

June 21, 2013

Mr. Wayne Byres
Secretary General of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
By email: baselcommittee@bis.org

CONSULTATIVE DOCUMENT: EXTERNAL AUDITS OF BANKS

Dear Wayne,

On behalf of the International Auditing and Assurance Standards Board's (IAASB) Steering Committee, I am pleased to provide comments on the Basel Committee on Banking Supervision (BCBS) consultative document, *External Audit of Banks* (the "Document").

General Comments

The BCBS and IAASB share a common interest in recognizing the importance of banks' external audits to financial stability. Accordingly, we commend the BCBS on its commitment to help improve audit quality at banks, and we fully support the BCBS' initiative to develop the Document to enhance and replace the BCBS' 2002 and 2008 related publications.

The final Document will serve as an important input to IAASB's related initiative on its 2012-2014 Strategy and Work Program to determine actions to be taken regarding the topic of the relationship between external auditors and supervisors / regulators. In this regard, we are pleased to have been able to have a member of the IAASB serve as an observer at select meetings of the BCBS' audit working group that developed the Document. This collaboration has been beneficial and is greatly appreciated. We look forward to the opportunity to observe future meetings of the working group as it deliberates responses to this consultation.

We are also pleased to see that the BCBS recognizes that a holistic approach to audit quality needs to be considered if real gains are to be made towards its enhancement. We are therefore encouraged that the BCBS has included references to the role and responsibilities of audit committees and regulators in the Document, as well as the importance of key interactions between stakeholders. 'Interactions' is a central theme in IAASB's recent consultation paper, titled *A Framework for Audit Quality*. This consultation paper describes the input and output factors that contribute to audit quality at the engagement, audit firm, and national levels, and demonstrates the importance of appropriate interactions among stakeholders and the importance of various contextual factors.

Specific Comments

Overall, we found the Document to be comprehensive and well written, and we believe it will serve as an important contribution to the literature.

Our principal concern with the Document pertains to its intended authority and use, which we found to be unclear. This concern is compounded by the use of imperatives within the Document directed at the external auditor: in particular, the word “should” in most cases; and in several cases “must.” These can be construed as imposing a requirement on the external auditor, even though the document is intended to be addressed to banking supervisors. We are very concerned that there will be confusion among external auditors and banking supervisors in relation to the requirements that external auditors need to comply with in conducting an audit in accordance with the International Standards on Auditing (ISAs) and the principles and guidance contained in the Document.

We encourage the BCBS to further clarify the intended authority and use of the Document, particularly in relation to the ISAs and other professional standards such as the IESBA Code of Ethics, and to review aspects of the Document that could potentially create confusion in relation to the compliance responsibilities of the external auditor.

We suggest that the following be clearly stated in the early part of the Document:

1. The purpose of the Document.

In regard to the external auditor, we understand that the intention of the BCBS is to contribute to audit quality by i) describing supervisory expectations regarding audit quality and how that relates to the external auditor’s work in a bank; ii) emphasizing the specific areas of the external audit of a bank which the BCBS regards as particularly important for audit quality, and iii) encouraging greater communication between supervisors and external auditors.

2. The expected use of the Document.

In regard to the external auditor, we thought that paragraph 31 of the Document expressed well how the guidance was expected to be used. That paragraph could be usefully elaborated on and given greater prominence. Paragraph 31 states: “The principles and explanatory guidance set out in this section provide a framework for the supervisor’s interactions with the external auditor, the audit committee and the relevant audit oversight body. The outcome of these interactions will inform the supervisor’s views as to the quality of the external audit and contribute to the supervisory process.”

3. The authority (or scope) of the Document.

In regard to the external auditor, we recommend a statement that the Document does not set out specific requirements for auditors, which is outside the Committee’s authority. (This is acknowledged on page 2 of BCBS Chairman Ingves’ letter to the IAASB dated 21 March 2013, but not within the Document itself.)

We also encourage the BCBS to adopt an alternative way of expressing the supervisory expectations of the external auditor other than through the use of imperatives such as “should” and “must” within

the principles and guidance. If this terminology is retained, the document should explain the status of such terms.

In addition, we encourage the BCBS to review the Document for statements that are inconsistent with the above, or could potentially create confusion in the responsibilities of the external auditor in conducting an audit.

For example, paragraph 26 of the Document appears to imply a dual compliance responsibility for the external auditor. This paragraph explains that audits of banks should be performed in accordance with internationally accepted auditing standards. However, it then states [emphasis added]: “As these standards are not industry-specific, for a quality audit supervisors expect external auditors not only to comply with internationally accepted auditing standards but also to tailor their audit work in response to the significant risks and issues applicable to banks.”

A more appropriate and clearer message might be delivered if the paragraph explained that as the standards are principles-based, supervisors expect the proper application of the internationally accepted auditing standards to include appropriate tailoring of audit work in response to the risks and issues applicable to banks.

Another example where further review may be appropriate is paragraph 12, which references the principles and guidance as “recommendations” and “best practices”, and directs supervisors to “...articulate the measures [banks and] external auditor should undertake to meet them...”

Given the importance of the above matters to the regulatory infrastructure of auditors in many countries and the role of the IAASB, we would be pleased to have a follow up conversation if that would assist you in addressing these issues as you finalize the guidance.

Other Matters

Principle 12 of the Document, and related explanations in paragraphs 144 to 163, highlight a range of matters that banking supervisory authorities believe are important for having an effective relationship with external auditors. We are encouraged to note that the BCBS recognizes the need for safe harbors to be available to auditors (paragraphs 160 and 161) when there are expectations of communications between the external auditor and banking supervisory authorities that may conflict with the ethical principle of confidentiality. We encourage the BCBS to continue to explore how this might be achieved globally in support of the aims of the BCBS.

BCBS Letter to IAASB dated 21 March 2013

I would like to take this opportunity to acknowledge BCBS Chairman Ingves’ letter to the IAASB in which the BCBS shares further views on how to enhance the quality of external audits. As always, we welcome specific input relating to how the International Standards on Auditing (ISAs) might be further improved, and suggestions for how the IAASB might develop a Practice Note for audits of banks to be used in

conjunction with the Committee's guidance on external audits. We also welcome exploring with the BCBS how it might be able to contribute to IAASB's efforts.

The IAASB will consider the comments in the BCBS letter, along with the findings from the ISA Implementation Monitoring project and other inputs received through its strategy consultation process, at its September 2013 meeting for purposes of developing IAASB's future strategy and standard setting priorities.

I hope you find the above comments useful. If you need clarification of our comments, please do not hesitate to contact me or IAASB Technical Director James Gunn.

Yours sincerely,

A handwritten signature in blue ink, which appears to read "Arnold Schilder".

Prof. Arnold Schilder
Chairman, IAASB

Cc. René van Wyk, Chair, BCBS Accounting Task Force
Pat Sucher, Chair, BCBS Audit Subgroup
Xavier-Yves Zanota, BCBS Secretariat
IAASB Steering Committee
Marc Pickeur, IAASB Member and Observer to BCBS Audit Subgroup