



REGULATORY INTERPRETATION 2000-RI-24

Date: September 19, 2000

Subject: Accounting Issues: Audit Committee Disclosures

Request Summary:

This is an interpretation of 12 C.F.R. § 985.6(b)(1) and is issued in response to a final rule (Release No. 34-42266) adopted by the Securities and Exchange Commission (SEC) on December 22, 1999 (17 C.F.R. § 228.310, 64 Fed. Reg. 73389 (Dec. 30, 1999)).

Background:

On December 22, 1999, the SEC adopted a final rule (Release No. 34-42266) that, among other things, amends SEC Regulation S-X (17 C.F.R. part 210). The SEC rule, effective for fiscal quarters ending on or after March 15, 2000, requires that companies include in their proxy statements certain disclosures about their audit committees and reports from their audit committees containing certain disclosures.

On June 2, 2000, the Federal Housing Finance Board (Finance Board) amended its regulations governing the operations of the Office of Finance. As part of that rulemaking, new section 985.6(b)(1) codified existing Finance Board policy by requiring that the scope, form and content of the Federal Home Loan Bank (Bank) System's combined financial reports be consistent with the requirements of the SEC's Regulations S-K and S-X (17 C.F.R. parts 229 and 210).

Analysis or Discussion:

The SEC noted in its Adopting Release that "the required disclosure will help inform shareholders of the audit committee's oversight with respect to financial reporting, and underscore the importance of that role." The SEC adopted a requirement that a company's proxy statement should disclose whether the company's audit committee has reviewed and discussed certain matters with the independent auditors and management. The audit committee must state whether:

- (1) The audit committee has reviewed and discussed the audited financial statements with management.
- (2) The audit committee has discussed with the independent auditors the matters required to be discussed by Statement of Auditing Standards (SAS) No. 61, *Communication with Audit Committees*, as may be modified or supplemented. (SAS No. 90, *Audit Committee Communications*, amends SAS No. 61.)

- (3) The audit committee has received the written disclosures and the letter from the independent auditors required by Independence Standards Board (ISB) Standard No. 1, *Independence Discussions with Audit Committees*, as may be modified or supplemented, and has discussed with the auditors the auditor's independence.
- (4) Based on the review and discussions referred to in (1)-(3) above, it recommended to the Board of Directors that the financial statements be included in the Annual Report on Form 10-K or 10-KSB for the last fiscal year for filing with the SEC.

The SEC's final rule also requires that the new disclosures appear over the printed names of each member of the audit committee. The disclosure needs to be provided only once during the year.

In addition, the SEC's rule requires companies to disclose in their proxy statements whether a charter governs their audit committee and, if so, to include a copy of the charter as an appendix to the proxy statement at least once every three years. Also to be disclosed in the proxy statement is whether the audit committee members are "independent," as that term is defined in the listing standards of either the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers. Companies that have a non-independent audit committee member must disclose the nature of the relationship that makes the member non-independent and the reasons for the board of directors' determination to appoint the non-independent director to the audit committee.

Finance Board staff has determined that the SEC rule requiring certain audit committee disclosures represents current "best business practice" and that the Banks should adopt that practice.¹ Because the Banks do not issue proxy statements, Finance Board staff has determined that the required SEC audit committee disclosures, and the audit committee report, should be included in each Bank's annual report.

Interpretation:

Effective with its year end 2000 annual report, each Bank's annual report shall include the audit committee's report and shall state whether:

- (1) The audit committee has reviewed and discussed the audited financial statements with management.
- (2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS No. 61, as may be modified or supplemented, and SAS No. 90, *Audit Committee Communications*.
- (3) The audit committee has received the written disclosures and the letter from the independent auditors required by ISB Standard No. 1, as may be modified or supplemented, and has discussed with the auditors the auditor's independence.

¹ With the exception of the "independence" disclosure. Section 917.7 of the Finance Board's regulations addresses audit committees and requires each Bank's audit committee to adopt formal written charters. The regulation also defines independence and requires that each audit committee member meet the criteria set forth in the regulation, rendering the SEC's required lack of independence disclosure inapplicable to a Bank.

- (4) Based on the review and discussions referred to in (1)-(3) above, it recommended to the Board of Directors that the financial statements be included in the Annual Report.

These new disclosures in each Bank's annual report must appear over the printed names of each member of the audit committee. Each Bank's audit committee must disclose that it is governed by a charter and include a copy of its charter as an appendix to the annual report at least once every three years.

A Regulatory Interpretation applies only to the particular transaction or activity proposed by the requestor, may be relied upon only by the requestor, and is subject to modification or rescission by action of the Board of Directors of the Finance Board. *See* 12 CFR part 907.