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SUPPLEMENTARY INFORMATION:

I. Background

Section 36 of the FDIA, as implemented by FDIC regulations, requires every large insured depository institution to submit an annual report containing its financial statements and certain management assessments to the FDIC, the appropriate Federal banking agency, and any appropriate state bank supervisor.¹ Section 36 of the FDIA also requires that an independent public accountant audit such insured depository institution's annual financial statements to determine whether those statements are presented fairly in accordance with generally accepted accounting principles (GAAP) and with the accounting objectives, standards, and requirements described in section 37 of the FDIA.

Under section 37, the accounting principles applicable to financial statements required to be filed with the Agencies must be uniform and consistent with GAAP.² In addition, the accountant must attest to and report on management's assertions concerning internal controls over financial reporting.³ The institution's annual report also must contain the accountant's audit and attestation reports.⁴ Section 36 of the FDIA gives

the Agencies the authority to remove, suspend, or bar an accountant from performing the audit services required under section 36 for good cause.⁵ This authority is in addition to the enforcement tools the Agencies have under section 8 of the FDIA, which enable the Agencies to remove or prohibit an institution-affiliated party (IAP), including an accountant, from further participation in the affairs of an insured depository institution for certain types of misconduct.⁶ Section 36 authority is also distinct from the Agency's capability to remove, suspend, or debar from practice before the Agency parties, such as accountants, who represent others.⁷

Section 36 does not define good cause, but authorizes the Agencies to implement section 36 through the joint issuance of rules of practice.⁸ A removal, suspension, or debarment under section 36 would limit an accountant's or accounting firm's eligibility to provide audit services to insured depository institutions with total assets of \$500 million or more. A section 36 action would not restrict the ability of accountants and firms to provide audit services to financial institutions with less than \$500 million in total assets, however, or to provide other types of services to all financial institutions.

The Agencies have jointly prepared proposed rules of practice to implement the provisions of section 36. The texts of the Agencies' proposed regulations are substantively identical and differ with respect to conforming changes each Agency is making to its existing rules. These proposed rules do not create independent professional standards or obligations for accountants or firms. Rather, they are consistent with an accountant's existing responsibility to adhere to applicable professional standards such as generally accepted auditing standards and generally accepted standards for attestation engagements. The proposed rules are also consistent with the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act),⁹ which, among other things, provides for significant reforms in the oversight of the accounting industry. The discussion that follows refers more specifically to the provisions of the Sarbanes-Oxley Act that are relevant to this proposal.

II. Discussion of the Proposal and Request for Comment

The proposal would amend the Agencies' rules of practice by adding provisions for removal, suspension, or debarment of accountants or accounting firms from performing the audit services required by section 36 of the FDIA. The proposed rules would define "good cause" to remove, suspend, or debar an accountant or firm from performing audit services and establish procedures for removal, suspension, or debarment of accountants or firms if the "good cause" standards are satisfied.

The first part of the discussion that follows describes the common elements of the proposed rules. The second part explains proposed technical and conforming changes to the existing rules of the OCC, Board, and FDIC. The Agencies invite comment on all aspects of the proposed rules.

A. Proposed Additions to the Rules of All the Agencies

1. Audit Services

The proposed rules define "audit services" as any service required to be performed under section 36 of the FDIA (12 U.S.C. 1831m) and 12 CFR part 363, including attestation services.¹⁰

2. Good Cause for Agency Action

The proposed rules define good cause for removal, suspension, or debarment of accountants from providing audit services required by section 36. Under the proposal, the Agencies would have "good cause" if the accountant does not possess the requisite qualifications to perform audit services; engages in knowing or reckless conduct that results in a violation of applicable professional standards, including those standards and conflicts of interest provisions applicable to accountants through the Sarbanes-Oxley Act and developed by the Public Company Accounting Oversight Board (Accounting Oversight Board) and the Securities and Exchange Commission (SEC), as such standards and provisions become effective;¹¹

¹⁰ For the Board and OTS, "audit services" also includes services provided to a bank holding company or thrift holding company that satisfy the audit requirements under section 36 of a subsidiary bank or thrift of that holding company.

¹¹ The FDIC's Guidelines and Interpretations concerning annual independent audits and reporting requirements, see 12 CFR part 363 app. A, at para. 14, call for accountants who perform audit and attestation services to comply with the American Institute of Certified Public Accountants' *Code of Professional Conduct* and meet the independence requirements and interpretations of the SEC and its staff. Title II of the Sarbanes-Oxley Act amended the Securities and Exchange Act of 1934 by adding new auditor independence provisions.

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¹ 12 U.S.C. 1831m, 1831m(j)(2); see also 12 CFR part 363 (describing the requirements for independent audits and reporting for all insured depository institutions). The statute gives the FDIC Board of Directors the discretion to establish the threshold asset size at which a section 36 annual report is required. That amount is currently set at \$500 million. See 12 CFR 363.1(a). While a section 36 audit is not required of financial institutions with less than \$500 million in total assets, the Agencies encourage every insured depository institution, regardless of its size or character, to have an annual audit of its financial statements performed by an independent public accountant. See 12 CFR part 363 App. A (Introduction).

² 12 U.S.C. 1831m(d), 1831n.

³ *Id.* 1831m(c); see also 12 CFR part 363 (independent audit and reporting requirements).

⁴ 12 U.S.C. 1831m(a)(1) and (2).

⁵ *Id.* 1831m(g)(4)(A).

⁶ *Id.* 1813(u)(4), 1818(e)(1).

⁷ See 12 CFR part 19, subpart K; 12 CFR part 263, subpart F; and 12 CFR part 513.

⁸ 12 U.S.C. 1831m(g)(4)(B).

⁹ The Sarbanes-Oxley Act of 2002, Pub. L. 107–204, 116 Stat 745 (2002).