing on the power cables of the auxiliary hydraulic pump, as well as fuel system reviews conducted by the manufacturer. We are proposing this AD to prevent shorted wires or arcing at the auxiliary hydraulic pump, which could result in loss of auxiliary hydraulic