Shareholders' Equity

Operations and Audit Objectives

All records relating to capital stock and capital notes of the bank are maintained by the corporate trust section of the trust department. Custody of the unissued stock certificates, the transfer of certificates, and payment of interest on capital notes are functions of that section.

The Capital Surplus account represents earnings that have been segregated by formal action of the board of directors. The board should authorize all entries to this account. Credits to the Capital Surplus account include transfers from Retained Earnings and the sale price of additional capital stock over and above the par value.

The Retained Earnings account represents accumulated earnings in excess of amounts transferred to the Capital or Capital Surplus accounts, or paid to the stockholders as dividends. The Retained Earnings account is charged for the amount of declared dividends, periodic transfers to Capital Surplus, and possible transfers to Capital Stock in connection with a stock dividend. In addition, the Income and Expense account balances at the end of the annual accounting period are charged or credited to the Retained Earnings account. Applicable income tax liability related to income and expense is reviewed as part of the end result computation of the transfer figure to Retained Earnings.

The objectives of an internal audit of shareholders' equity are to determine that:

1. Where appropriate, transactions are in accordance with resolutions of the board of directors.
2. Records are complete and properly maintained.
3. Adequate internal control procedures exist.

These objectives are accomplished by proving detail records to controls, accounting for stock certificates, reviewing transfers, verifying capital changes, verifying entries and tracing authority for the entries to the minutes of the board of directors, and by reviewing the system of internal control.

General Ledger Accounts

Account Title	Debit	Credit
Liabilities		
Dividends Declared Not Payable	Transfer to Official Checks	Dividends declared
Prior Year's Deferred		Cumulated timing difference between book and tax entries
Current Year's Estimated	Estimated	

Payment	tax liability	
Current Year's Accrual	Tax accrual	
Capital		
Capital Stock	Par value of shares redeemed and cancelled	Par value of shares issued
Capital Surplus	Error corrections	Transfers from Retained Earnings
Retained Earnings. Prior Years	Transfers to Capital or Capital Surplus	Current year net income
Income Accounts	Error correction	Income received
Expense Accounts	Payment of expense	Expense refund or error corrections
Income Taxes		
Applicable Income Taxes	Transfer to accrued income taxes payable	Monthly accrual
Demand Deposits		
Dividend Checks	Payment of dividend	Transfer from dividends declared

Preparation and Documentation Checklist

	Comments
ELECTRONIC OR PREPRINTED FORMS	
None	
AUDIT DIVISION	
Permanent File	
None	
Forms	
□ ICQ for Shareholders' Equity	
□ Index for Shareholders' Equity	
□ Audit Procedures for Shareholders' Equity	
BANK DEPARTMENTS	

General Ledger Entry Tickets	*Accounting department*
◻ Minutes of the Board of Directors and Committee Meetings	
◻ Income Tax Returns	
General Ledger Accounts	*Accounting/Auditing department*
◻ Surrendered Stock Certificates	
◻ Company-Maintained Stock Record Book	
◻ Certificates Representing Unissued, Retired, or Treasury Shares	
◻ Detailed Analysis of Retained Earnings	

Internal Control Questionnaire

Date of Examination: As of ________

Prepared by ________ Date ________

Reviewed by ________ Date ________

	Yes	No	N/A	Remarks
Separation of Duties and Access Restrictions				
1. Is there adequate segregation of the following duties:				
a. Approving capital stock and other equity transactions?	[]	[]	[]	__________
b. Issuing, transferring, and canceling stock certificates?	[]	[]	[]	__________
c. Maintaining detailed stockholder records?	[]	[]	[]	__________
d. Handling cash or issuing official checks (e.g., dividend checks)?	[]	[]	[]	__________
2. Is access to computerized equity records limited to those with a logical need for such access?	[]	[]	[]	__________
Recording				
3. Are stock certificates prenumbered and sequentially issued?	[]	[]	[]	__________
4. Are unissued stock certificates adequately safeguarded?	[]	[]	[]	__________
5. Reconciliations and reviews:				
a. Are stock records monitored and periodically reconciled to the general ledger?	[]	[]	[]	__________
b. Are the reconciliations reviewed by an appropriate supervisory official?	[]	[]	[]	__________
6. Other checking or processing routines:				
a. Are all shares of stock authorized by the institution's charter and by the board of directors or stockholders, as appropriate?	[]	[]	[]	__________
b. Are appropriations of equity determined as required by applicable regulations?	[]	[]	[]	__________
c. Are dividends and other equity transactions approved by the board of directors?	[]	[]	[]	__________
d. Have terms and conditions been established by the board of directors for shares purchased for retirement or to be held in treasury?	[]	[]	[]	__________
e. Is a process in place to identify and properly account for (including classification) other comprehensive income items?	[]	[]	[]	__________
f. Do all entries to income and expense accounts, capital surplus, and retained earnings possess adequate explanations and authorized approvals?	[]	[]	[]	__________
7. Is an accepted method used to estimate compensation expense related to share-based compensation plans and is this expense amortized over the vesting period of the plans?	[]	[]	[]	__________
8. Has management determined that other-than-temporary impairment of investments exists? If so, has the equity and the net income impact been	[]	[]	[]	__________

separated in accordance with generally accepted accounting principles?

Regulatory Capital

9. Are responsibilities appropriately assigned for capital planning, monitoring compliance with capital laws and regulations, and preparation of call reports?	[]	[]	[]	__________
10. Is regulatory reporting subject to risk assessment?	[]	[]	[]	__________
11. Regarding capital amounts in call reports or other regulatory reports:				
a. Does the institution prepare and maintain documentation supporting the capital amounts reported in call reports or other regulatory reports?	[]	[]	[]	__________
b. Are capital amounts reconciled to subsidiary ledgers, and are reconciling items supported by appropriate documentation?	[]	[]	[]	__________
c. Do appropriate supervisory personnel review the call reports, other regulatory reports, and related documentation?	[]	[]	[]	__________
d. Are procedures in place for collecting and reporting by branches and subsidiaries the amounts needed for regulatory capital reporting?	[]	[]	[]	__________
e. Does management reassess significant accounting estimates, risk weightings, classifications, or other subjective determinations each time a new call report or regulatory report is prepared?	[]	[]	[]	__________
f. Does management obtain competent outside advice, as needed, on significant classification or risk weighting questions when major transactions are executed?	[]	[]	[]	__________
g. Is the regulatory reporting process (including classifications and risk weightings) reviewed by the internal audit department, if applicable?	[]	[]	[]	__________

Index to Audit Procedures

Date of Examination: As of ________

Prepared by ________ Date ________

Reviewed by ________ Date ________

Audit Procedure	Page Coverage/Remarks
I. Account for shares outstanding.	
II. Check changes in capitalization during the period under review.	
III. Perform a dividend review.	
IV. Prepare a detailed analysis of general ledger accounts since the date of the last examination and trace to offsetting entries.	

V.
Check entries to authorizations in the minutes of the board of directors.

VI.
Review income taxes.

VII.
Review surrendered stock certificates.

VIII.
Review directors' qualifying shares.

IX.
Review stock-based compensation.

X.
Review other-than-temporary impairment.

Audit Procedures

Audit Procedure	Remarks
	Date of Examination: As of ______________________ Prepared by ________________ Date ____________ Reviewed by ________________ Date ____________
I. **Account for shares outstanding.** **A.** Determine the number of shares outstanding, multiply this number by the par value, and settle the result to the general ledger. **B.** If the state banking code requires a director to own shares in the banking institution of which he or she is a director, determine the aggregate par value of the amount required. **1.** Account for any differences.	
	Date of Examination: As of ______________________ Prepared by ________________ Date ____________

Reviewed by ________________
Date ____________

II.

Check changes in capitalization during the period under review.

A. Review changes since the previous audit for proper authorization.

1. Determine that necessary approval of stockholders has been obtained when applicable, that permission has been received from supervisory authorities, and that necessary reports have been filed.

B. Develop and maintain a permanent record of the number of shares authorized and issued.

1. Verify that the number of shares outstanding does not exceed the number authorized.

Date of Examination: As of ______________________

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

III.

Perform a dividend review.

A. Review the minutes of the board of directors to ascertain the date of the last dividend declaration.

1. Trace the flow of entries through applicable general ledger accounts from declaration to transfer to holding company.

B. Determine the accuracy of the dividend amount by multiplying the dividend per share amount by the number of shares outstanding.

C. Determine that any undeliverable dividend checks are maintained under dual control and that provisions are made to locate the shareholders.

1. Confirm that there are controls in place to provide for escheatment to the state if undeliverable.

D. Determine that state and federal regulations that limit the amount of dividends that can be paid to bank shareholders are being followed.

1. Confirm that regulatory approval has been obtained for dividends paid that exceed the prior two years' net income plus net income to the date of declaration.

2. Calculate the maximum dividends that can be paid, and determine that these maximums have not been exceeded. (This provision is applicable only to dividends paid by the bank subsidiaries. It is not applicable to dividends paid by the holding company.)

E. Review the corporation's capital policy and determine that subsidiaries are in compliance with the policy provisions (Holding Company Regulation Y, Federal Reserve Regulation H, OCC–Part 3 Chapter II, and FDIC–Part 325 Chapter III).

1. Review the bank's procedures and calculations of the cash-based capital positions.

2. Make conclusions about the adequacy of the capital ratios noted.

Date of Examination: As of
____

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

IV.

Prepare a detailed analysis of general ledger accounts since the date of the last examination and trace to offsetting entries.

A. List the balance at the date of the last examination. Include an explanation for and the amount of each entry and the current account balance for each account:

1. Capital surplus.

2. Retained earnings.

3. All other applicable accounts affecting the computation of (A)(1) and (A)(2).

B. Foot and prove the current balance.

C. Inspect entry forms or other postings media for each transaction listed and trace the offsetting entry to the general ledger posting or summary.

D. Trace to board of directors minutes for proper approval.

E. Review minimum capital ratios. *(Note: Review 12 CFR 3 for definitions of "Minimum Capital Ratios" and "Risk-Based Capital Guidelines.")*

Date of Examination: As of
____

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

V.

Check entries to authorizations in the minutes of the board of directors.

A. Any entries not specially authorized, other than normal closing of nominal accounts, should be discussed with a responsible officer and explanations obtained.

VI.

Review income taxes.

A. Obtain a copy of the latest income tax return.

B. Verify all items and computations as to propriety with the general ledger.

1. Account for any differences.

Date of Examination: As of
____

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

VII.

Review surrendered stock certificates.

A. Examine surrendered stock certificates located in the vault.

1. Determine that the original certificate is cancelled and attached to the stub.

a. If the original certificate is not on file, a signed affidavit should be in its place.

Date of Examination: As of ______________________

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

VIII.

Review directors' qualifying shares.

A. Confirm that directors comply with the state and national bank regulations requiring directors to own “in their own right” minimum amounts of stock.

1. Obtain a list of all directors of each subsidiary bank.

2. Compare the list of directors to the most recent shareholders listing.

3. Determine that each of the directors owns an amount of stock equal to or greater than any of the following:

a. Aggregate par value of $1,000.

b. Aggregate shareholder's equity of $1,000.

c. Aggregate fair market value of $1,000.

Date of Examination: As of ______________________

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

IX.

Review stock-based compensation.

A. Determine if the institution has a share-based compensation plan and if shares or options have been issued.

Note: On December 16, 2004, FASB issued its final standard relating to share-based payment. As a result of this guidance, entities are required to recognize the fair value of stock option grants as compensation cost.

1. Obtain the stock option plan and signed stock option agreements for all stock options issued and obtain a schedule of options that are still vesting or have vested.

a. Match the grant date, number of options issued and vesting period from each agreement to the stock option schedule.

2. Identify the option-pricing model used. Determine whether it has been consistently applied and whether the assumptions included in the model are reasonable.

3. Determine whether the option-pricing model was developed by a valuation specialist or is something other than the Black-Scholes-Merton, lattice model, or Monte Carlo model. If it is not one of these methods, further testing may be warranted.

4. Determine whether the value assigned to the options is being expensed over the vesting period of the options.

5. For any stock options issued during the testing period, trace approval for these options to the board of directors' meeting minutes.

6. If options were exercised during the testing period, trace approval for these options to the board of directors' meeting minutes and determine if the transactions were properly recorded on the general ledger.

B. Determine if restricted stock awards exist.

1. Were restricted stock awards approved by management or the board of directors prior to issuance?

2. Have restricted stock awards been properly recorded on the general ledger?

Date of Examination: As of ______________________

Prepared by ________________
Date ____________

Reviewed by ________________
Date ____________

X.

Review other-than-temporary impairment.

A. Determine whether management determined there was other-than-temporary impairment (OTTI) of financial assets during the testing period.

B. If OTTI adjustments were made during the testing period, determine if management separated OTTI into a credit component (recognized in earnings) and a remaining portion (recognized in other comprehensive income).

C. In light of the information collected in the two steps above, determine if the journal entries made to record OTTI were correct.

Frequency and Scope Schedule
RECOMMENDED

Audit Procedure	Frequency	Scope
I.	Annually	100%
II.	Annually	100%
III.	Annually	100%
IV.	Annually	100%
V.	Annually	100%

VI.	Annually	100%
VII.	Annually	100% since last examination
VIII.	Annually	100%
IX.	Annually	100% since last examination
X.	Annually	100%