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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Via email: basel committee@bis.org

Dear Sirs:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) Consultative Document, *External Audits of Banks*, March 2013 (the proposal). ABA represents banks of all sizes and charters and is the voice for our nation's $14 trillion banking industry and its two million employees.

We recognize the importance of healthy interaction between the external auditors and banking supervisors, as banking supervisors are important users of banks' financial information. We believe, for the most part, the banking industry in the U.S. is in compliance with the proposal, and we understand the BCBS's need to encourage best practices around the globe. However, we have some fairly significant concerns about the proposal, and appreciate your consideration of our views.

During the development and implementation stages of Section 404 of the Sarbanes Oxley Act of 2002 (mainly the assessment and attestation on systems of internal controls over financial reporting), the U.S. experienced wide expectation gaps among external auditors, the Public Company Accounting Standards Oversight Board (PCAOB), banking agencies, and industry. In our rules-based environment, the well-intended and important principle of reporting on internal controls became an enormous and intricate web of rules that were both costly and often unnecessary. We are fearful that the proposal may follow that same path in the U.S. and result in several significant unintended consequences.

Our primary concerns are that the proposal:

1. Is overly prescriptive: For the most part, the general principles are worthwhile; however, the proposal appears to be overly prescriptive with too many details and checklists[1] for banks, external auditors, and audit committees. The proposal would be improved by providing examples of best practices, rather than requirements.

2. Is too rules-based: The tone of the language in the proposal is rules-based. For example, the document often uses "should" and "expect" when "should consider" or "may want to consider"

[1] The details and checklists are contained both within the principles and in Annex 1 and Annex 2 of the proposal.

would suffice, allowing for local supervisors, auditors, and bankers to use their judgment in tailoring the principles to their individual situations.

3. Appears to create a new engagement: The proposal appears to create a new and direct reporting relationship for the external auditor with the banking supervisors on a very frequent basis.[2] [3] The proposal will be improved by clarifying that this relationship is between the external auditor and the audit committee rather than between the external auditor and the supervisors.

   Communication by the external auditors should first be with management, then with the audit committee, and then with supervisors, unless there are extenuating circumstances that necessitate going first to the audit committee or the banking supervisors. In any case, issues that are discussed with the supervisors should not be a surprise to management or the audit committee. Additionally, since the audit committee is responsible for remuneration, it should be aware of any significant increases in the external auditor's fees as a result of significant increases in communications between the external auditor and the supervisor. The communications and the related fees should not be open-ended or be viewed as a training ground for banking supervisors.

4. Often focuses on standards not relevant to U.S. banks: The proposal is written from the perspective of those who follow a variety of international standards, which are used in the principles and as references in the proposal. Many of these international standards are not well known in the U.S., and should not be the basis for its use in the U.S., unless the language is changed to ensure that other standards are acceptable. Broadly including the international standards could result in: (a) requiring their use by companies in the U.S. for the first time and without sufficient "due process", and (b) not only an endorsement by the BCBS of current rules, but also, by implication, the BCBS's endorsement of any future rules issued by those international bodies without due process.[4]

5. May discourage local regulator decision-making: The proposal appears to require that the principles be followed by all banks (paragraph 13). Instead, we believe each supervisor should determine whether every principle is required. A way to resolve this would be to re-word paragraph 13 as follows: "The Committee recognizes that the principles set out in this document will need to take into consideration any statutory and corporate governance structures, as well as supervisory judgment, applicable in each country." For countries that are already in compliance, there may be no need for the proposal; for countries that are mostly in compliance, some form of

[2] If this is the case, a new engagement letter between the supervisor and the external auditor appears to be necessary.

[3] The proposal appears to create a new audit engagement between the external auditor and the supervisor (paragraphs 154-159), which we would not support without an evaluation of whether the additional work is needed and prior consent by the audit committee.

[4] Additionally, the proposal states that internationally accepted auditing standards are applicable to all entities, and we are not aware that they are required in the U.S.

shortened version may be appropriate; for those that are not in compliance and are in need of details, the document may be useful.

6. Could unnecessarily expand external auditor work:[5] The proposal could result in an understandable over-reaction by the accounting firms in the U.S., accompanied by ongoing and in-depth analyses of the proposal by the external auditors, oversight from the PCAOB, focus by management and audit committees, and the associated costs, without sufficient measureable improvement.[6] In some instances, the proposal appears to create new rules for external auditors, which might be better addressed by the external auditors' regulators (the PCAOB, for example, in the U.S.). The proposal adds responsibilities for the external auditors,[7] [8] some of which may be beyond their expertise,[9] and requires some direct reporting to supervisors that may be unnecessary.[10]

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[5] The proposal appears to establish new requirements for auditors (generally because of the tone and the use of the words "should" and "expects") for external auditors to follow. These sorts of new requirements are relatively detailed and, if required, should be proposed for comment with more visibility and sunshine discussion than this document provides. Two examples of this, though there are others, include the section on communications and the section on interacting with audit firms and oversight bodies, which are overly-detailed and burdensome. Additionally, portions of the proposal require that written documents be provided from external auditors to supervisors. If such documents are needed, then a more appropriate process would be for the supervisor to require them from the bank rather than from the external auditor.

[6] Examples of this are the requirements that external auditors follow the most stringent independence standards and ethical standards, as well as the requirements relating to quality control. How will external auditors continuously monitor others' standards, and how will they determine which are the most stringent? Will each firm evaluate this on a global basis? Will smaller, local auditing firms have the ability/capacity to evaluate this?

[7] We agree that peer information can be helpful to an audit committee. However, this should not be the required responsibility of the external auditors. Further, depending on the complexity of the bank's size, operations, and markets served, the implication that the external auditors should compare the bank with its peers (paragraph 123) could be a very expensive process, as compiling the data, determining who the banks peers are, and the fees that would be paid to the external auditor could be extraordinarily high and should be excluded from the document. In lieu of this, it could be recommended that the audit committee ask the external auditor whether, during the audit, any differences with peers were noted.

[8] The proposal requires the audit committee to receive a report from the external auditor on areas of disclosure that could be improved. We agree that this could be a good discussion to have, but should not be a requirement and should not require that the external auditor provide the information relative to the bank's peers (paragraph 138). Recommendations related to such discussions may also conflict with the applicable securities regulator (Securities and Exchange Commission in the U.S.).

[9] The proposal requires external auditors to determine what items would be of significant interest to supervisors and to report that information to supervisors, even though external auditors are not normally trained to make such a determination.

[10] The proposal implies that consistently being at the high or low range of acceptable accounting alternatives is problematic (paragraph 51). However, in practice in the U.S., it is often viewed as preferable to be consistently positioned within a range. Rather than requiring that the auditor inform those in charge of governance, the auditor should first discuss this with management.

7. Creates new audit committee responsibilities: Audit committees appear to have a significant increase in certain areas of responsibility, which may not be necessary.[11] We also question whether guidelines that increase audit committee responsibilities belong in a document on external auditors. Instead of requiring many of these, the document could say that the audit committee may want to consider them.

8. Appears to require new disclosures: The proposal establishes disclosure requirements, which should not be included in this document as a requirement (paragraph 79(f)). If the Committee believes the disclosures are lacking, then it would be appropriate to work with securities regulators, standard setters, and the industry to improve disclosures. Additionally, the requirement to provide users with disclosures to enable them to compare the bank's loan loss methodologies with others across the banking sector is not necessarily the purpose of financial reporting and could add volumes to the disclosures.[12] Additionally, we question whether the requirement to disclose the process for recommending external auditors (paragraph 105) is a necessary disclosure and whether it detracts from the more important disclosures.

We appreciate your consideration of our views and would be glad to provide further information. Please feel free to contact me at dfisher@aba.com or 1.202.663.5318.

Sincerely,

Donna J. Fisher

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[11] An example of this is requiring that the audit committee ensure that the process for hiring auditors is included in the annual report. Bank financial statements have an overwhelming volume of disclosures, and we question whether disclosure about the process for recommending auditors is the type of detail that we want audit committees to focus on and whether the process for recommending auditors adds unnecessary words for users to wade through in the annual report. We recommend that discussions with local securities regulators and local supervisors be held to determine the appropriate venue that such information be included.

[12] Loan loss methodologies could vary significantly from country to country.