

**MEMORANDUM TO:** Board of Directors  
**FROM:** William F. Kroener III  
General Counsel  
Michael J. Zamorski  
Director  
Division of Supervision and Consumer Protection  
**SUBJECT:** Notice of Proposed Rulemaking - 12 C.F.R. Part 308, Subpart U  
Removal, Suspension and Debarment of Accountants From  
Performing Audit Services

## **I. Proposal**

The attached Joint Notice of Proposed Rulemaking requests comment on the proposals of the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (collectively, the Agencies) to revise their respective rules of practice to establish procedures for the removal, suspension or debarment of independent public accountants from the performance of audit services required by section 36 of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1831m. Section 36(g)(4)(A) of the FDI Act gives the Agencies authority to remove, suspend or bar independent public accountants for good cause from the performance of required audit services. Section 36(g)(4)(B) authorizes the Agencies to jointly issue rules of practice to implement this authority. The proposed revisions to the Agencies' rules of practice to implement the enforcement provisions of section 36(g)(4) are substantively identical and will be issued jointly.

Concur: \_\_\_\_\_  
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The proposed rules of practice:

- define "good cause" to remove, suspend, or bar and establish a procedure for the removal, suspension or debarment of independent public accountants and accounting firms from the performance of section 36 audit services following notice and opportunity for a formal hearing;
- provide for an immediate suspension in appropriate circumstances with an expedited, post-suspension informal hearing procedure;

- establish rules specifying a variety of disciplinary actions against accountants that result in an automatic disqualification from the performance of audit services; and
- establish procedures governing applications for reinstatement.

## **II. Recommendation**

The Legal Division and the Division of Supervision and Consumer Protection recommend that the Board of Directors (Board) approve publication of the attached *Federal Register* document for a comment period to end 60 days from the date of publication in the *Federal Register*. The attached proposal has been drafted jointly among the Agencies. Although the proposed enforcement procedures are substantively identical among the Agencies, it is recommended that the Board authorize the Executive Secretary and the General Counsel to make technical and nonsubstantive changes to the text of the attached *Federal Register* document where necessary to ensure that the FDIC and the other Agencies can jointly publish their proposals with a common preamble.

## **III. Discussion**

Section 36 of the FDI Act, and its implementing regulation at 12 C.F.R. part 363, require each insured depository institution with total assets of \$500 million or more to produce an annual report containing the institution's financial statements, prepared in accordance with generally accepted accounting principles, as well as certain required management assessments regarding internal controls. Section 36 also requires that each covered insured depository institution obtain from an independent public accountant an audit of its financial statements and an attestation on management's assertions concerning internal controls over financial reporting. The annual report, along with the audit and attestation reports, must be provided the FDIC, the appropriate Federal banking agency, and any appropriate state bank supervisor. Section 36(g)(4)(A) of the FDI Act gives the FDIC (and the other Agencies) authority to remove, suspend or bar accountants for good cause from the performance of required audit services. Section 36(g)(4)(B) authorizes the Agencies to jointly issue rules of practice to implement this authority. The proposed rules of practice, while somewhat different in order to facilitate their inclusion in the Agencies' different current rules of practice, are substantively identical.

### **Good Cause**

The proposed rules describe the conduct that must be found to exist, after notice and opportunity for a formal hearing, for the Agencies to order removal, suspension or debarment from providing section 36 audit services. The proposals essentially reiterate the current rules of practice standards from section 308.109 of the FDIC's rules, and add reckless conduct that results in a violation of applicable professional standards as well as two types of negligent conduct which incorporate the same standard applied to accountants by the Securities and Exchange Commission (SEC) in its rule 2(e). (17 C.F.R. § 201.102(e)(1)(iv)). It is believed that parity in the accountant practice rules among the various Federal regulatory agencies would be desirable.

## **Scope of Suspension or Debarment**

The proposed rules establish a general rule that a removal, suspension or debarment order would prevent the independent public accountant from performing section 36 audit services for any insured depository institution for which the issuer is the appropriate Federal banking agency. The rules do provide, however, for the issuance of limited scope orders in circumstances where a more limited sanction is appropriate.

## **Accounting Firms**

The proposed rules provide for the possible removal, suspension or debarment of accounting firms in addition to individual accountants, and provide a number of specific factors that can be considered in determining if culpability at the firm level is appropriate. Making section 36 sanctions applicable to accounting firms is consistent with clear congressional intent manifested in the legislative history of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (H.R. Rep. No. 54, 101st Cong., 1st Sess. 466-67 (1989)) that banking agency enforcement actions should apply to commercial entities in appropriate circumstances.

## **Immediate Suspensions**

The proposed rules also provide for an immediate suspension without a preliminary hearing where such immediate suspension is determined to be necessary for the protection of an insured depository institution or its depositors or the depository system as a whole. An immediately suspended independent public accountant could petition for a stay of such order. A hearing officer would conduct an expedited informal hearing and would be required to issue a decision within 30 days after the hearing. Review of the hearing officer's decision by the Board could be sought, and the Board's final decision would have to be issued within 60 days after certification of the record to the Board.

## **Automatic Suspension and Debarment**

The proposed rules of each of the Agencies provide that an independent public accountant or firm that is subject to a final order to remove, suspend or debar issued under section 36 shall be automatically suspended from performing required audit services for any insured depository institution within the jurisdiction of such agency. Section 36 immediate suspension notices and limited scope orders are excluded.

In addition, staff believed that certain other disciplinary actions should result in an automatic disqualification. Thus, action by the Public Company Accounting Oversight Board under sections 105(c)(4)(A) or (B) of the Sarbanes-Oxley Act of 2002 (relating to revocation of registration and association with a public accounting firm or issuer), suspension or debarment from practice before the SEC, and suspension or debarment for cause from practice as an accountant by any duly constituted licensing authority also result in an automatic suspension. Where any of the listed actions are present, the section does permit the FDIC to override the disqualification and grant written permission to perform audit services in appropriate circumstances.

## **Applications for Reinstatement**

Finally, the proposed rules provide that an application for reinstatement may be made in writing at any time more than one year after the effective date of the order, and, thereafter, at any time more than one year after the most recent application for reinstatement. These restrictions are identical to those applicable to reinstatement applications of counsel under section 308.109 of the FDIC's rules.

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