

AUDITS--Audit Committee Duties and Responsibilities

The Board has revised its policy on audit committee duties and responsibilities to incorporate requirements consistent with those in the Sarbanes-Oxley Act of 2002 and the American Institute of Certified Public Accountants' Statement on Auditing Standards No. 99, "Consideration of Fraud in a Financial Statement Audit." Under the revised policy, at least one member of a Reserve Bank's audit committee should have banking, accounting, or other relevant financial proficiency. The Board believes that, as a general matter, most class A directors and many class B and C directors meet this requirement. The boards of directors need not explicitly designate and publicly disclose which audit committee members meet the financial proficiency requirement.

In addition, the revised policy requires that the audit committee establish procedures for the confidential, anonymous submission of accounting and auditing complaints and concerns (whistle-blower procedures), and that audit committee members be prepared to answer inquiries from the external auditors, especially concerning fraud and fraud mitigation. The revised policy also acknowledges the audit committee's authority to engage counsel and other advisors it determines necessary to carry out its duties.

Policy

The audit committee of each Reserve Bank's board of directors, acting on behalf of the board of directors, is responsible for assessing the effectiveness and independence of the Reserve Bank's internal audit function. This function, directed by a general auditor, is responsible for assessing the adequacy and effectiveness of the controls over (1) financial reporting, (2) efficiency and effectiveness of operations, and (3) compliance with laws and regulations.¹

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1. The internal audit function should consult legal counsel in all matters involving legal issues and should not render legal advice or substitute its legal judgment on legal matters for those of the general counsel.
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To promote independent and objective assessments, the general auditor reports directly to the board of directors through its audit committee. The general auditor must not be dependent on any Reserve Bank executive or operating officer for the security of his or her position. The audit committee must take care to ensure that the general auditor has access to the board of directors, on a confidential basis, and that the audit function is independent of Reserve Bank management, both by intent and in actual practice.

The Board expects the chairman of the board of directors to appoint a minimum of three directors to the audit committee; these individuals should be independent²

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2. Members of the audit committee are considered to be independent if they have no relationship with the Reserve Bank that might interfere with the exercise of their independence from management and the Bank. Examples of relationships include (i) a director being employed by that Reserve Bank within the past five years; (ii) a director accepting compensation

from that Reserve Bank other than compensation for board services; (iii) a director being a member of the immediate family of an individual who has been employed by that Reserve Bank as an officer within the past five years; and (iv) a director being a partner in, or controlling shareholder or an executive officer of, any for-profit business to which that Reserve Bank made, or from which that Reserve Bank received, payments that have been significant to the Reserve Bank within the past five years. For purposes of this policy, a director who is an officer or director of a depository institution or its holding company is not considered to have a relationship that interferes with his or her independence solely because the depository institution makes payments to the Reserve Bank for financial services or an extension of credit.

and financially literate (i. e., able to understand financial statements and general finance concepts) and at least one member should have banking, accounting, or other relevant financial proficiency.³

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3. Banking, accounting, or other relevant financial proficiency means significant employment experience in finance, accounting, auditing, or banking functions, professional certification in accounting, or other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer or other senior officer with financial oversight responsibilities.
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The members should be particularly suited to fulfill the following responsibilities.

1. To the extent the audit committee's responsibilities are not set forth in the Bank's bylaws, to adopt a formal written charter that is approved by the full board of directors and that specifies the scope of the audit committee's responsibilities and how it should carry out those responsibilities, and to review annually the performance by the audit committee of its responsibilities, as set forth in the bylaws or charter.
2. To hold regular meetings to permit adequate and timely discussions of audit results, losses, and irregular occurrences, and other matters of concern to the auditors and directors, and to hold an executive session with the general auditor whenever other officers of the Bank attend audit committee meetings.
3. To obtain from the general auditor an independent and objective assessment of the adequacy and effectiveness of the controls over (1) financial reporting, (2) effectiveness and efficiency of operations, and (3) compliance with laws and regulations, at such regular meetings and at other times as necessary.
4. To recommend to the board of directors the appointment and termination (including separation payments) of the general auditor, and to concur with any reassignment of the general auditor to another position in the Reserve Bank. The policy at [1-005](#) ("Appointment, Termination, and Reassignment of General Auditors") provides guidance on communications that should occur between the chair of a Reserve Bank's board of directors and the chair of the Board's

Committee on Federal Reserve Bank Affairs about changes in the general auditor position.

5. To formally evaluate the performance of the general auditor, following guidelines set forth by the Reserve Bank for evaluating the performance of other officers.
6. To recommend to the board of directors, or a designated subset of the board, a review of all actions affecting the salary or classification of the general auditor.
7. To review and approve an annual internal audit program that provides for audits for which the scope and frequency are reasonably expected to ensure an appropriate level of audit attention and to coordinate with any external audit conducted at the direction of the Board of Governors.
8. To review and approve an annual internal audit budget that is sufficient to carry out an effective audit program, to review performance against budget, and to determine whether any significant variances from existing System and Reserve Bank guidelines are justified.
9. To meet with the external auditors to discuss the Reserve Bank's financial statements and issues arising from the annual external audit. Audit committee members should be prepared to answer inquiries from the external auditors, especially concerning fraud and the mitigation of fraud risk.⁴

4. SAS 99, "Consideration of Fraud in a Financial Statement Audit," requires the external auditors to obtain information to identify the risks of material misstatement due to fraud, including making specific inquiries of management, the general auditor, and the audit committee. Members of the audit committee should be prepared to answer the auditors' questions about the risks of fraud in the Bank and whether the committee members have knowledge of fraud or suspected fraud affecting the Bank. Audit committee members should also be prepared to discuss how the audit committee exercises oversight of the assessment of the risk of fraud, and activities that mitigate those risks.

10. To bring before the board of directors any matters reported by the Board of Governors, general auditor, or external auditors that warrant the board's attention, and to ensure that audit recommendations and concerns receive proper attention by Bank management.
11. To establish procedures for (1) the confidential, anonymous submission by employees of complaints and concerns regarding questionable accounting, internal accounting control, or auditing matters and (2) the receipt, retention, and treatment of such complaints and concerns.
12. To engage independent counsel and other advisors as it determines necessary to carry out its duties. (In the case of an external auditor engaged by the Board, S-2612, at [1-008](#), sets out additional conditions that must be observed by the Reserve Bank and requires Board approval before engaging the external auditor to perform services. The letter at [1-083](#) provides procedures for Banks to follow when engaging outside legal counsel for fees of more than a specified threshold).