

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
www.bis.org

Chris Barnard
Germany

09 January 2012

**Your Ref: Comment letter on Consultative Document
- The internal audit function in banks**

Dear Sir.

Thank you for giving us the opportunity to comment on your consultative document on The internal audit function in banks.

The objective of this proposed guidance is to help supervisors assess the effectiveness of a bank's internal audit function. The guidance reflects developments in supervisory and banking practices and incorporates lessons drawn from the recent financial crisis.

The proposed guidance sets out 20 principles that aim to promote a strong internal audit function within banks as part of a sound corporate governance structure. In general I agree with the 20 principles, particularly the inclusion of Principle 4 on integrity, which was not explicitly covered in the previous guidance on Internal audit in banks and the supervisor's relationship with auditors (previous guidance),¹ and the enhanced wording on conflicts of interest contained therein. The previous guidance concerning conflicts of interest under Principle 5, paragraph 20 stated that:

Independence also requires that the internal auditors should not have a conflict of interest with the bank.

The proposed guidance under Principle 4, paragraph 21 states that:

The head of the internal audit function and all internal auditors should avoid conflicts of interest. Internally recruited internal auditors should not engage in auditing activities for which they have had previous responsibility before a sufficiently long "cooling off" period has elapsed.

¹ See Internal audit in banks and the supervisor's relationship with auditors, BCBS, August 2001. Available at: <http://www.bis.org/publ/bcbs84.htm>

This increased focus on integrity and conflicts of interest is critical, as unprofessionalism, poor controls and conflicts of interest throughout banks' corporate governance functions were a contributory factor to the financial crisis.

I would like to suggest some changes to the proposed guidance, which I believe will enhance their usability and strengthen their relevance.

1) Paragraph 27 lists the activities that the internal audit function should evaluate. The listed activities do not explicitly cover models, which are of increasing importance and significance in modern banking, and where significant problems have arisen concerning their validity, integrity, and the processes around their input parameter and assumption setting. I would therefore recommend that you should change the wording in the second bullet point under paragraph 27 to "Reliability, effectiveness and integrity of management information systems, processes and models (including relevance, accuracy and comprehensiveness)", for completeness.

2) Paragraph 87 concerns the appointment and replacement of the head of the internal audit function. I would only additionally recommend that wording should be added here concerning any change in the head of the internal audit function that would require the new head to consult with its immediate predecessor in order to discover if there were any professional reasons not to accept the appointment. The new head should be required to contact the supervisory authority, should this be the case.

Yours faithfully

C.R. Barnard

Chris Barnard