



COMMISSIONER OF FINANCIAL INSTITUTIONS

GOVERNMENT OF PUERTO RICO

JOSEPH P. O'NEILL
COMMISSIONER

CIRCULAR LETTER NUMBER CIF CC-00-6

TO : Eligible Institutions as defined by Section 4.2.12 of Regulation 5105

DATE : December 4, 2000

RE : **REVISED AUDIT GUIDE FOR THE ANNUAL EXAMINATION OF ELIGIBLE INSTITUTIONS REQUIRED UNDER SECTION 5.2 OF REGULATION 5105**

SECTION I - AUTHORITY

This Circular Letter is issued pursuant to the provisions of Act Number 4 of October 11, 1985, as amended, known as the Act of the Office of the Commissioner of Financial Institutions; Act Number 170 of August 12, 1988, as amended, known as the Uniform Administrative Procedures Act and Section 5.2 of Regulation 5105, approved on July 24, 1994, as subsequently amended (the Regulation).

SECTION II - PURPOSE

Section 5.2 of the Regulation provides that every Eligible Institution shall be subject to an annual examination (the Annual Examination) of its books and records by the Commissioner. Such examination may be carried out by personnel of the Office of the Commissioner (the Office), by a firm of certified public accountants selected by the Commissioner, or by a firm of certified public accountants selected by the Eligible Institution and approved by the Commissioner (the CPA). For this purpose, the Office has issued an Audit Guide (the Guide) which serves as the guidelines for the CPA to carry out the Annual Examination. The purpose of this Circular Letter is to provide a Revised Guide for the Annual Examination.

SECTION III - AUDIT GUIDE

The revised Guide attached to this Circular Letter is made an integral part hereof. It was revised primarily to modify the requirement included in the previous version of the Guide that the CPA verify that the Eligible Institution has performed the due diligence procedures required by Section 6.4 of the Regulation.

SECTION IV - EFFECTIVE DATE

This Circular Letter is effective immediately.

APPROVED

**COMMISSIONER OF FINANCIAL INSTITUTIONS
GOVERNMENT OF PUERTO RICO**

**AUDIT GUIDE
REGULATION 5105, AS AMENDED**

December, 2000

PURPOSE

This guide sets forth: (a) the procedures to be followed in the performance of the annual examination of Eligible Institutions called for by Section 5.2 of Regulation Number 5105, as amended; (b) the scope of the examination; and (c) the type of report format which will be acceptable to the Commissioner of Financial Institutions (the "Commissioner"). This guide provides for the execution of certain compliance tests but is not intended to supplant the independent public accountant's judgment as to any additional work the independent public accountant believes is required to be performed.

BACKGROUND

On July 26, 1994 the Financial Board of Puerto Rico, the Commissioner, and the administrator of Economic Development Administration of Puerto Rico, approved Regulation 5105 of the Office of the Commissioner of Financial Institutions to regulate the institutions that are eligible to pay tax-exempt interest under the Puerto Rico Industrial Tax Incentives Acts (see Appendix VII). On September 19, 1996 a new regulation was approved amending Regulation 5105. The new regulation is referred to herein as Amendments to Regulation 5105 (see Appendix VIII).

Reference is made to Regulation Number 5105 (the Regulation) of the Office of the Commissioner of Financial Institutions, its related circular letters, and administrative determinations for information relative to the requirements imposed on Eligible Institutions, as this term is defined in the Regulation.

APPLICABILITY

This examination guide is intended exclusively for the examinations of those institutions that are eligible to pay tax-exempt interest under the Puerto Rico Industrial Incentives Acts Number 6 of December 15, 1953, Number 57 of June 13, 1963, Number 26 of June 2, 1978, Number 8 of January 24, 1987, as amended, and Number 135 of December 2, 1997 officially titled as the "Tax Incentives Act of 1998."

AUTHORIZATION

Section 5.2 of the Regulation provides that every Eligible Institution shall be subject to an annual examination of its books and records by the Commissioner. Such examination may be carried out by personnel of the Office of the Commissioner, by a firm of independent public accountants selected by the Commissioner, or by a firm of independent public accountants selected by the Eligible Institution and approved by the Commissioner.

Every year, on or before June 30, the Commissioner shall inform the Eligible Institution the name of the independent public accountants who will carry out the examination for the year in progress. Eligible Institutions may request to be exempt from such procedure and submit to the Commissioner, for his approval, the name of the firm of independent public accountants they wish to select. The Commissioner will evaluate the request considering, among other factors, the projected date of the examination, the independent public accountants' technical training, proficiency and knowledge of the subject. The Commissioner will also consider the Eligible Institutions' prior compliance record and the results of previous examinations. The Commissioner may approve the request or he may deny it. The approval by the Commissioner under no circumstances shall constitute relinquishment of his authority to examine the Eligible Institution.

The independent public accountant must be a Certified Public Accountant, licensed under the laws of the Commonwealth of Puerto Rico. The public accountant must be independent as defined by the Codes of Ethics of the Board of Accountancy of the Commonwealth of Puerto Rico and the Puerto Rico Society of Certified Public Accountants.

EXAMINATION STANDARDS

The examination must be performed in accordance with the Statement on Attestation Standards -Compliance Attestations issued by the American Institute of Certified Public Accountants ("AICPA"), which standards have been adopted by the Commonwealth of Puerto Rico and the Puerto Rico Society of Certified Public Accountants.

The independent public accountant's working papers are expected to conform to the guidelines prescribed in the AICPA Statements of Attestation Standards.

EXAMINATION REQUIREMENTS

The objective of the examination is to express an opinion about whether the Eligible Institution's assertions are fairly stated in all material respects. The examination requirements set forth in Appendix I

are not intended to limit the scope of the examination. Determining the sufficiency of the evidence obtained is a matter for the independent public accountant's professional judgment.

REPORTING REQUIREMENTS

The independent public accountant shall issue a report stating his opinion on whether management's assertions about the Eligible Institution's compliance with the requirements of Articles 5 and 6 of Regulation 5105 are fairly stated in all material respects. Management's written assertions should be included as an exhibit to the independent public accountant's report. Management's written assertions should be obtained prior to the examination and shall not be modified to include the independent public accountant's findings.

All noncompliance, other than clerical inaccuracies which do not result in either: a) an overstatement of the level of eligible activity, or b) in the Eligible Institution not being in compliance with the investment requirements of Regulation 5105, as amended, must be reported. Noncompliance will be categorized and reported as follows: a) isolated noncompliance that are not significant in relation to the number of records or transactions examined; b) noncompliance which the independent public accountant judges to be material, or that represents a pattern of noncompliance with the provisions of the Regulation. (noncompliance which are reported in management's assertions must be reported separately from those not disclosed in management's assertions); c) matters in dispute with the eligible institutions or controversial items, or whenever the independent public accountant is relying on expert advice, such as an attorney, to state his opinion; d) items on which the independent public accountant has been unable to form an opinion as to compliance (explanatory comments should be included in the report to permit the Commissioner to make an evaluation).

The independent public accountant's report shall include a section summarizing the suggestions for improvements in the Eligible Institution's controls and procedures (or incorporate by reference any letter to management that may have been issued for that purpose), as these relate to transactions with eligible funds.

The independent public accountant's report must be filed with the Office of the Commissioner of Financial Institutions on or before the fifteenth day of the fourth month following the close of the Eligible Institution's fiscal year.

The Eligible Institution shall inform the Commissioner within a period of 30 days from the date of submission of the independent public accountant's report

as to the corrective action taken or planned on the noncompliance reported.

EXAMINATION WORK PAPERS

The independent public accountant should retain the examination work papers and reports for at least five years after issuance of the compliance report. The work papers are to be made available to the Commissioner or his authorized representative upon their request.

APPENDIX I

TEST FOR COMPLIANCE

TEST FOR COMPLIANCE

I. GENERAL

Section 5.3.3(a) of the Regulation requires Eligible Institutions to submit such reports as deemed necessary by the Office of the Commissioner of Financial Institutions for the proper administration of the Regulation. These reports shall be in filed in the manner, form, and on such dates as prescribed by the Commissioner. Based on the above, the Commissioner designed a monthly and a quarterly report that compiles the transactions with eligible funds affected by the Eligible Institution. Appendix III includes examples of the different types of reports.

Section 5.3.3(b) of the Regulation requires Eligible Institutions, if applicable (that is, if the annual examination is performed by a firm of independent public accountants selected by the Eligible Institution and approved by the Commissioner) to submit an annual report prepared by an independent public accountant. This report will be based on an examination of the reports required by Section 5.3.3(a). The report shall include any knowledge that the independent public accountant may have as to the existence of exceptions to the provisions of Section 5.3.2 and Article 6.

INVESTMENT REQUIREMENTS (ARTICLE 6 SECTION 6.1.1, 6.1.2, 6.2.2 AND 6.3)

Section 6.1.1 requires Eligible Institutions to comply with whichever of the following two investments alternatives for funds received before October 1, 1996 is applicable. Eligible funds received after September 30, 1996 shall not be subject to the provisions of Section 6.1.1.

ALTERNATIVE A

Subject to the additional investment requirements, invest seven percent (7%) of the eligible funds received after August 31, 1994, but before October 1, 1996, in certificates of indebtedness or repurchase agreements with the Government Development Bank ("GDB") that bear an interest rate not lower than the Special GDB/EDB Investment Rate defined in Section 4.2.2 of the Regulation. Subject to the additional investment requirements, invest fifteen percent (15%) of the eligible funds received before September 1, 1994, in certificates of indebtedness, and or repurchase agreements with GDB, in loans to, or obligations of, the Government of Puerto Rico or any of its instrumentalities or political subdivisions that meet the conditions of Section 6.1.1(b)(i) or (ii) of the Regulation.

ALTERNATIVE B

Subject to the additional investment requirements, invest fifteen percent (15%) of all eligible funds received before October 1, 1996, in certificates of indebtedness, and or repurchase agreements with GDB, in loans to, or obligations of, the Government of Puerto Rico or any of its instrumentalities or political subdivisions that meet the conditions of Section 6.1.1(b)(i) or 6.1.1(b) of the Regulation.

Eligible Institutions must have submitted a letter to the Commissioner on or before October 15, 1994, indicating the alternative selected for compliance. An Eligible Institution that initially selected the second alternative described above is permitted to change its selection once without the approval of the Commissioner. The change must be notified in writing prior to the first day of the month during which the institution desires to make applicable the alternative of compliance. Eligible Institutions that initially selected the first option of compliance described above may change to the second alternative of compliance, with GDB's prior written approval and after providing prior written notice to the Commissioner.

Section 6.1.2 requires Eligible Institutions to invest and maintain invested the following percentages of their daily monthly average of eligible funds received in direct deposits or repurchase agreements with, loans to or obligations of EDB that bear interest at a rate not lower than the Special/EDB Investment Rate.

<u>Daily Monthly Average of Funds Received</u>	<u>Investment Requirement</u>
Before September 1, 1994:	2%
After August 31, 1994, but before October 1, 1996:	3%
After September 30, 1996 ¹ :	4%

In addition to the above requirement, Eligible Institutions must invest an additional amount for funds received after September 30, 1996⁽¹⁾, in direct deposits, repurchase agreements with, or obligations of, EDB. The additional investment requirement in EDB is based on the cost of eligible funds to the Eligible Institution. The additional investment requirement shall be in accordance with the table set forth below:

¹Funds received after September 20, 1996 in transactions with fixed maturities of five years are also subject to the investment requirements.

**Cost of New Eligible funds as a Percentage
of the LIBID Rate**

**Additional EDB Investment
Requirement**

0.00%	to	76.00%	0%
76.01%	to	79.00%	2%
79.01%	to	82.00%	6%
82.01%	to	85.00%	11%
85.01%	to	88.00%	22%
88.01%	or	higher	32%

Section 6.3 requires that for each deposit, repurchase agreement or other transactions involving eligible funds entered into, or received after September 30, 1996, ² the Eligible Institutions shall generate additional eligible activity based on the Additional Eligible Activities Factor determined by the Commissioner pursuant to the following table:

**Daily Monthly Average of Eligible Funds in
the Market During the Preceding Month
(in Millions)**

**Additional Eligible Activities
Factor**

\$ 10,000	or	more	0%
9,500	to	9,999	5%
9,000	to	9,499	10%
8,500	to	8,999	15%
8,000	to	8,499	20%
7,500	to	7,999	25%
7,000	to	7,499	30%
6,500	to	6,999	35%
6,000	to	6,499	40%

²Refer to footnote (1) in page 7.

Section 6.3 requires that for each deposit, repurchase agreement or other transaction entered into, or renewed after August 31, 1994, but before October 1, 1996, the Eligible Institution shall generate additional eligible activity, in accordance with the Additional Eligible Activity Table set forth below:

ADDITIONAL ELIGIBLE ACTIVITY TABLE

Cost of Eligible Funds as a percentage of <u>Applicable LIBID Rate (%)</u>	Daily monthly average of Additional Eligible Activity required as a percentage of the daily monthly average of Eligible Funds <u>received in each transaction (%)</u>
0 to 70	0
70.01 to 73	5
73.01 to 76	10
76.01 to 79	30
79.01 to 82	40
82.01 to 85	50
85.01 to 88	75
88.01 and above	100

DUE DILIGENCE

An Eligible Institution shall be considered to have exercised due diligence if it can demonstrate through appropriate documentation that prior to its disbursement of Eligible Funds to an Ultimate Recipient it conducted a reasonable investigation which in light of all facts and circumstances, provided reasonable grounds for the belief that upon disbursement of the funds the same would be utilized in an Eligible Activity. The standard for determining what constitutes a reasonable investigation and a reasonable ground to believe, shall be that required of a prudent man acting in a fiduciary capacity.

II. EXAMINATION PROCEDURES FOR ELIGIBLE INSTITUTIONS

In general, at least two (2) monthly reports and two (2) quarterly reports should be selected for the examination procedures herein described. If the minimum examination procedures reveal a significant degree of noncompliance, the independent public accountant should extend his scope to other reports to determine, where practicable, the degree of such noncompliance and clerical deficiencies.

1. Prior to the examination, obtain from the Eligible Institution management's written assertions regarding compliance with Articles 5 and 6 of the Regulation, as amended, (refer to Appendix II for an example). It should be signed by both the Chief Operating Officer and the Officer directly responsible for compliance with the Regulation (the "Compliance Officer"). Management's written assertions shall not be modified to include compliance exceptions revealed during the examination.
2. Discuss with the Chief Financial Officer management's assertions regarding compliance with the Regulation.
3. Review all relevant correspondence between the Eligible Institution and the Commissioner, including any relevant ruling obtained from the Commissioner by the Eligible Institution. In addition to reviewing the correspondence, the independent public accountant should review all rulings and circular letters and memoranda issued by the Office of the Commissioner of Financial Institutions and should be aware of all amendments to the Regulations.
4. Document the Eligible Institution's accounting procedures related to activities with eligible funds. Evaluate the identified accounting procedures to determine if they are adequate to properly capture information related to eligible funds transactions in order to properly process and reflect said information in the institution's accounting books.
5. Review the internal audit function as it relates to monitoring compliance with the Regulation. The review should include examining the results of compliance test performance by the internal auditor. The work of the internal auditors will assist the independent public accountants in understanding the internal control structure and assessing risk. The internal audit staff cannot be used to provide direct assistance to the independent public accountant or to limit the scope of the latter's examination procedures.

Records, Reports and Supervision **(Section 5.3.2 and 5.3.3)**

6. Review and evaluate the accounting procedures and the system of internal accounting controls in such a manner and, to the extent deemed necessary, in order to ascertain that the Eligible Institution:

- a. Maintains an accounting system sufficiently capable of identifying the utilization of proceeds from eligible deposits or net eligible funds realized from the repurchase agreements. Such accounting system shall clearly segregate the institution's transactions involving Eligible Funds and other transactions on which the institution relies for compliance with the Regulation, from other transactions unrelated to said Regulation. It shall provide information sufficiently clear with which to produce a balance sheet of the Eligible Institution which clearly segregates eligible Funds from other funds as of the end of the month. The accounting system shall also provide a reconciliation of the Institution's transactions involving Eligible Funds and other transactions on which the institution relies for compliance with the Regulation with the Institution's total operations, and shall be supported by such records as may allow the Commissioner to readily verify such reconciliation.
- b. Has not classified any Eligible Funds as non-eligible funds. Testing should include reviewing funds received by the institution which have been classified as non-eligible to determine whether they are correctly excluded.
- c. Maintains in its offices in Puerto Rico a complete set of accounting books, records and documents for a period of not less than five years after the end of each fiscal year.
- d. Submits on a timely basis the monthly and quarterly report of transactions effected by the institution, together with a balance sheet of said institution.

Test of the Monthly Report (Section 5.3.3(a) and 6.3.1(b))

7. In order to test the monthly report to the Office of the Commissioner of Financial Institutions for two (2) months of the year under examination, each line reported therein should be tested as follows:
 - a. Ascertain the accuracy of the Monthly Report and schedules A, B and C by tracing the information reported therein to the underlying analyses, subsidiaries, and the general ledger.
 - b. Examine a representative sample of related items to establish propriety of their classification as Eligible Funds and Eligible Activities.

These procedures may be performed concurrently with the procedures to test the quarterly report.

Test of the Quarterly Report (Section 5.3.3(a))

8. In order to test the quarterly report addressed to the Commissioner (the "Report") for two quarters of the year under examination, each line item reported therein should be tested as follows:
 - a. Ascertain the accuracy of the Report by cross-referencing to the extent feasible the figures in Sections I and II, and the Report Summary to the

underlying Schedules and when such internal verification is not feasible, by tracing the information reported therein to the underlying analyses.

- b. Examine a representative sample of the related items to establish the propriety of their classification as Eligible Funds and Eligible Activities.

For Eligible Depository Institutions this is applicable to those eligible activities included in Schedule 3A.

For Eligible Similar Institutions this is applicable to those eligible activities included in Schedule 3B.

9. Identify the due diligence procedures of the Eligible Institution and review them to determine their propriety in accordance with the standards established in the Regulation. The review should consist of reading the documentation of the due diligence procedures followed by the institution, including those internal safeguards to monitor that the procedures are followed and exceptions are corrected, and discussing with officials responsible for monitoring compliance with such procedures. If they are found inadequate, suggestions for improvements should be provided by the independent public accountant.

Particular care should be exercised by the independent public accountant when dealing with eligible activities generated through affiliates (intercompany accounts). The substance of the transaction should be carefully reviewed, to determine if funds are staying in Puerto Rico or not.

10. The Daily Monthly Average (the "DMA") of eligible activities generated through other Eligible institutions (Item 1.b of Report) should be traced to underlying analyses and examine a representative sample of selected transactions to determine propriety of classification given by the Eligible Institution. Schedule 5 (page 6 of 10) of the Report should be tested in connection with this procedure.
11. Review the quarterly reports not selected for detail testing to obtain knowledge regarding events of noncompliance with Article 6 of the Regulation which were reported by the Eligible Institution. Events of noncompliance noted in this review should also be included in the independent public accountant's report.

TEST OF SCHEDULES

Schedule 1

12. The cost of the eligible funds when compared to the Eurodollar Market Rates for a comparable deposit will determine the amount of additional eligible activity to be generated by the Eligible Institution for funds received after August 31, 1994 but before October 1, 1996. Refer to the table on Regulation Number 5105, Sections 6.3.1(b) or page 9 of this Guide for related percentages and the multiples of eligible activity to be used for the calculation. The independent public accountant should perform the following work on the Eligible Institution's calculation of the additional eligible activities investment requirement.
 - a. Trace amount shown on line 1 to appropriate supporting analyses and documentation. Recalculate, on a test basis, the daily monthly average of additional eligible activity required as a percentage of the daily monthly average of eligible funds received on those transactions originated after August 31, 1994 but before October 1, 1996.
 - b. Ascertain that the eligible funds transactions shown in the supporting analyses and documentation include all transaction with eligible funds and that said transactions were subject to confirmation or examination procedures.
 - c. Verify that the computation follows the example included in the instructions of the monthly and quarterly reports.

13. For funds received after September 30, 1996, the amount of additional eligible activities to be generated by the Eligible Institution will be determined by applying the additional eligible activities factor to the total daily monthly average of eligible funds. The additional eligible activity factor will be determined and notified to the Eligible Institution by the Commissioner based on the daily monthly average of eligible funds in the market during the preceding month. Refer to the table on Amendments to Regulation 5105, Section 4D or page 8 of this Guide for the additional eligible activities factor. The independent public accountant should perform the following work on the Eligible Institution's calculation of the additional eligible activities investment requirement.
 - a. Trace amount shown on line 2 to appropriate supporting analyses and documentation. Recalculate the daily monthly average of additional eligible activities for funds received after October 1, 1996. **Pursuant to Section 7 of the Amendments to Regulation 5105, eligible funds received after September 20, 1996, in transactions with fixed maturities of five years or more are subject to the additional eligible activities investment requirements.**

- b. Ascertain that the eligible funds transactions shown in the supporting analyses and documentation include all transaction with eligible funds and that said transactions were subject to confirmation or examination procedures.
14. Recalculate the total shown in line 3.
15. Trace amount shown in lines 4(a) through 4(f) to underlying analysis and documentation. Relate to work performed on Step 8 above.
16. Recalculate the total shown in line 4(g).
17. Recalculate the ratio expressed in 4(h).
18. Recalculate the amount shown in line 4(i).
19. Recalculate the amounts indicated in lines 6(a) and (b). In doing so, trace the amounts against which the 25% and 50% allowances are being calculated to the appropriate underlying analyses.
20. Recalculate the total shown in line 6(c).
21. Recalculate the amount shown in line 7.
22. Trace amount shown on line 8 to appropriate supporting documentation and recalculate, on a test basis, the daily monthly average of Additional Eligible Activity Required, as a percentage of the daily monthly average of Eligible Funds received, on those transactions originated prior to September 1, 1994, in which the interest rate paid exceeded 70% of the applicable market rate.
23. Recalculate the amount stated in line 9 and ascertain that it agrees with item 2(c) of the Report.

Schedule 1B

24. Trace amount shown in line 1 to the underlying analyses and documentation. Relate to work performed on Step 8, above, where analyses are tested by reference to selected transactions and source documents.
25. The cost of the eligible funds when compared to the Eurodollar Market Rates for comparable deposit will determine the amount of Additional EDB Investment Requirement for funds received after September 30, 1996. (Funds received after September 20, 1996 in transactions with fixed maturities of five years or more are also subject to the Additional EDB Investment Requirement. Refer to the table on Section 4(c) of the Amendments to Regulation 5105 or page 8 of this Guide for the related percentages to be used for the calculation.

Trace amounts shown in line 2 to the appropriate supporting analyses and documentation. Recalculate on a test basis, the daily monthly average of Additional EDB Investment Requirement as a percentage of the daily monthly average of Eligible Funds received on those transactions originated after September 30, 1996, and after September 20, 1996, as applicable.

26. Recalculate amount shown in line 3.
27. Trace amount shown in line 4 to line 11(c) of Schedule 2.
28. Recalculate amount shown in line 5.
29. Trace amounts shown in lines 6(a) and 6(h) to the amounts shown in lines 11 and 7 of the Report, respectively.
30. Recalculate amount shown in line 6(c).
31. Trace the percentage to the transition table shown in Section 4c of the Amendments to Regulation 5105.
32. Recalculate amounts shown in lines 8 and 9.
33. Verify that the amount shown in line 10 is the lesser of the amounts shown in lines 8 and 9.
34. Recalculate amount shown in line 11 and ascertain that it agrees with line 19 of the report.

Schedule 2

35. Trace amounts indicated in lines 1, 2(a)(i), 2(a)(ii), 2(b), 2(c), 4, 6(a), 6(b), 8(a), (8b), 10(a), 10(b), 10(c), and 10(d), to the underlying analyses. Examine a sample of the underlying documentation to ascertain the propriety of the classification of the items reflected in Schedule 2.
36. Verify the mathematical accuracy of the amounts reflected in lines 2(a)(iii), 2(d), 3, 6(c), 7, 8(c), 9, 10(e) and 11.
37. Trace amounts shown in lines 7 and 11 to the applicable lines in the report.

Schedule 3A

38. Refer to Steps 7 and 8.

Schedule 3B

39. Refer to Steps 7 and 8.

Schedule 4 and 5

40. The information reflected in these schedules should be traced to the underlying analyses. Select a representative sample of the items reported for examination. Funds placed with non-eligible institutions (schedule III page 5 of 5) should be subject to the due diligence tests referred to in step 9 above.

Clerical Accuracy Tests

41. The independent public accountant should verify the mathematical accuracy of all amounts shown on the monthly and quarterly reports to the Commissioner of Financial Institutions.

The need for detailed clerical tests for verifying the mathematical accuracy of underlying analyses used during the examination, including recalculating DMA's shown on these analyses, etc., will vary depending on the institution's internal accounting controls and the independent public accountant's review and evaluation of these controls as well as his own judgment. For example, if an institution uses electronic data processing techniques to perform the above calculations, the independent public accountant can evaluate and test the input, processing and output controls and depending on the outcome of this evaluation, his audit tests in this area can be varied. For manual systems, clerical tests can be varied depending on the institution's accounting controls and nature and amount of errors found.

42. Prepare an analysis showing the following information for the year under examination (in DMA):

- Eligible Funds (Direct and Indirect)
- Eligible Funds subject to each of the Special Investment Requirements
- Investments in the Special Investments Requirements
- Excess or Shortage in each of the Special Investment Requirements
- Additional Eligible Activities Required
- Total Investments in Eligible Activities
- Excess or Shortage in the Eligible Activities Investment Requirement

Evaluate the trends and relationships among the data. Inquire from management as to the reasons for unusual relationships and trends. Consider the need to perform additional examination procedures.

**APPENDIX II
MANAGEMENT'S ASSERTIONS REGARDING
COMPLIANCE WITH REGULATION 5105**

MANAGEMENT'S ASSERTIONS REGARDING COMPLIANCE WITH REGULATION 5105

(Date)

To the Office of the Commissioner of
Financial Institutions and
(Name of the Independent Public Accountant)

In connection with your examination of our books and records to test our compliance with the provisions of Regulation 5105 of the Office of the Commissioner of Financial Institutions, as amended, for the year ended December 31, xxxx, we represent the following:

1. We are responsible for compliance with Regulation 5105, as amended.
2. We are responsible for establishing and maintaining an effective system of internal control to ensure compliance with Regulation 5105, as amended.
3. We have performed an evaluation of:
 - a. the institution's compliance with the requirements of Regulation 5105, as amended.
 - b. the institution's internal control policies and procedures for ensuring compliance and detecting noncompliance with the requirements of Regulation 5105, as amended.
4. We have complied with the provisions of Section 5.3.2(a) and (b) of Regulation 5105, as amended except as follows:
5. We have complied with the provisions of Section 5.3.3(a) of Regulation 5105, as amended except as follows:
6. We have complied with the provisions of Section 6.1.1 of Regulation 5105, as amended except as follows:
7. We have complied with the provisions of Section 6.1.2 of Regulation 5105, as amended except as follows:

8. We have complied with the provisions of Section 6.2.1 of Regulation 5105, as amended except as follows:
9. We have complied with the provisions of Section 6.3.1 of Regulation 5105, as amended except as follows:
10. We have complied with the provisions of Section 6.4 of Regulation 5105, as amended except as follows:
11. We have disclosed to you and the Office of the Commissioner of Financial Institutions all known noncompliance with Regulation 5105, as amended.
12. We have made available to you all documentation related to compliance with Regulation 5105, as amended.
13. We have disclosed all communications from the Office of the Commissioner of Financial Institutions, internal auditors, and other regulatory agencies concerning possible noncompliance with Regulation 5105, as amended.
14. We have disclosed any noncompliance occurring subsequent to December 31, xxxx.

Very truly yours,

(Name of Chief Operating Officer)

(Name of Compliance Officer)

**APPENDIX III
INDEPENDENT ACCOUNTANT'S REPORT**

Report When the Eligible Institution's Assertions are Fairly Stated

INDEPENDENT ACCOUNTANT'S REPORT

[Date]

To the Board of Directors of
XYZ Bank

We have examined management's assertions about XYZ's compliance with the requirements of Articles 5 and 6 of Regulation 5105 of the Office of the Commissioner of Financial Institutions during the year ended December 31, xxxx included in the accompanying Exhibit A. Management is responsible for XYZ's compliance with those requirements. Our responsibility is to express an opinion on management's assertions about XYZ's compliance based on our examination.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included examining on a test basis, evidence about XYZ's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on XYZ's compliance with specified requirements.

In our opinion, management's assertions that XYZ complied with the aforementioned requirements for the year ended December 31, xxxx, are fairly stated in all material respects.

The accompanying Exhibit B includes all noncompliance identified in our examination and other information reportable in accordance with the provisions of the Audit Guide issued by the Office of the Commissioner of Financial Institutions. This report is solely for the purpose of complying with the provisions of Section 5.3.3(b) of Regulation Number 5105 and is intended for the information and use of the Board of Directors and management of XYZ, and the Office of the Commissioner of Financial Institutions and others responsible for the administration of the aforementioned regulation, and is not intended to be and should not be used by anyone other than these specified parties.

Report of material noncompliance when the Eligible Institution has disclosed the noncompliance.

INDEPENDENT ACCOUNTANTS' REPORT

(Date)

[Standard introductory paragraph]

[Scope paragraph]

In our opinion, management's assertions that except for the noncompliance with [list noncompliance], XYZ complied with the aforementioned requirements for the year ended December 31, xxxx, is fairly stated, in all material respects.

The accompanying Exhibit B includes all noncompliance identified, including material noncompliance discussed in management's assertions and other information reportable in accordance with the provisions of the Audit Guide issued by the Office of the Commissioner of Financial Institutions. This report is solely for the purpose of complying with the provisions of Section 5.3.3(b) of Regulation 5105 and is intended for the information and use of the Board of Directors and management of XYZ, and the Office of the Commissioner of Financial Institutions and others responsible for the administration of the aforementioned regulation, and is not intended to be and should not be used by anyone other than these specified parties.

Qualified Report Due to Material Noncompliance Not Disclosed by the Eligible Institution

INDEPENDENT ACCOUNTANT'S REPORT

[Date]

[Standard introductory paragraph]

[Scope paragraph]

In our opinion, except for the material noncompliance described in Exhibit B, management's assertions that XYZ Bank complied with the aforementioned requirements for the year ended December 31, xxxx, are fairly stated.

The accompanying Exhibit B includes all noncompliance identified in our examination and other information reportable in accordance with the provisions of the Audit Guide issued by the Office of the Commissioner of Financial Institutions. This report is solely for the purpose of complying with the provisions of Section 5.3.3(b) of Regulation 5105 and is intended for the information and use of the Board of Directors and management of XYZ, and the Office of the Commissioner of Financial Institutions and others responsible for the administration of the aforementioned regulation, and is not intended to be and should not be used by anyone other than these specified parties.

Adverse Report Due to Material Noncompliance Not Disclosed in the Eligible Institution's Assertions

INDEPENDENT ACCOUNTANT'S REPORT

[Date]

[Standard introductory paragraph]

[Scope paragraph]

In our opinion, because of the material noncompliance described in the accompanying Exhibit B, management's assertions that XYZ Bank complied with the aforementioned requirements for the year ended December 31, xxxx, are not fairly stated.

The accompanying Exhibit B includes all of noncompliance identified in our examination and other information reportable in accordance with the provisions of the Audit Guide issued by the Office of the Commissioner of Financial Institutions. This report is solely for the purpose of complying with the provisions of Section 5.3.3(b) of Regulation 5105 and is intended for the information and use of the Board of Directors and management of XYZ, and the Office of the Commissioner of Financial Institutions and others responsible for the administration of the aforementioned regulation, and is not intended to be and should not be used by anyone other than these specified parties.

XYZ
DECEMBER 31, XXXX

EXHIBIT B

- I.
 - a. Independent accountant's sampling approach and methodology.
 - b. Monthly report selected for detail testing.
 - c. Quarterly reports selected for detail testing.
 - d. Due diligence sample selection process and criteria; sample size; actual error rate and projection of sample results.

- II. The following exceptions are considered reportable under the provisions of the Audit Guide:

(2)

- III. Suggestions for improvement of accounting procedures and internal accounting controls related to transactions with eligible funds:

(3)

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- (1) This Exhibit to the Independent Accountant's Report should be attached to the report, even when no reportable exceptions are found.
 - (2) Reportable exceptions should be listed under the four categories described of the Audit Guide. In the event that no such exceptions exist, "none" should be indicated.
 - (3) If such suggestions for improvements are reported in a separate letter, indicate this in the space provided.
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