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M E M O R A N D U M

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To Our Clients and Friends

Re: Interagency Policy Statement on the Internal Audit Function

The federal banking agencies (Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency and Office of Thrift Supervision) have issued a policy statement on the internal audit function and its outsourcing. The policy statement, which is applicable to insured depository institutions, bank and thrift holding companies, and U.S. operations of foreign banking organizations, updates the agencies' guidance on the independence of an accountant who provides both external and internal audit services.

The Sarbanes-Oxley Act of 2002 and regulations of the Securities and Exchange Commission prohibit an accounting firm from acting as the external auditor of a public company while providing internal audit outsourcing and certain non-audit services to the company. In addition, if a public company's external auditor will be providing auditing and permitted non-audit services, such as tax services, the company's audit committee must pre-approve each of these services.

The interagency policy statement addresses the applicability of these provisions of the Sarbanes-Oxley Act and the SEC's rules to the following institutions:

- Public companies;
- Depository institutions with \$500 million or more in assets, which are subject to the annual audit and reporting requirements of Section 36 of the Federal Deposit Insurance Act, whether or not they are public companies; and
- Non-public institutions that are not subject to Section 36.

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The interagency policy statement, which replaces a policy the agencies issued in 1997, also contains:

- a revised discussion of the responsibilities of the board of directors and senior management with respect to the internal audit function and its placement within an organization, its management and staffing and the communication of concerns and weaknesses in accounting and control;
- expanded guidance on the use of independent reviews of significant internal controls by small institutions that do not have a formal internal audit manager or staff; and
- guidance for examiners on addressing concerns about the adequacy of the internal audit function outsourcing arrangements.

The policy statement can be found at www.schwartzandballen.com/WhatsNew.htm.

If you have any questions concerning the agencies' policy statement, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.