

# FDICIA Reporting for Financial Institutions

Reporting Changes Under Part 363 and SAS 130

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# INTRODUCTION

A number of annual reporting and other requirements have been placed on insured depository institutions with \$500 million or more in consolidated total assets since the Federal Deposit Insurance Corporation (FDIC) Improvement Act was signed into law in December 1991.

Effective December 15, 2016, Statement of Auditing Standards (SAS) No. 130, *An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of the Financial Statements* changed how annual reporting requirements under the Federal Deposit Insurance Corporation Improvement Act (FDICIA) Part 363 are applied.

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Nonpublic institutions continue to be divided into three tiers based on consolidated total assets.



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Institutions over the \$1 billion threshold are now subject to a much more rigorous audit, similar to many public institutions subject to SEC oversight.

The new audit requirements are rigorous and could put a strain on an institution's internal resources and expertise. Compliance with these new requirements will require greater diligence by management in assessing their institution's existing internal control framework and evaluating control system effectiveness.

# REQUIREMENTS BY TIER

The FDICIA requirements effectively create a four-tiered system with some key differences in annual audit and reporting requirements for institutions in the top two tiers.

REQUIREMENTS UNDER FDICIA PART 363	\$500 million– \$1 billion	>\$1 billion
Audited comparative annual financial statements	Yes	Yes
<b>Management statement</b> of responsibility over internal control over financial reporting (ICFR)	Yes	Yes
<b>Management assessment</b> of the operating effectiveness of ICFR	No	Yes
External integrated audit of ICFR by <b>independent auditors</b>	No	Yes

## MANAGEMENT STATEMENT AND ASSESSMENT

Institutions with total assets greater than \$500 million must include a report by management on its responsibilities and conclusions for the following:

- Preparation of annual financial statements
- Establishment and maintenance of an adequate internal control structure over financial reporting
- Compliance with the designated safety and soundness laws and regulations related to insider loans and dividend restrictions, as well as a conclusion by management regarding compliance and disclosures of any noncompliance

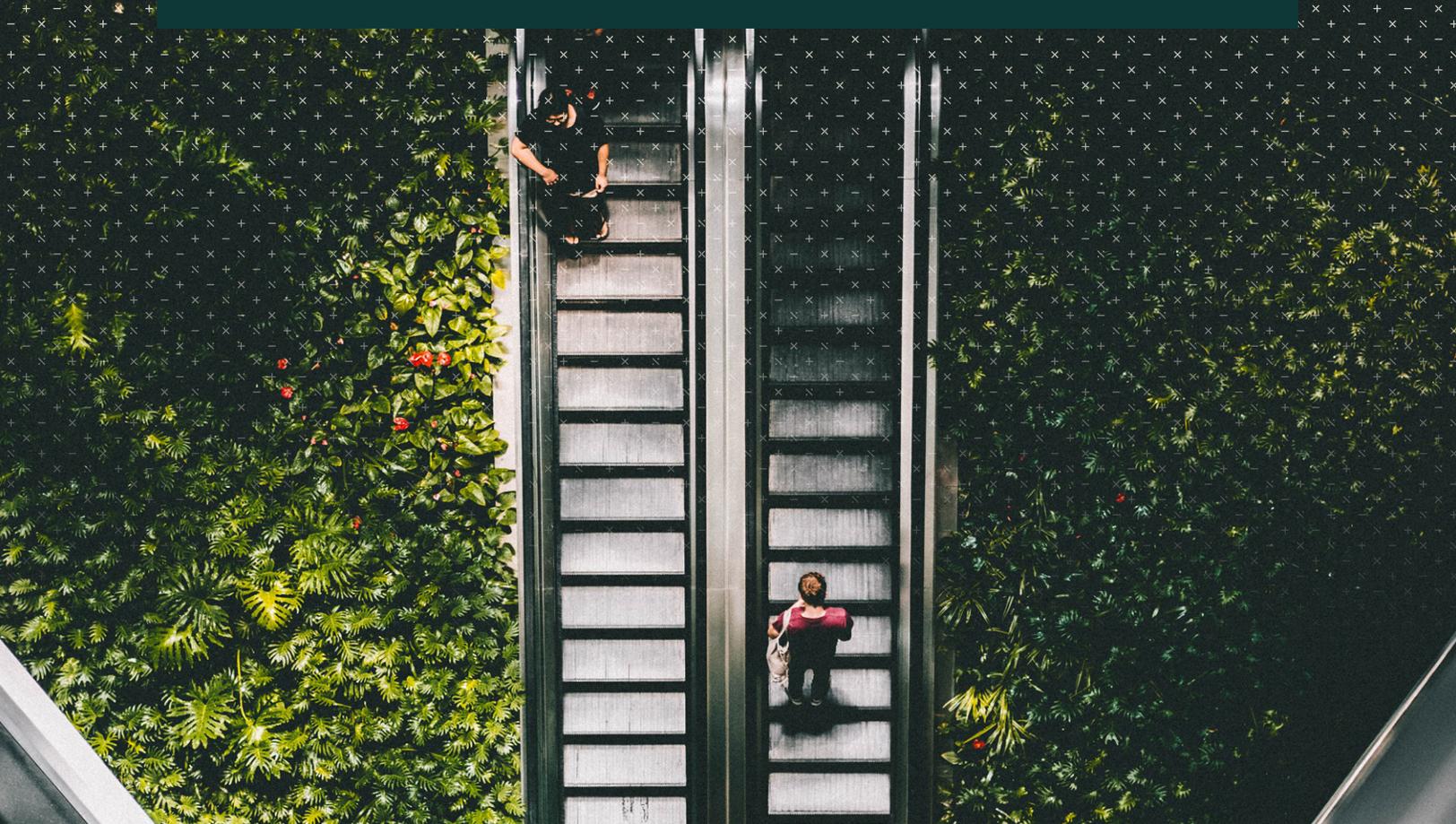
Institutions with \$1 billion or more in consolidated total assets must also include a statement on the effectiveness of the internal control structure over financial reporting from both management and an independent public accountant.

## INDEPENDENT AUDITORS

Historically, use of an independent auditor to examine and report on management’s assertion about the effectiveness of ICFR was allowed as an attestation engagement under American Institute of CPA (AICPA) standards.

Now, independent auditors no longer have the option to examine and report on management’s assertion, due to the AICPA’s rescission of the attestation standard. In its place, the AICPA adopted a standard for an integrated audit of both the financial statements and ICFR, in accordance with SAS 130.

While SEC issuers are very familiar with an integrated audit due to the requirements of the Sarbanes-Oxley Act, this is the first time an integrated audit standard is available for nonpublic institutions and their auditors.



## FILING DEADLINES

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An institution's FDICIA annual report needs to be filed within **120 days after the end of the fiscal year** unless one of the following applies:

- The institution is a public company or subsidiary of one.
- The institution is a subsidiary of a public holding company with consolidated total assets that make up 75% or more of the total consolidated assets of the public holding company as of the beginning of its fiscal year.

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Institutions meeting one of these criteria need to file the report within **90 days after its fiscal year end**.

If you're unable to file within the allotted timeframe, a notification of late filing must be filed to the FDIC, the appropriate federal banking agency, and any appropriate state bank supervisor.

# INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)

*Internal control* is “a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.”

The concept of internal control can be applied broadly to operational, compliance, and other areas of an organization’s operation. **ICFR focuses on controls that prevent or detect errors in external financial reporting.**

Federal law has required companies to establish and maintain ICFR since 1977, with a number of changes along the way.

## ICFR REPORTING REQUIREMENTS TIMELINE

- |      |                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1977 | <b>FCPA</b><br>Federal law began requiring public companies to establish and maintain a system of internal controls with the passage of the Foreign Corrupt Practices Act (FCPA). This act was intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles (GAAP).                                                     |
| 1991 | <b>FDICIA</b><br>The passage of FDICIA introduced the ICFR concept to nonpublic depository institutions, and extended to both financial statements prepared in accordance with GAAP and quarterly financial reports prepared for regulators, commonly referred to as call reports.                                                                                                                                                                           |
| 1992 | <b>COSO</b><br>The Committee of Sponsoring Organizations of the Treadway Commission (COSO) released a framework to assist companies in structuring and evaluating controls that address a broad range of risks, which was revised in 2013.                                                                                                                                                                                                                   |
| 2002 | <b>SOX</b><br>Section 404 of the Sarbanes-Oxley Act, commonly referred to as SOX, added the requirement that most public companies assess and publicly report on the effectiveness of their ICFR. The act also required many public companies to use an external independent auditor to audit the effectiveness of their ICFR, in accordance with standards and reporting requirements established by the Public Company Accounting Oversight Board (PCAOB). |
| 2015 | <b>SAS 130</b><br>Internal control reporting for nonpublic companies is now required to be an integrated audit of the financial statements and ICFR.                                                                                                                                                                                                                                                                                                         |



The concept of internal control can be applied broadly to operational, compliance, and other areas of an organization's operation. ICFR focuses on controls that prevent or detect errors in external financial reporting.

Under the COSO framework, there are five interrelated components to an effective internal control system, based on the way a company is managed on a day-to-day basis.

## FIVE COMPONENTS OF AN INTERNAL CONTROL SYSTEM

as applied to financial reporting

- 1 CONTROL ENVIRONMENT**  
How the company views internal control, including the ethical tone set by management and the effectiveness of the board's audit committee in its high-level oversight of financial reporting.
- 2 RISK ASSESSMENT**  
Understanding the processes, data points, and judgements that feed into the company's financial reports and their associated risks is essential. A process that is highly susceptible to fraud would be considered a high-risk area.
- 3 CONTROL ACTIVITIES**  
The way in which controls are actually designed and implemented within the company, so as to address the identified risks.
- 4 INFORMATION AND COMMUNICATION**  
How information within the company is gathered and shared, both internally among people responsible for financial reporting and externally with users of financial reports.
- 5 MONITORING**  
Tracking the way control efficiency is assessed by company management.

## OBJECTIVES FOR AUDITORS UNDER SAS 130

The primary objective for auditors under SAS 130 is to assess whether material weaknesses in ICFR exist as of the date specified in management’s assessment. This change brings annual ICFR reporting requirements more in line with SOX Section 404 requirements for public companies than the previous examination standard used to comply with FDICIA.

Here’s how an auditor achieves this objective.



Closer alignment between the ICFR requirement under FDICIA and SOX, and overall sophistication of ICFR audits is motivating larger nonpublic institutions to be more rigorous in evaluating the design and structure of their internal control systems, and in assessing their effectiveness in preparation for an external integrated audit.

# IMPLEMENTATION

Regardless of whether companies are meeting FDICIA or SOX Section 404 requirements, compliance requires considerable personnel time, extensive analysis and documentation, and a willingness to take on additional costs.

## CHALLENGES

Some common implementation challenges may include the following nine items.

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### ADOPTION

Framework and compliance procedures that are completely foreign to your financial institution, particularly the internal audit function

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### SUPPORT

Difficulty maintaining buy-in from senior management and the board due to unfamiliarity with appropriate internal control framework and process

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### PLANNING

Not allowing sufficient time to plan and commit necessary resources

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### EXPERTISE

Existing personnel lacking the skills needed to consider, document, or test ICFR, particularly around IT and other specialty areas

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### PURPOSE

Confusing operational, regulatory, and asset safeguarding controls with key internal controls over financial reporting

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### CULTURE

An institutional culture that doesn't emphasize ownership of key internal controls beyond day-to-day responsibilities

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### RIGOR

Over or under documenting and testing of key internal controls

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### COORDINATION

Superficial communication with external auditors resulting in ineffective, duplicative, or last-minute testing

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### SUBSTANCE

Following a checklist approach rather than a thoughtful, risk-based mindset

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## AN EFFECTIVE APPROACH

### Planning and Risk Assessment

This phase sets the stage for further control evaluation, testing, and reporting. The initial steps include coordinating risk assessment and logistics between staff, internal auditors (either in-house or outsourced), and external independent auditors. Make sure procedures between internal audit and external independent auditors are agreed upon ahead of time to ensure effectiveness. IT systems have become an increasingly important element of ICFR and should also be addressed early in the process.

### Documentation

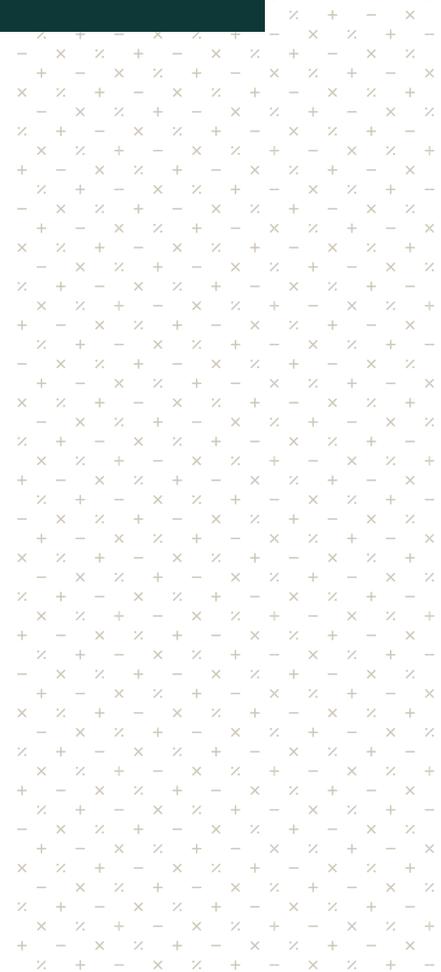
Setting and adhering to a defined set of standards when documenting control system design and walkthrough procedures—including flowcharts and narrative outlines—can help encourage efficiency and facilitates a common understanding among all parties. Rigorous documentation is particularly important for controls that require the exercise of judgment, such as accounting estimates or management review controls.

### Testing

While testing individual controls is fairly routine, it's important to establish expectations and lines of communication between staff, internal auditors, and external auditors before testing begins. Understanding key factors such as sample sizes, testing protocols, timing of test procedures, and remediation processes is essential to the effective completion of a successful ICFR engagement. This especially includes procedures that address IT controls and ensuring appropriate specialist resources are coordinated among all parties.

### Evaluation

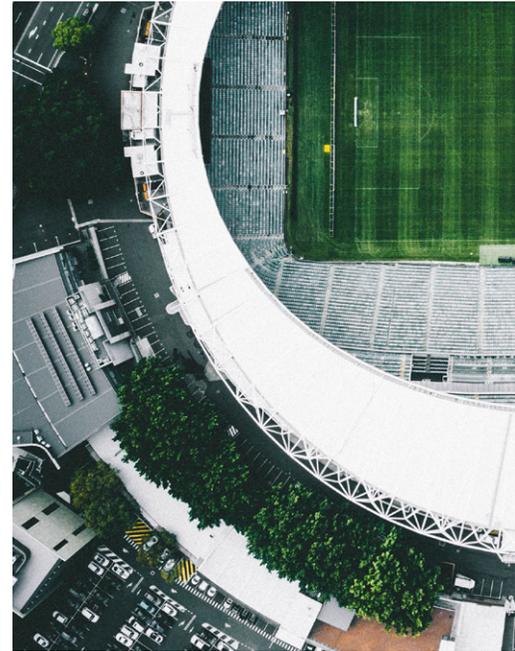
It's important to identify deficiencies, effectively communicate findings, identify and document mitigating controls that may exist, and conclude on the results of the ICFR assessment. Financial institutions and their external independent auditors are expected to reach similar conclusions on the effectiveness of ICFR. Following a similar framework for evaluating the results of the ICFR process will help avoid any communication gaps.



Implementing ICFR assessment procedures and executing testing and reporting grows in complexity every year and is often outside of management's day-to-day expertise. Many executives seek the assistance of third-party professionals to assure compliance and coordination with independent external auditors.

### **BENEFITS OF OUTSOURCING**

- An independent, open-minded view of the control systems and processes that exist within the company
- In-depth understanding of the COSO control framework and the ability to coordinate organization-wide implementation
- Cost-effective due to third party industry knowledge and procedures and tools that have already been developed
- Efficient communication between management and external independent auditors
- Strong coordination and cooperation between auditors and third parties who understand the requirements and procedures they follow, resulting in less duplicative effort



### **WE'RE HERE TO HELP**

Understanding a financial institution's ICFR requirements and coordinating them with the efforts of its independent external auditors is complex and important. To learn more, contact your Moss Adams professional.

[mossadams.com](https://www.mossadams.com)

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