

Effective date: January 9, 1991

TITLE 45 - DEPARTMENT OF BANKING AND FINANCE

Chapter 25 - STANDARDS FOR ACCEPTABILITY AND SCOPE OF EXAMINATIONS FOR DIRECTORS' EXAMINATIONS

001 (Bank)

001.01 STANDARDS FOR ACCEPTABILITY:

001.01A An annual examination of a state bank, to be acceptable, must be made in accordance with the minimum examination procedures outlined in this rule or in accordance with the standards for acceptability of audits of financial statements in accordance with generally accepted auditing standards and in accordance with 45 NAC 24 of the Rules and Regulations of the Department of Banking and Finance.

001.01B The Director of Banking and Finance has the responsibility to determine whether an examination or an audit is acceptable. The Director also has the authority to reject any examination or an audit which does not conform in all respects with prescribed requirements. If, at any time, it is found that the individual(s) conducting the examination has not followed recognized rules of ethics or conduct, or has not met the minimum standards of the Department of Banking and Finance, the examination will be rejected. Any misstatement of facts or circumstances or any misrepresentation of any kind knowingly made will not only cause an examination to be rejected but will also form a basis for the temporary or permanent disqualification of the individual(s) from conducting similar examinations under Section 8-124 as amended of the Nebraska Banking Act.

001.02 SCOPE OF EXAMINATION:

001.02A General - The examination procedures listed below are minimum procedures to be performed under provisions of Section 8-124, as amended, of the Nebraska Banking Act. They should not be construed as restrictive. Circumstances relating to individual engagements or situations encountered may make it necessary or desirable to expand certain procedures, apply alternate procedures, or extend examination procedures to other areas. The examination should be coordinated with the Nebraska Department of Banking and Finance to avoid conflicts with the Department's examination timing.

001.02B Minimum Examination Procedures

001.02B1 Control - Commence examination on a surprise basis. Assume control over all irregular items and records to be examined until procedures have been completed.

001.02B2 Cash, Cash Items, Clearings and Exchange - Count cash on a test basis and reconcile to general ledger,

examine cash items on a test basis and request confirmation of totals of clearings and exchanges. Determine the disposition of larger return items.

001.02B3 Due From Banks - Examine (or prepare if necessary) bank reconciliations with correspondent banks by obtaining statements for several days beginning with the audit date, and on a test basis compare checks and drafts with the records of instruments issued. Also confirm the balance directly with the related banks.

001.02B4 Investments - Total the securities ledgers, reconcile carrying values with applicable general ledger accounts, account for all securities by examination of securities on hand and confirmation of those held by others.

001.02B5 Loans - Total the loan ledger cards, or obtain a trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with applicable ledger accounts. See Direct Confirmation with Borrowers and Depositors in this section for confirmation requirements.

001.02B6 Federal Funds Sold - Confirm all Federal funds sold with the borrowing bank, ascertain that the aggregate of the detail agrees with the general ledger and examine evidence of subsequent settlement.

001.02B7 Bank Building: Furniture and Fixtures - From the date of the prior examination, review transactions in the accounts, trace approval of major expenditures to the minutes of the board of directors' meetings and test the computation of depreciation.

001.02B8 Demand Deposits - Total individual ledgers or obtain trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Review overdrafts, trace disposition of selected unposted items. Review the latest reconciliation for official checks and bank money orders. See Direct Confirmation with Borrowers and Depositors in this section for confirmation requirements.

001.02B9 Time Deposits - Total the time deposit accounts or obtain trial balance from the service center and prove totals on a test basis, or review the service center audit, and reconcile totals with general ledger accounts. Trace disposition of selected unposted items. See Direct Confirmation with Borrowers and Depositors in this section for confirmation requirements.

001.02B10 Income and Expense - Test selected "debits" to both income and expense accounts for possible overstatement. Do this by examination of proper documentation for selected items. Ascertain on a test

basis by some independent means that all "credits" to the income and expense accounts have been recorded and have not been understated. Review the related accounts of accrued income, accrued expenses, unearned discounts and deferred income by testing "debits" and "credits" as above; also ascertain that the balances in these accounts are fairly stated.

001.02B11 U.S. Savings Bond, Travelers Checks and Other Consigned Items - Examine bank's most recent reconciliation of items on hand with memo controls and related confirmation from issuing agents, or, if such records are not available, count items on hand; reconcile with total on consignment, and obtain confirmation from issuers.

001.02B12 Safekeeping Department - Review accounting procedures for recording items held in safekeeping for customers; inspect selected items on hand and confirm selected items held in custody by other banks; and confirm selected safekeeping accounts by direct communication with customers.

001.02B13 Trust Department - Total the summary cards for the various trust accounts and reconcile the totals with the trust general ledger control accounts where practicable. Total the detail asset cards and reconcile to the amounts shown on the trial selected trusts as noted on the detail asset cards. Verify savings on a test basis by reference to the bank records or by direct communication with the bank.

001.02B14 Internal Controls - The bank's system of internal controls and operating procedures shall be reviewed, and the report shall include comments and recommendations from this review.

001.03 GENERAL - Review accounting procedures for handling nonledger assets, such as charged-off loans, recoveries, etc. Review minutes of board of directors' meetings and latest report of supervisory examiners; trace authorizations for dividends declared and transfers to surplus.

001.04 DIRECT CONFIRMATION WITH BORROWERS AND DEPOSITORS - Prepare (or have prepared, under the auditor's supervision) and mail positive and/or negative confirmation requests on a test basis for all loans and deposit categories, including participation loans purchased and sold. For participation loans purchased, confirm balances with the selling bank only. For participation loans sold, confirm the balances sold with the purchasing bank and the total balances with the borrower on a test basis. Mail confirmation requests to a selected number of customers whose loans were charged off since last examination. Mail confirmation requests for a selected number of those that are dormant, accounts that have zero balances and have been closed since last examination. Any positive confirmation request not acknowledged by a loan customer after two weeks from the date of the original mailing shall be followed by a second confirmation request. A listing of positive confirmation

requests not acknowledged after the mailing of both a first and second request shall be included in the report.

001.05 REPORTING - A report shall be prepared and submitted to the board of directors describing the scope of examination and setting forth the findings and recommendations as a result of the examining procedures performed and review of the bank's operating procedures and system of internal controls. Any open or unreconciled item at the time the report is submitted to the board of directors shall be disclosed and commented upon in the report.

001.05A The report shall include the date of the audit and a statement that the minimum requirements outlined in the minimum examination procedures under the scope of examination in this rule were met.

001.05B For purposes of review by the Department of Banking and Finance, reports should follow the order of section entitled, Scope of Examination, and include the balance of the general ledger asset and liability accounts examined as of the examination date under the specific account headings. A description of procedures followed is to be a part of this report.

001.05C Verification of accounts may be made on a basis of sampling based on statistical probability as set forth in any handbook on sampling. Such handbooks available include, "Sampling in Auditing" by Hill, Roth and Arkin, and "Handbook of Sampling for Auditing and Accounting" by Arkin. Once the number of accounts are determined for confirmation, a review of a statistical sampling table will indicate the number of such accounts that should be verified in order to achieve a certain percent of reliability. For most examinations, a 95% reliability factor is considered adequate; or in lieu thereof, the accountant may verify 10% of the number of accounts determined for confirmation; these two methods will give the accountant some flexibility when examining larger banks. If a shortage is determined to exist, a 100% verification of accounts should be made.

001.05D With respect to the confirmation of loan and deposit accounts, submit confirmation statistics summary showing the extent and results by type of confirmation and type of account rather than report the extent and results of such procedures under each specific account heading in the body of the report. Any accounts selected for confirmation which have not been or cannot be mailed or delivered to the customer are to be so listed in the final report.

001.05E The board of directors must file three copies of the report with the Department of Banking and Finance within 90 days from the examination date, or authorize the individual or firm performing the examination to file three copies of the report with the Department of Banking and Finance within 90 days from the examination date. Any defalcation discovered during the examination shall be reported to the Department of Banking and Finance immediately by the board of directors. In

the event the board of directors does not report the defalcation immediately, the individual or firm performing the examination has the obligation to do so. The individual conducting the examination should have the bank authorize him or her in advance of his or her examination to notify the Department of Banking and Finance of discovered defalcations.