Hong Kong Institute of
Certified Public Accountants
香港會計師公會

**By e-mail < baselcommittee@bis.org >**

20 June 2013

Our Ref.: C/AASC

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

Dear Sirs,

**Consultative Document "External audits of banks"**

The Hong Kong Institute of Certified Public Accountants ("HKICPA") is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong.

We welcome the opportunity to provide you with our comments on the Consultative Document "External audits of banks" (the "CD"). Our comments provided are in the context of us being the auditing and assurance standard setter in our jurisdiction.

We are supportive of the Basel Committee's initiative in revising the document and setting out supervisory expectations. We agree with the Committee's view that there is a continuing need for market confidence in the quality of external audits of banks' financial statements. However, the CD should be much clearer as to the purpose of the document and its implications for auditors. In particular it is important that the CD is clear where it is referring to financial statements audits and where it is recommending that auditors perform additional work which is not part of the financial statements audit (for example, regulatory compliance reporting).

We are pleased to note that the CD has endeavoured to make references to the underlying principles in International Standards on Auditing (ISAs). We believe that ISAs are robust and fit-for-purpose. In carrying out any financial statements audit, the only applicable auditing standards should be the ISAs or an equivalent promulgated by any jurisdiction's standard setter. However, it appears to us that significant portions of the CD seek to apply requirements to auditors which are in addition to, or as a substitute for, ISAs rather than providing guidance in applying ISAs when auditing banks to assist in meeting supervisory expectations.

If it is the intention for the Basel Committee to align its requirements with that of the ISAs the document should simply refer to the relevant requirements in the these standards and should not re-write the relevant requirements in other words to avoid misinterpretation as additional requirements. We therefore recommend that the CD make it clear that audits of the financial statements of banks should be carried out in accordance with ISAs or local equivalents.  It would also helpful for the CD to explain to stakeholders how the requirements under the ISAs support the principles in the CD.

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We support the intention of the CD to include guidance on aspects of the audit of a bank which should be an area of focus. We therefore support the co-operation of the Basel Committee and the IAASB in developing application guidance for the audits of banks. This would supplement ISAs and fall within the established framework of auditing guidance issued by the profession and would avoid the risk of their being conflicting, overlapping or unclear requirements and guidance.

We have the same observations in respect of the elements of the CD which deal with quality control and ethics. There are existing standards in International Standard on Quality Control ("ISQC") 1, and the IESBA Code of Ethics for Professional Accountants ("IESBA COE"), and the document should also simply refer to the relevant requirements in the these standards and should not re-write the relevant requirements in other words to avoid misinterpretation as additional requirements.

If the Basel Committee does believe that there are deficiencies in the existing auditing or ethics standards, then the CD should clearly say so.

Our observations with regard to references to the relevant standards are set out in the
--- attachment for your consideration.

We welcome banking supervisors enhancing supervision of the banking sector by the use of external auditors in undertaking additional work. Whilst the scope of any additional work would be a matter for local regulators to determine, it would be helpful if the CD included a general framework. This work could include assurance work over prudential returns, specific investigations and themed reviews of internal controls or business practices. As an example of how the CD currently co-mingles discussion of aspects of a financial statements audit and additional work, we note that the discussion of the internal controls and control activities in Principle 5 may not necessarily be part of a financial statements audit. This should be clarified. If the Basel Committee seeks to require additional and separate reporting for supervisory purposes, it should be clearly stated and there should be further discussion with the IAASB as to the appropriate framework for this additional reporting. It is important that there is a proper framework in place to reduce the potential for expectation gaps and to ensure that auditors are indeed able to undertake the work within their professional framework, including auditing and ethical standards. We note that such frameworks are more developed in some countries than others and there is currently little consistency.

Recently, there has been increasing discussion on improving communications between banking supervisors and external auditors. We note that in the CD, there are principles and guidance focusing in this area. Though we are supportive of open and effective communication as proposed in the CD, we believe that communications should be two-way. As currently drafted, the proposals seem to only cover one-way flow of communicating information from the auditor to the supervisor (e.g. in Appendix 1). To enhance audit quality, we believe that the supervisor should be in a position to communicate relevant information to the auditor. This two-way communication between the auditor and supervisor is also discussed in the IAASB's consultation paper "A Framework for Audit Quality" issued in January 2013.

To facilitate an effective and open communication, we believe that the Basel Committee should provide clarity and guidance on the following areas in the CD by establishing protocols. These protocols would be useful in setting out clear guidelines for relevant parties such as external auditors, supervisors, those charged with governance and audit oversight bodies.

- Confidentiality – according to the IESBA Code, auditors are required to comply with the "confidentiality" principle. Section 140.1 (a) of the IESBA Code states that "the principle of confidentiality imposes an obligation on all professional accountants to refrain from: disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose". We believe it is important that appropriate protocols are established to eliminate the risk of auditors breaching ethical standards.

- Safe harbour – it is critical that supervisors take steps to ensure that there is a safe harbour set up through legal provisions in their jurisdictions to enable effective communication. Without such infrastructure in place, it would be difficult for auditors to communicate as intended within an effectively-operating prudential supervision regime.

- Scope of information – it is important for relevant parties to have an understanding of the nature of information to be communicated. Generally, auditors would not be in a position to comment on matters outside the scope of audit. We note that discussion in the CD (e.g. paragraph 155, paragraph 123, paragraphs 129 to 132, paragraphs 154 to 159) seem to go beyond what auditors are expected to report in the normal course of an audit. We recommend the Basel Committee clarify that the communication of matters within the scope of the external auditor's duty to report/alert would only relate to matters which have come to the attention of the auditor's in the course of the audit.

We are concerned that the proposal in paragraph 114 would be interpreted as a requirement for the audit committee to call for an audit tender at a stipulated time. We believe that guidance should only be for the audit committee to consider whether to call for a tender periodically. Paragraph 115 could be finessed with reference to the rotation requirements in the IESBA COE.

In the CD, there is an in-depth discussion of the interaction with the audit committee, but the discussion seems to be restricted to audit committees only. We consider that interaction with other committees within the bank (e.g. risk committee) should also be covered.

We are of the view that the guidance in the CD on interaction with the audit committee appears to go beyond the responsibilities of an auditor as required under the ISAs. We note that other "responsibilities" include "the exchange of views on business performance, risk and other topics"; "interaction between the accounting information and regulatory information"; "matters that are likely to be significant to the responsibilities of those charged with governance in overseeing the strategic direction of the entity or the entity's obligations related to accountability"; which we consider to be outside the scope of a financial statements audit. We would recommend the Basel Committee to restrict the discussion to matters within the scope of the external auditor's duty to report/alert which would only relate to matters which have come to the attention of the auditor's in the course of the audit. Reference should be made to ISA 260 "Communication with those charged with governance".

We are supportive of the Basel Committee issuing guidance on the roles and responsibilities through various papers such as "Internal audit function in banks" and "Principles for enhancing corporate governance". We note there have been different types of guidance disseminated on the role and responsibilities of audit committees without an overarching framework. We believe it would be beneficial if the Basel Committee would consider linking the various papers and outlining the objectives of the papers in a framework paper.

We have provided comments on the presumption that the supervisors will implement the proposed principles when issued in final. However, we note that there is no indication of an implementation time-line in the CD.

We trust that our comments are of assistance to you. If you require any clarification on our comments, please do not hesitate to contact me at simonriley@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/SH/jn

Encl.

c.c. Hong Kong Monetary Authority

**ATTACHMENT**

**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE BASEL COMMITTEE'S CONSULTATIVE DOCUMENT "EXTERNAL AUDITS OF BANKS"**

| ***References to relevant standards*** | ***Observations/Recommendations*** |
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| IESBA Code<br>ISQC 1<br>ISAs | • The guidance in principle 1 regarding the proficiency of knowledge and competency of the engagement team should be referenced or aligned with the relevant requirements in the ISQC 1, ISAs and IESBA COE. If there are additional specific requirements for competency, they should be clearly stated in the CD.<br>• The guidance in paragraphs 53 to 57 of the CD should be referenced to the relevant requirements in the ISA 220 or ISQC 1.<br>• We believe there are sufficient requirements and guidance in ISQC 1, ISAs and IESBA Code on appropriate training to staff. The proposal in paragraph 35 to have documented policies and procedures that set minimum competency criteria appears to go beyond the requirements in ISQC 1, ISAs and IESBA Code.<br>• In the last bullet of paragraph 166, the appropriate terminologies with reference to the ISAs should be used.<br>• The guidance in principle 5 on identifying and assessing risks of material misstatement may need to be re-worded. We believe the relevant ISAs provide sufficient guidance on identifying and assessing the risks of material misstatement, determining materiality and designing and implementing appropriate responses to the risks. We are of the view that the ISAs are more appropriately worded. |
| Public Interest Entities (PIEs) | In principle 2 the CD proposes that the auditor applies requirements applicable to PIEs in internationally accepted ethical standards to the audits of banks.<br>Paragraph 290.25 of the IESBA COE defines PIEs as:<br>"(a) All listed entities; and<br>(b) Any entity:<br>(i) Defined by regulation or legislation as a public interest entity; or<br>(ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator." |

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| | Paragraph 290.26 also states:<br>"Firms and member bodies are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:<br>• The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;<br>• Size; and<br>• Number of employees."<br>Unless a bank meets the definition of public interest entities under paragraph 290.25 or treated as a public interest entities under paragraph 290.26, in general, it would not be considered a public interest entity by default (e.g. a small branch of an overseas bank).<br>We recommend the Basel Committee to re-consider the proposal for all banks to be treated as PIEs.<br>In addition, we recommend that Basel Committee to clarify the requirement in paragraph 45 of the CD where it proposes the network audit firms also comply with the overseas regulatory authority's independence requirements. |
| Engagement Quality Control Review | It is also not clear if the proposals in the CD (principle 4) are intended to be stricter than that in the ISAs in regard to communication of matters to the audit committee to include areas where views differed between the engagement quality control reviewer and the audit engagement team.<br>Paragraph 22 of ISA 220 states that if differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion. Therefore, the engagement quality control reviewer and the engagement partner would have resolved their differences of opinion when the audit is finalised. If the Basel Committee intends to extend the requirements of the ISAs or ISQC 1, it should be stated clearly. |

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