

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.

II. Proposed Rule and Comments Received

On January 8, 2003, the Agencies proposed amending their rules of practice by adding provisions for the removal, suspension, or debarment of accountants or accounting firms from performing the audit services required by section 36 of the FDIA.⁹ The proposed rules defined “good cause” for such actions and established procedures for removal, suspension, or debarment of accountants. The proposals also contained conforming amendments to the existing practice rules of the OCC, Board, and FDIC.

The Agencies received six comments. One comment was from a major trade association for community banks; another was from four large accounting firms and a major professional association for the accounting industry; a third was from three accounting firms that provide audit services to publicly held and non-publicly held banks in one state; the fourth and fifth comments were from certified public accountants; and the final comment was from a banking, management, and economic consultant. The commenters generally stated their support for the underlying goals of section 36 and the proposal—to bolster the quality of audit services.

One commenter expressed concern about immediate suspensions. The commenter asked how an insured depository institution can meet the deadline for submitting section 36 audits if the institution’s accountant is subject to an order of immediate suspension and requested guidance on the Agencies’ expectations under these circumstances. Another commenter questioned why the Agencies are pursuing this rulemaking, given the role of the newly constituted Public Company Accounting Oversight Board (PCAOB) as a regulator of accountants. The commenter’s more specific concern was with the level of due process associated with immediate and automatic suspensions. A third commenter questioned whether the Agencies have authority to use a negligence standard of any kind, given

the higher standards elsewhere in the FDIA for IAPs who are independent contractors. The commenter also questioned the authority of the Agencies to extend sanctions to accounting firms and offices.

In response to the comments, the Agencies have revised the proposal, as discussed in detail below.

III. Final Rule

Below is a more detailed discussion of the issues raised in response to the proposal and the Agencies’ responses thereto. Because each Agency is codifying the final rules using different section numbers, this discussion will follow the order of the proposal, using captions instead of section numbers for reference.

Definitions

The proposal defined “accounting firm,” “audit services,” and “independent public accountant.” Under the proposal, “accounting firm” means a corporation, proprietorship, partnership, or other business firm providing audit services. “Audit services” means any service required to be performed by an independent public accountant by section 36 of the FDIA and 12 CFR part 363, including attestation services. “Independent public accountant” means any individual who performs or participates in providing audit services.

The Agencies did not receive any comments on the definitions. The final rule adopts the definitions as proposed.

Removal, Suspension, or Debarment

Good Cause for Removal, Suspension, or Debarment. The proposed rules defined “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 of 2002 (Sarbanes-Oxley Act)¹⁰ and developed by the

PCAOB and the Securities and Exchange Commission (SEC), as such standards and provisions become effective; engages in a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or engages in repeated instances of unreasonable conduct, each resulting in a violation of applicable standards, that indicate a lack of competence to perform annual audit services.

Under the proposal, good cause also included knowingly or recklessly giving false or misleading information to the Agencies with respect to any matter before the Agency; knowingly or recklessly violating any provision of the Federal banking or securities laws or regulations, or any other law, including the Sarbanes-Oxley Act; and removal, suspension, or debarment from practice before any Federal or state agency regulating the banking, insurance, or securities industry on grounds relevant to the provision of audit services, other than those actions that result in automatic removal, suspension, and debarment under the proposed rules.

Conduct giving rise to good cause under the proposed rules does not have to occur in connection with the provision of audit services or in connection with services provided to depository institutions. Any actions or failures to act by an independent public accountant or accounting firm that meet the criteria for good cause set forth in the regulation, whether or not related to the banking industry, could constitute good cause for Agency action.

One commenter expressed a variety of reservations about the good cause standard. The commenter’s broadest suggestion was that the Agencies should refer all section 36 actions against accountants to the PCAOB and SEC, given the entities’ new roles as regulators of accountants under the Sarbanes-Oxley Act.

This comment does not reflect the jurisdictional differences among the Agencies, PCAOB, and SEC. The Agencies have enforcement jurisdiction that is separate and distinct from the PCAOB’s and the SEC’s enforcement jurisdictions. Congress gave the Agencies discretion to suspend or debar accountants from performing annual audit services for good cause under section 36 of the FDIA. While an

Governance Initiatives to Non-Public Banking Organizations (May 5, 2003). See also FDIC Financial Institution Letter 17–2003 (Corporate Governance, Audits, and Reporting Requirements) (March 5, 2003).

⁹ 68 FR 1116 (January 8, 2003); see also 68 FR 4967, 5075 (January 31, 2003) (technical corrections).

¹⁰ Pub. L. 107–204, 116 Stat 745 (2002). For further guidance on the obligations of insured depository institutions under the Sarbanes-Oxley Act, see OCC Bulletin No. 2003–21, Application of Recent Corporate Governance Initiatives to Non-Public Banking Organizations (containing the Statement on Application of Recent Corporate Governance Initiatives to Non-Public Banking Organizations by the Board, OCC, and OTS (May 6, 2003)); Federal Reserve Board SR Letter 03–8, Statement on Application of Recent Corporate