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Dear Sirs

**Consultative Document - *External audits of banks***

We appreciate the opportunity to comment on the Consultative Document - *External audits of banks* (the Document) issued by the Basel Committee on Banking Supervision (the Committee) in March 2013. We have consulted with, and this letter represents the views of, the KPMG network.

This letter provides a discussion of our views, followed by more detailed comments in the Appendix. We also contributed to the joint response submitted by members of the Global Public Policy Committee.

**Summary of views**

We welcome the Committee's continuing efforts to consider the role of the profession in contributing to financial stability as external auditors of banks. We agree with the Committee's position that banking supervisors should engage not only with the independent auditor, but also with management and, where appropriate, a bank's audit committee with the dual objective of enhancing the quality of both external audits and financial supervision in the banking sector.

To help better support both these objectives, we recommend that the Committee enhance the proposals in the Document by:

- establishing a principle that supervisors should communicate relevant information to auditors;
- incorporating communication protocols that would enable the 'two-way' exchange of information between banking supervisors and external auditors that is critical for effective communication, including an emphasis on the need for appropriate support in laws and regulations;

- encouraging involvement of auditors in discussions between banking supervisors and audit oversight bodies; and
- including a principle that management shall provide the external auditor with full cooperation and access to all information necessary to perform the audit.

We are encouraged by the fact that the Document recognises the importance of internationally accepted auditing standards, for example International Standards on Auditing (ISAs), in delivering audit quality and that paragraph 26 supports the application of such standards to the audits of banks.

We also recognise that ISAs are not industry-specific and that therefore they will need to be applied taking into account the specific circumstances of banks. However, we have concerns with how this issue is addressed in the Document. The Document combines the Committee's recommendations – which, in many cases, go beyond ISAs – with selected portions of and interpretation of those existing standards. It essentially does the same for internationally accepted ethical standards.

In the case of ISAs, we believe it is important that the IAASB continues to set internationally accepted standards for audits of financial statements, including those of banks. We therefore believe that the Document should state simply that external auditors should comply with applicable professional standards in performing a financial statement audit and we support the Committee in encouraging the IAASB to work with the Committee to provide additional practice guidance specific to financial statement audits of banks. As the Committee notes, supervisors and other stakeholders may benefit from having external auditors of banks undertake additional work that goes beyond an audit of financial statements performed in accordance with ISAs. We recommend that the Committee provides a framework for supervisors to evaluate whether and to what extent they should consider requiring banks in their respective jurisdictions to engage external auditors to undertake such additional work. We suggest that the framework includes guidance on the objective, basis and form of reporting associated with the additional work. Considerations are often jurisdiction specific and some jurisdictions already have in place a framework requiring external auditors of banks to carry out additional work or reporting that goes beyond the financial statement audit – but an explanation of common underlying factors would be of benefit globally.

In the case of internationally accepted ethical standards, we believe it is important that the International Ethics Standards Board for Accountants (IESBA) continues to establish ethical requirements for professional accountants worldwide. The IESBA Code is a robust code of ethics, which is designed to reflect international norms and to be capable of application globally. Therefore, similar to our suggested approach to ISAs, we believe that the Document should state simply that external auditors of banks should comply with internationally accepted ethical standards.

We agree with the Committee that the recent financial crisis has highlighted a need for new thinking and new measures to improve how holders of positions of trust in the public interest, including the auditing profession, work together to contribute to global financial stability. While we do not believe that the crisis revealed widespread failures to comply with internationally accepted auditing standards, we are committed to continuing improvements in audit quality and we look forward to being able to contribute constructively to ongoing discussion on relevant issues. Also, we would emphasise that the Document should establish complementary principles on how bank managements, audit committees and banking supervisors fulfil their respective fiduciary roles.

### **Supervisory expectations relevant to the external auditor and the external audit**

#### *Comingling of ISA and IESBA Code requirements and the Committee's expectations*

Since the financial crisis, there has been an increased focus on audit quality by audit oversight regulators and professional bodies around the world and we support those activities. The Committee has demonstrated its concern with audit quality by incorporating in the Document selected parts of, and commentary on, ISAs and the IESBA Code as well as suggesting to the IAASB enhancements to ISAs. However, the way in which the Document comingles existing requirements with the Committee's comments results in the Document being unclear as to what are actual requirements of ISAs and the IESBA Code and what are the Committee's interpretations of those requirements or its recommendations for incremental requirements over and above existing ISAs or the IESBA Code.

For example, when the Document says that the auditor "should" or is "expected" to do something, it is not clear whether this is intended to report the Committee's understanding of a current requirement of ISAs or recommend something additional. If the latter, it is not clear how the Committee intends those recommendations to be realised in practice. The potential confusion would likely not be helpful to a supervisor who has the task of considering how to make use of the external audit in the context of meeting its supervisory responsibilities.

Specific paragraphs in the Document that we believe convey unclear messages or create potential misunderstanding relating to the performance of an audit in accordance with ISAs and the IESBA Code are provided in the Appendix.

#### *ISA requirements*

We believe that the Document should more clearly and succinctly articulate the external auditor's responsibilities that form part of a financial statement audit under ISAs. The Document should avoid interpreting ISAs or providing guidance on how the external auditor could perform an audit under ISAs – since doing so may inadvertently create expectations that specific procedures which in fact go beyond ISAs were carried out as part of an ISA audit.

### *IESBA requirements*

The Document also incorporates portions of the IESBA Code; however, we believe these requirements are better expressed in the IESBA Code itself and that additional interpretive guidance from the Committee in this area may add confusion rather than clarity. Parts in the Document where this could occur include:

- *Knowledge and competence:* While it is appropriate to stress the importance of giving consideration to specialised industry knowledge and competence, we have concerns relating to the detailed recommendations in the Document. Section 130 of the IESBA Code on professional competence and due care, the International Standard on Quality Control (ISQC 1) and the ISAs already impose obligations on audit firms to maintain professional knowledge and skill at the level required to ensure that clients receive competent professional service and to act diligently in accordance with applicable technical and professional standards when providing professional services.
- *Audit quality and audit firm re-tendering:* The Document proposes that audit committees should have a policy that stipulates the frequency with which there should be a tender for the external audit. We believe such a statement is too prescriptive and might be interpreted to create a requirement for mandatory tendering. We believe that it is the audit committee's role to reassess regularly the effectiveness and independence of the auditor and to consider whether or not the external audit should be put out to tender; this consideration should encompass various factors and we include more detailed comments in the Appendix. The question of audit tendering is a complex one that is being considered by various regulatory and legislative bodies and we do not believe that it would be appropriate for the Committee to make more rigid recommendations while these debates are ongoing.
- *Designation of banks as public interest entities (PIEs):* The Document proposes that all banks are treated as PIEs regardless of the size, complexity, structure, economic significance or risk profile of the Bank. Footnote 28 to the Document notes that a PIE is defined by IESBA and that definition allows for a relevant regulator to make such a designation. It does not automatically make all banks PIEs. In practice the use of the PIE designation leads to a significant increase in the extent of quality control and independence compliance requirements that must be applied by the external auditor. For small or narrow purpose banks we believe the requirements should be proportionate to the risks of the institution and therefore do not believe the extra cost involved is always justified. To the extent the auditor believes a bank is not a PIE, this determination could form part of the dialogue between the auditor and the supervisor.
- *Independence requirements of the home jurisdiction / overseas regulatory authority:* Paragraph 45 in the Document may be read as meaning that the independence requirements that apply to the auditor of a regulated entity should be applied to each network member firm involved in the audit of a subsidiary or related entity in the same way at each level (irrespective of whether and how those member firms are involved in the group audit). The

IESBA Code is clear how the independence standards applicable to PIEs are to be applied to a group audit. In contrast, the intention of the Document is not clear and may not be practicable.

#### *Improving clarity*

We suggest the following approach for expressing supervisory expectations with regard to the external auditor and the external audit of banks' financial statements:

- Confirm as a minimum base principle that external audits of banks' financial statements should be conducted in compliance with internationally accepted auditing standards and codes of ethics, such as ISAs and the IESBA Code.
- Separately identify other work or reporting that a supervisor could or should ask the external auditor to perform, taking into consideration the circumstances of the specific jurisdiction, so as to contribute to the supervisor's supervisory objectives.

We agree that implementation of the principles should be 'proportionate' to the size, complexity, structure, economic significance and risk profile of the bank; however, the Document also should explain that individual facts and circumstances as well as materiality filters should be considered in determining how and whether specific principles are applicable.

#### *Enhanced guidance on the application of ISAs*

In addition to the above, we support the Committee in requesting that the IAASB works with the Committee to develop an industry-specific practice guide for the audit of banks' financial statements in accordance with ISAs, perhaps similar to UK Audit Practice Note 19 – *The Audit of Banks and Building Societies*. This would provide a clearer source of more detailed guidance on the application of ISAs that would be developed and updated by the IAASB as the appropriate international standard-setting body. This may be of benefit both to auditors, in terms of planning and performing audits, and to supervisors, in more fully understanding the nature and extent of an ISA audit.

#### **A framework for evaluating the need for additional work and reporting by external auditors**

With respect to the nature and extent of additional work or reporting to be performed by the external auditor, we do not believe that a 'one size fits all' approach would be the most efficient or effective approach – what is appropriate will vary with the different circumstances and practices of individual jurisdictions and institutions. Various jurisdictions already have requirements or practices in place for external auditors to perform additional procedures that go beyond the scope of an ISA audit.

However, rather than the Document integrating additional work or reporting as part of a discussion of ISA requirements or noting possible types of reports without further explanation, we believe the Committee should establish a clear framework for supervisors. In particular, we believe the Committee should make clear the following principles:

- Supervisors should evaluate the need for additional work or reporting in the context of obtaining adequate assurance regarding institutions' compliance with relevant legal and regulatory requirements, including aspects of the Committee's Core Principles. Supervisors might obtain this assurance either by undertaking direct inspections of institutions or by engagement of the auditor or another third party to undertake additional work.
- Additional work or reporting should be clearly differentiated from the requirements of a financial statement audit performed in accordance with ISAs. It would be helpful for the Committee and supervisors to explain the objectives of requests for additional assurance or reporting.
- Supervisors should ensure that any requirements for additional work or reporting by auditors are clearly communicated in their respective jurisdictions, including guidance on the basis and form of reporting to be provided. Any additional procedures or engagements, including terms of reference, should be agreed between the relevant parties.
- Supervisors should engage in discussion with the auditing profession about any proposed additional engagements or reporting to ensure that they are capable of being performed in accordance with relevant professional standards, including that any threats to the auditor's independence and objectivity are considered.

It would be helpful for supervisors to stay engaged with and contribute to wider debates about the future of corporate and financial reporting. Enhancements in corporate reporting – e.g. separate reporting by management about going concern or forward-looking risk information – may contribute to supervisory objectives and may provide additional subject matter on which auditors could be engaged to report. Supervisors also should consider the extent to which additional reporting requirements for auditors – e.g. on regulatory capital calculations – could enhance transparency and public confidence in regulated institutions.

### **Open and effective communications**

We fully support the objective of fostering effective two-way communication between external auditors and supervisors and between external auditors and audit committees of banks. However, the principles and guidance as drafted are more focused on information to be provided by the auditor to the supervisor or to the audit committee respectively. We believe the guidance should be more balanced so as to better support open two-way discussion. Accordingly, we recommend the inclusion of an additional principle that the supervisor should provide information that may be relevant to the conduct of the external audit to the external auditor. Information supplied by the supervisor may make a direct contribution to audit quality

through assisting auditors in making judgements about risk. Similarly, audit committees should share information that is relevant to the conduct of the external audit with the external auditor. There may be circumstances when the most effective way of communicating the relevant information would be to include all interested parties, for example, the supervisor, the audit committee and the external auditor.

Further, bank supervisors, having a sector-wide view and wide powers, are in a position to obtain and share information that may be helpful to auditors – e.g. the results of thematic analyses or reviews, such as benchmarking of valuations.

We also believe that regular, open trilateral communication between the external auditor, supervisor and audit oversight body is key to helping prevent confusion by improving the parties' understanding of matters discussed and the consistency of resulting communication.

In addition, while the Document addresses reporting by the external auditor, we believe additional emphasis should be given to the responsibility of a bank's management to make full and frank disclosure to the supervisor, including with respect to matters that are discovered by the auditor. We also believe that the Document should include a principle that management shall provide the external auditor with full cooperation and access to all information necessary to perform the audit since this is fundamental to the ability to perform an effective audit.

In order for improved dialogue between the various parties to occur, it is necessary for supervisors to secure the establishment of appropriate communication protocols. Progress in this regard has already been made in some jurisdictions – for example, in the Netherlands detailed agreements are in place relating to the exchange of information between external auditors and supervisors.

The protocols should remove or alleviate potential barriers to effective communication faced by all relevant parties including external auditors, supervisors, audit oversight bodies, audit committees and management. Matters we believe should be addressed include the following:

- *Confidentiality*: The Document establishes, in Principle 16, confidentiality requirements for the supervisor and the audit oversight body when sharing information. The Document acknowledges that external auditors are required to comply with the duty of confidentiality in the IESBA Code. Many countries will also have laws, regulations and professional standards concerning an auditor's duty of confidentiality or professional secrecy. Therefore, protocols – which may need to be reflected in local laws and regulations – are required in order to address potential conflicts with this duty, in particular relating to information reported by the external auditor to the banking supervisor.
- *Safe harbour*: While the Document acknowledges the effect on communication of the availability of a safe harbour to an external auditor, we believe greater emphasis should be placed on the importance of jurisdictions working towards achieving a safe harbour that is reflected in local laws and regulations, if not already in place. This would be consistent with

protections afforded to external auditors in disclosures to audit regulators. We believe safe harbours should extend to ensuring that communications are kept confidential and protected against disclosure to third parties. The safe harbour enables auditors to communicate more frankly with supervisors than might otherwise be the case.

- *Independence and objectivity:* As reiterated in the Document, the external auditor complies with the IESBA Code on independence and objectivity. We believe consideration should be given to developing a framework for representatives of the banking supervisor, including requirements related to the communication of information to, and use of information received from, external auditors.
- *Reporting:* The Document establishes expectations regarding communications from the external auditor to the supervisor but provides limited guidance to enable the auditor to determine what would be of “material significance to the functions of the supervisor.” We recommend that either the Document provides criteria within which the external auditor and supervisor can evaluate what is expected to be communicated, or indicates the importance of establishing such criteria at a jurisdictional level. For example, the Bank of England's Prudential Regulation Authority has issued a code of practice providing greater clarity around such communications with respect to banks under their jurisdiction.
- *Communication with audit oversight bodies:* We believe protocols between the banking regulator and relevant audit oversight body should be established that address what information would be shared between the parties and the manner in which the information would be shared. We also think it is important to ensure the participation of external auditors so there is a full understanding of the different perspectives.

In order to facilitate constructive and informed dialogue within jurisdictions, we support the formation of professional faculties or panels with a banking focus. Such bodies can play a role in identifying emerging industry issues and engaging in dialogue with regulators, standard setters, industry groups, government agencies or audit oversight bodies – for example, the AICPA Depository Institutions Expert Panel in the United States.

We attach to this letter an Appendix containing our detailed observations and comments on specific paragraphs of the Document.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Sylvia Smith or Chris Spall at +44 (0)20 7694 8871.

Yours faithfully

*KPMG IFRG Limited*

KPMG IFRG Limited

## Appendix – Detailed Observations

The following are our detailed observations relating to the Document, organised by paragraph. They include specific observations where we believe the Document conveys unclear messages or creates potential misunderstanding relating to the performance of an audit in accordance with ISAs and the IESBA Code. While some comments relating to the principles also are included in the observations that follow, this appendix should be read in the context of the covering letter.

### Introduction, application, structure and the Committee’s international engagement

Para	Observation
11	As mentioned in the covering letter, in addition to discussing “proportionate implementation” the Document should explain that individual facts and circumstances as well as materiality filters should be considered in determining how and whether specific principles are applicable. For example, as discussed in our comments relating to paragraphs 27, 33, 42, 53, 80 and 94, particular facts and circumstances should be considered when evaluating if a bank is a PIE, identifying and assessing significant risks of material misstatement, or identifying key areas of judgement.
16	As a clarification to the first sentence, internationally accepted auditing standards are not applicable to “all entities”; rather they are applicable to audits of any entity’s financial statements conducted in accordance with those standards.  We recommend correcting the logic in the second sentence to reflect that the fact a risk “often” arises does <i>not</i> mean that it always arises and “therefore requires particular attention for a quality audit.” This could be addressed by amending “requires” to “may require.”
22	We suggest clarifying why supervisors are in a “unique” position to identify audit quality issues. The Committee also should articulate what it believes the supervisor’s role and involvement in audit quality matters should be, including in particular its limitations given the governing role and expertise of the audit oversight body.  In this regard, the Committee should explain that any actions taken to address issues raised by the audit oversight body should be co-ordinated with the audit oversight body.

**Supervisory expectations relevant to the external auditor and the external audit of financial statements**

Para	Observation
26	While internationally accepted auditing standards are not industry-specific they do require the auditor to tailor his work so as to address the risks of material misstatement in the particular circumstances. Accordingly, contrary to what is implied by this paragraph, tailoring audit work in response to significant risks and issues applicable to banks is not an additional requirement.
27	It is unclear what is meant by the “most stringent rules for independence under these standards” or “most stringent standards on quality control.” This paragraph should be clarified to indicate, at a minimum, that the standards and rules referred to are the ones that are applicable to the audit in the particular circumstances. However, if the intention is to communicate that banks should be treated as PIEs and makes the assumption that the PIE standards will be the most stringent; this requirement is better addressed in Principle 2. As mentioned in our covering letter, although many banks are PIEs, for small or narrow purpose banks, the designation may not be appropriate and therefore compliance with the “most stringent standards” on independence and quality control at the engagement level may not be necessary in all cases.

***Principle 1:*** *The external auditor of a bank should have banking industry knowledge and competence sufficient to respond appropriately to the risks of material misstatement in the bank’s financial statements and to properly meet any additional regulatory requirements that may be part of the statutory audit.*

Para	Observation
32-33	<p>As mentioned in the covering letter, section 130 of the IESBA Code on professional competence and due care and ISQC 1 impose obligations on audit firms to maintain professional knowledge and skill at the level required to ensure that clients receive competent professional service and to act diligently in accordance with applicable technical and professional standards when providing professional services.</p> <p>In addition, ISA 220 requires that the engagement partner is satisfied that the engagement team <i>collectively</i> has the appropriate competence and capabilities to perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements and to enable an auditor’s report that is appropriate in the circumstances to be issued. ISA 220 also requires the engagement partner to take responsibility for the direction, supervision and performance of the audit engagement as well as reviews performed and appropriate consultations when</p>

	<p>necessary.</p> <p>While the engagement team should have the knowledge necessary to competently perform a specific audit, knowledge about a wide range of banking activities or risks that are not relevant to the particular audit may not be required. Accordingly, any discussion of knowledge of “industry practice” should be focused on what is relevant to the particular audit.</p> <p>Given that IAPN 1000 is guidance that “audit firms can use in developing their training programs and internal guidance”, internal guidance established by audit firms may be more relevant and comprehensive than IAPN 1000. In such cases, it would not necessarily be effective or efficient to require engagement team members to have knowledge of the IAPN itself.</p> <p>It is not clear what “proficient” means in the context of knowledge and competence or what, if any, standards should be applied in assessing proficiency. If this paragraph is intended only to repeat existing requirements, we recommend deletion of this paragraph, subject to reiteration of a general principle to comply with ISAs and the IESBA Code. However, if it is intended to introduce incremental requirements, it is unclear what they are and additional explanation would be required. Moreover, we do not believe that existing requirements are deficient in this regard and do not see a need for any incremental guidance.</p>
35-36	<p>We agree that the overall engagement team should have the necessary skills and competency required for the specific bank audit and that in particular, the engagement partner is likely to need a high degree of experience in bank audits. However, the Document should reflect that the applicability of competency requirements to individual members of the engagement team may vary. For example, junior engagement team members, staff working on areas other than banking operations, or specialists assisting with non-banking matters may not need a high degree of experience, if any, in bank audits to effectively perform their roles.</p> <p>In addition, different banks may or may not undertake a wide range of different activities, such as private banking, investment banking, transaction banking and custody business. The audit of each may require different expertise and industry experience. In practice, many audit firms have specialised audit teams that focus on different banking activities.</p> <p>Moreover, as explained in our comments on paragraphs 32-33 above, we do not believe that existing requirements are deficient in this area and do not see a need for any incremental guidance.</p>

**Principle 2:** *The external auditor of a bank should be objective and independent in fact and appearance with respect to the bank, consistent with the more stringent requirements applicable to public interest entities in internationally accepted ethical standards.*

Para	Observation
42	As discussed in the covering letter, although many banks are PIEs, for small or narrow purpose banks, the designation may not be appropriate. To the extent the auditor believes a bank is not a PIE, this determination could form part of the dialogue between the auditor and the supervisor.
43	This paragraph appears to reiterate the IESBA Code, although the language in the IESBA Code is much clearer as to how it applies. If it is intended only to repeat the IESBA requirement, we recommend deletion of this paragraph, subject to reiteration of a general principle to comply with the IESBA Code. However, if it is intended to introduce incremental requirements, it is unclear what they are and additional explanation would be required. Moreover, we do not believe the IESBA Code is deficient in this regard and do not see a need for any incremental guidance.
45	<p>We have concern that this paragraph may be read as meaning that the independence requirements that apply to the auditor of the regulated entity (i.e. the parent bank) should be applied to each network member firm involved in the audit of a subsidiary or related entity in the same way at each level (irrespective of whether and how those member firms are involved in the group audit).</p> <p>In the IESBA Code it is clear how the independence standards that apply to PIEs are to be applied to a group audit. For example, the IESBA Code has the concept of a key audit partner for the group audit and rotation rules apply to key audit partners at the group level, not to every key audit partner for every audit of every entity in the group. If the Committee intends to require that a national regulator's standards must apply across the entire group, this may be problematic as these standards will likely reflect the local environment and not necessarily international norms (for which the IESBA Code is designed). If the national regulator already requires application, then presumably those national standards will make clear how and to what extent they should be applied internationally. However, if those national regulations do not themselves require wider application, it is difficult to see how the Committee can require it and the results may not be practicable (e.g. if the national requirements are based on specific national laws and regulations).</p>
46	The meaning of "significant non-audit services" is not clear - for example, whether significance should be determined by size of fee, impact on the entity, extent of independence threat or other criteria. The suggestion of a higher standard for the evaluation of such services than is stated in the IESBA Code (i.e. "carefully evaluated" as opposed to "evaluated") also lacks clarity.

	<p>The concept of the need to evaluate threats to independence according to a conceptual framework and taking into account, for example, the significance of threats, which can be cumulative, is better expressed in the IESBA Code itself. As discussed in the covering letter, it would be preferable to establish a principle to comply with the IESBA Code rather than trying to paraphrase select pieces in a manner that may be misconstrued.</p>
47	<p>The suggestion of a higher standard for the consideration of potential threats to independence (i.e. “consider <i>actively</i>”) lacks clarity (see comment on paragraph 46 above). In addition, this paragraph could more clearly distinguish between self-review threats and management responsibility issues.</p> <p>The relationship between the wording provided here and the IESBA Code, which addresses independence rules relating to accounting assistance, is not clear. As discussed in the covering letter, it would be preferable to establish a principle to comply with the IESBA Code rather than trying to paraphrase select pieces in a manner that may be misconstrued.</p>

**Principle 3:** *The external auditor should exercise professional scepticism when planning and performing the audit of a bank, having due regard to the specific challenges in auditing a bank.*

Para	Observation
Principle 3	<p>There has been an increased focus on professional scepticism since the financial crisis including amendments made to ISA 540 <i>Audit of accounting estimates, including fair value accounting estimates, and related disclosures</i>. We support these activities and agree with the importance of external auditors exercising professional scepticism when planning and performing the audit of a bank.</p>
50	<p>On the basis that audits of banks should comply with ISAs, which include a requirement to exercise professional scepticism, this paragraph could be included in a practice guide on the audit of banks. However, the second sentence would be more straightforward if expressed simply as a statement indicating that the external auditor should apply scepticism in evaluating complex transactions that may have been structured to achieve a particular accounting treatment or regulatory outcome.</p>

**Principle 4:** *Audit firms undertaking bank audits should comply with the more stringent requirements on quality control applicable to listed entities in internationally accepted quality control standards, having due regard to the complexity of a bank audit.*

Para	Observation
53	<p>Similar to our comment on paragraph 27, it is unclear what is meant by “more stringent requirements” or “more restrictive rule.”</p> <p>In terms of ISAs, the requirement for an EQC review to be performed should be linked to the assessment of whether the bank is a PIE. As noted in our comment on paragraph 42, although many banks are PIEs, for small or narrow purpose banks, the designation may not be appropriate and therefore an EQC review would not necessarily be required. Relevant factors an external auditor may consider in determining whether an audit should be subject to an EQC review include the size of the bank, the nature and extent of interaction with the public, and extent of systemic risk.</p>
54	<p>The use of the phrase “EQCR performed <i>internally</i> by the audit firm” appears to create a stricter requirement than ISQC 1 and ISA 220, which permits an EQC reviewer to be a suitably qualified external person.</p> <p>In addition, while the EQC reviewer should have the competence to perform the particular review, specific knowledge of bank audits may not necessarily be required – in particular, the EQC reviewer is permitted to include other suitably qualified individuals within his team rather than having all the required knowledge personally.</p>
56	<p>We believe this paragraph should begin “where <u>more than one member of</u> a network of audit firms...” rather than “where a network of audit firms...”.</p> <p>Refer to our comments on paragraph 35 with regard to “ensuring that each audit engagement team member acquires the appropriate skills, knowledge and experience to perform bank audits.”</p> <p>Under ISA 600, the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement. ISA 600 includes detailed requirements as to the performance of audits of group financial statements, including the work of and relationship with component auditors. However, ISA 600 does not contain requirements relating to the responsibility of the group auditor for the performance of a quality audit by all teams reporting to it or quality control processes performed by member firms reporting to it.</p> <p>We do not believe that the existing requirements of ISA 600 are deficient in this regard and do not see a need for any incremental guidance.</p>

57,  Footnote 42	<p>It is not clear if the statement that any significant discussions between the EQC reviewer and the audit engagement team should be “fully documented” is intended to extend the requirements of ISAs or ISQC 1. In addition, the suggestion that the external auditor should discuss “these matters” lacks clarity as to what is intended to be communicated to the audit committee and whether the recommendation is intended to extend the requirements of ISA 260.</p> <p>Furthermore, we think that the reference to “particularly in areas where views may have differed” reflects some misunderstanding on how an EQC review is performed and its role in enabling the issuance of an audit report. The EQC reviewer and the engagement team may have many discussions and exchanges of views during the course of the audit. Each party’s understanding of the facts and their perspectives on them may change during that time as new information is obtained and discussions continue. Ultimately though, any “differences of opinion” have to be resolved following the firm’s applicable policies and procedures in order for an audit report to be issued. It is likely that in many cases the subject matter of such discussions would be reported to the audit committee because they relate to significant judgements about accounting or internal controls or auditor independence. However, in this case it is the substance of the issue and the conclusion that is communicated, not necessarily every discussion that took place or the views of each individual in the process of arriving at the final conclusion.</p>
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**Principle 5:** *The external auditor of a bank should identify and assess the risks of material misstatement in the bank’s financial statements, taking into consideration the complexities of banking activities and the need for banks to have a strong control environment.*

Para	Observation
Principle 5	<p>The objective of the principle, at a high level, is reasonable. However, the last phrase is not neutral and is not focused on the particular audit at hand and its objective. We believe it would be more appropriate to state: “...taking into consideration the complexities of <u>the bank’s activities</u> and <u>the effectiveness of its internal control</u>.”</p> <p>Regarding the paragraphs that expand on this principle, we note that under ISAs, the external auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. Accordingly, while some of the matters relating to fraud or error, including intentional or unintentional non-compliance with regulatory requirements may be considered in the course of performing an audit of the financial statements, it would not be correct to suggest that the auditor always plans to identify these matters. For example, paragraphs 58 to 72 appear to convey the message that in audits of financial statements of banks, the external auditor identifies all risks faced</p>

	by the bank and performs extensive tests of controls over internal control systems that have any connection with the financial statements. This message is inconsistent with the ISAs, which are quoted and referred to in paragraph 6.
59	<p>In accordance with ISAs, inherent and control risks are only considered with respect to the risk of material misstatement at the assertion level, not at both the assertion and financial statement levels.</p> <p>In addition, an external auditor gains an understanding of internal controls, including the control environment, to the extent necessary to perform the audit; therefore it is unclear why the auditor gains an understanding “particularly” of the control environment.</p>
60	<p>Testing of controls is not always mandatory in the performance of an external audit. ISAs require the auditor to select relevant controls and gain an understanding of them when:</p> <ul style="list-style-type: none"> <li>• the auditor has determined relevant assertions are associated with a significant risk, including a fraud risk;</li> <li>• the auditor’s assessment of risk of misstatement at the assertion level includes an expectation that the controls are operating effectively; or</li> <li>• it is not possible or practical to obtain sufficient appropriate audit evidence only from substantive procedures.</li> </ul> <p>Although testing of controls is not always mandatory, as explained in more detail in Auditing Practices Board Practice Note 19 <i>The Audit of Banks and Building Societies in the United Kingdom</i>, for large banks, the volume of transactions may mean that it is extremely difficult for the auditor to express an opinion without obtaining assurance from adequate systems of control. The Practice Note also identifies features of the business of banks that may be relevant to the auditor’s assessment of internal controls.</p> <p>While it may be more effective and efficient to perform control testing in some areas, particularly with respect to activities involving a high volume of transactions, the external auditor is not required to perform “extensive tests of controls over financial reporting.” In the event the auditor does decide to perform control testing, it is not clear what the document means by “extensive” testing.</p> <p>However, if the supervisor considers additional work or reporting in this area beneficial, the external auditor could be engaged to perform such work under the relevant framework as discussed in the covering letter.</p>
63	ISAs do not include discussion relating to the dismissal of misstatements and this paragraph seems to confuse certain ISA requirements, including the following:

	<ul style="list-style-type: none"> <li>the auditor shall accumulate misstatements identified, other than those that are clearly trivial; where clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with ISA 320, and will be matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances;</li> <li>the auditor shall communicate to management <i>all</i> misstatements accumulated during the audit with the appropriate level of management and request correction of all misstatements; and</li> <li>the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate.</li> </ul>
64	<p>We do not believe that simply stating that certain financial statement items are used for the calculation of regulatory ratios is sufficient justification for why a lower level of materiality may be appropriate. The use or calculation of key metrics is not unique to the audit of banks; listed entities in general are typically evaluated by analysts against such criteria. Also, some of the items quoted may relate to multiple items – e.g. a leverage ratio based on total assets and total equity.</p> <p>We do not believe that existing requirements relating to materiality considerations are deficient and therefore do not see a need for any incremental guidance in this area. However, if the supervisor considers additional work or reporting in this area beneficial, the external auditor could be engaged to perform such work under the relevant framework as discussed in the covering letter.</p>
66	<p>The internal control environment considerations listed are not unique to banks. In addition, these points seem to suggest that auditors should consider activities because they are critical to the strength of a bank's governance system and its ability to manage risk; in contrast, ISAs focus on risks of material misstatement, which may not correspond directly to these wider risks.</p> <p>The paragraph appears to extend the external auditor's scope of work. As discussed in our covering letter, to the extent that the Committee believes that supervisors and other stakeholders may benefit from having auditors of banks undertake additional work, supervisors should ensure that any requirements for additional work by auditors are separately identified and clearly understood and agreed between relevant parties in their respective jurisdictions.</p>
68	<p>This paragraph should clarify that factors to be taken into account are to the extent necessary for the purpose of the financial statement audit, which is not an audit of compliance with specific regulatory requirements.</p>
69	<p>In accordance with ISAs, deficiencies in internal control only need to be communicated to management if they are, in the auditor's judgement, of sufficient importance to merit management's attention. The text suggests that all deficiencies</p>

	<p>should be communicated to management.</p> <p>The suggestion that the external auditor “should communicate in writing all 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” is very broad and goes beyond ISAs. For example, it might be taken to include making recommendations on the commercial merits of business strategy rather than commenting on its accounting or control implications. The statement appears to instruct the external auditor to extend its scope of work to identify potentially relevant matters and to duplicate reporting that would be done by management and internal audit. Similar to our comments above on paragraph 66, if additional work is to be undertaken, supervisors should ensure that any requirements for additional work by auditors are separately identified and clearly understood and agreed between relevant parties in their respective jurisdictions.</p> <p>The example provided of communication of “actions by management that lack appropriate authorisation” would likely be considered a significant deficiency in internal control and therefore communicated under existing communication requirements in accordance with ISAs. If the intention is to recommend a new extended instruction to report that goes beyond ISAs, the inclusion of an example of something that would only be captured by the extension would be more useful.</p>
72	<p>This paragraph merely states a belief that the matters highlighted are of “particular interest” but does not include any clear recommendation. We note that a requirement to report on these matters would go beyond the requirements of ISAs.</p>

**Principle 6:** *The external auditor of a bank should respond appropriately to the significant risks of material misstatement in the bank’s financial statements.*

Para	Observation
73	<p>We suggest revising the wording to indicate “paragraphs 78-98 set out <del>key</del> areas of a bank’s financial statements where there <u>may be</u> a significant risk of material misstatement”. We believe the use of the word “often” is an over-generalisation as while these areas may usually give rise to a risk of material misstatement it is not always the case and, if they do not, they may not be “key.”</p>
74	<p>Similar to the comment above, we suggest revising the wording to indicate “as a consequence, there <u>may be</u> a greater risk of material misstatement of these items in the financial statements”.</p> <p>In addition to indicating that external auditors should consider whether the</p>

	regulatory treatment of certain items could give rise to incentives for management bias in the recognition and measurement of financial statement items, the Document should require supervisors to inform external auditors of new and emerging risks of this type.
76	It is not clear what is meant by issues that are “highly important to the bank” or “areas worthy of discussion”. In accordance with ISA 260, an audit plan, including risks identified and the planned audit response, as well as any significant findings from the audit should be communicated to those charged with governance. The Document should clarify that these are the types of communication intended to be addressed rather than being extended vaguely to any areas that are “highly important for the bank.”
79	<p>Given that the factors the external auditor considers in identifying and assessing significant risks of material misstatement depend on the particular facts and circumstances, we suggest modifying the wording to “...and the related allowance for loan losses <u>may</u> include...”.</p> <p>Para (a) – It would be challenging for external auditors to compare estimation techniques used to compute provisions among banks as all the information that would be required is not publicly available. As this information could be required by supervisors on an industry-wide basis, this is an area where the Document could encourage supervisors to undertake thematic reviews and analyses and to share the results with managements and external auditors of banks.</p> <p>Para (b) – It is unclear how the effect of estimation uncertainty on the level of provisioning affects the appropriateness of the recognised provision and the sufficiency of the related allowance. Accounting standards would generally require a neutral approach based on a best estimate or probability distribution.</p> <p>Para (c) – Depending on the applicable financial reporting framework, the impairment indicators listed may be potential rather than necessarily actual impairment indicators.</p> <p>Para (e) – There is no explanation provided as to why the Committee believes that large differences between provisions for accounting purposes and for regulatory purposes may indicate a risk of material misstatement of the accounting provision.</p> <p>Para (f) – This paragraph represents guidance on accounting and disclosure rather than any commentary on audit risks or procedures. In addition, it is not necessarily the case that disclosures in the financial statements should enable users to assess how the bank's methodology compares with methodologies applied across the banking sector.</p>

80	We suggest revising the wording to “financial instruments measured at fair value also include financial instruments that are subject to an impairment assessment which <u>may be</u> a key area of judgment” as this will depend on the particular facts and circumstances.
85	<p>It is not clear how “material significance to the functions of the supervisor” would be defined or specifically identified. Under ISAs, auditors would consider matters that could have a material impact on the financial statements or matters that are significant to the audit. Consistent with our comment on Principle 13, bank supervisors should formally communicate with external auditors what matters they deem to be of material significance.</p> <p>In addition, it should be emphasised that supervisors need to put in place the legal framework to support such a duty to report.</p>
86	It is not clear what “non-recognition of assets and liabilities” is intended to refer to.
89	<p>This paragraph inaccurately combines two different concepts:</p> <ul style="list-style-type: none"> <li>• individual audit teams have a duty under ISAs to consider whether financial statements are fairly presented and to report immaterial deficiencies in disclosure to management and the audit committee; and</li> <li>• audit firms play a wider role in encouraging and educating about good disclosure.</li> </ul>
91	The issues listed here are interrelated, rather than purely “separate.” Also, the second bullet contains two issues hence in total three issues are actually listed. In addition, the adequacy of disclosure about application of the going concern basis and any material uncertainties is a similarly related and relevant issue that has not been included in this list.
92	It is unclear how “signalling any uncertainty over the bank’s ability to continue as a going concern” would or should affect the work that is performed to assess the going concern status – rather it gives rise to difficult and sensitive issues related to reporting and disclosure about the going concern status.
93	<p>Another factor that makes the going concern assessment of a bank unique, and may be important in the assessment, is that banks may have access to “lender of last resort” funding.</p> <p>Para (a) – Inclusion of a more direct and clear description of the risk of a run on the bank as a result of loss of confidence by depositors would be helpful.</p>

	Para (b) – A potential issue that is not addressed is that if regulatory capital falls below minima set by the supervisor, the supervisor could take action that invalidates the going concern assumption.
94	We believe the appropriate level of emphasis to be placed on evaluation of liquidity and solvency would depend on precise facts and circumstances, rather than assuming that “equal” emphasis would be appropriate.
95	The term “robustness” is not defined and therefore may be challenging for an external auditor to apply. If it is intended to have the same meaning as ‘effective’, it would be more straightforward to the use that term here, as auditing standards provide guidance on how to evaluate the effectiveness of systems and controls.
96	Consistent with our comment on paragraph 85, supervisors need to put in place the legal framework to support such a duty to report.
97	The concept of “reputational risk” and its relationship to the audit risk model is not made clear. It seems to go beyond the risk of a material misstatement in the financial statements and it is unclear how or why the Committee believes this impacts the auditor’s work. It may be more useful to note that the sponsoring bank may contractually retain market, credit or liquidity risks.
98	<p>Whether and how much “special consideration” is required will depend on the materiality of the activities to the particular bank’s financial statements.</p> <p>Para (a) – The fact that different transaction structures might be accounted for differently does not seem a particular feature of principles-based accounting frameworks. Rules-based frameworks may give rise to a greater risk that minor changes in transaction structure will give rise to differences in accounting treatment.</p> <p>Para (b) – Rather than just expecting the auditor to remain alert to when the supervisor requires additional capital, if supervisors think this is a serious concern, then they should notify the external auditor of such regulatory actions. In addition, it is not clear how the requirement to hold additional capital is relevant to auditing the accounting for or disclosure of these structures. This merely seems to be a factor in considering disclosures about capital, going concern and compliance with regulations.</p> <p>Para (c) – This activity does not seem relevant to the conduct of an audit of a particular bank’s financial statements but rather is a macroprudential risk that might be considered for discussion at a firm-wide or profession-wide level.</p>

**Supervisory expectations with regard to a bank's audit committee and its relationship with the external auditor**

***Principle 7:** The audit committee should have a robust process for approving, or recommending for approval, the appointment, reappointment, removal and remuneration of the external auditor.*

Para	Observation
Section 5	The applicability of the Committee's recommendations with respect to audit committees will be dependent on how the role and responsibilities of audit committees and other governance bodies are defined in each jurisdictional legal framework. It may be helpful to acknowledge this specifically in the Document.
101	It is not clear who "all parties involved" is intended to extend to. Although an external auditor should of course show a high level of respect, it should be made clear that this should not be so as to compromise his sense of objectivity and scepticism.
108	<p>It is not clear what the "current nature of the audit environment" means. Also, rather than maintain an understanding and knowledge of "any" overseas jurisdictions, the consideration should be limited to those that are significant to the audit.</p> <p>Significant issues and concerns raised by the relevant audit oversight body regarding the audit firm are not necessarily "shortcomings."</p> <p>The final bullet point indicates that the audit committee should consider public lessons learned from any recent audit failures "associated with the bank's audit firm" and how it has dealt with them so that "similar deficiencies" do not occur. Firstly, we do not believe that the audit committee's consideration should focus solely on failures associated with the particular audit firm. In some cases, "audit failures" involving other unrelated audit firms may be indicative of lessons that need to be learned across the profession generally - e.g. as indicating new or emerging audit risks that might benefit from greater focus. Secondly, such "audit failures" (depending on how the term is defined) are not necessarily a result of deficiencies. In particular, however defined, they do not necessarily imply a deficiency in the audit firm's approach to the audit of the particular bank's financial statements. Therefore, it would be more useful to refer instead to how the particular audit firm is addressing the "lessons learned" so as to ensure similar audit risks are appropriately identified and limited.</p>

109	We suggest the matters identified in the second sentence should be qualified to indicate “...an <u>inappropriate</u> narrowing of the external auditor’s proposed scope of the audit, or an <u>inappropriate</u> reduction in the attention which will be given...”
110	We agree that the audit committee should approve the auditor’s [re]appointment prior to work starting; however, there should be some flexibility to allow the engagement letter to be finalised thereafter.

**Principle 8:** *The audit committee should monitor and assess the independence of the external auditor.*

Para	Observation
112	It appears excessive to say that all relationships between the bank and the audit firm have to be considered each year; rather the language should reflect the consideration of relationships that might reasonably be thought to bear on independence.
114	<p>As discussed in the covering letter, we believe a policy that stipulates the frequency with which there should be a tender for the external audit is inappropriate and undermines the role and responsibility of those charged with governance, including the audit committee.</p> <p>The policy might be interpreted to create a requirement for mandatory tendering. Instead, we believe that it is for the audit committee to reassess regularly the effectiveness and independence of the auditor and to consider whether or not the external audit should be put out to tender.</p> <p>This consideration would include the possible impact of a change in auditor on audit quality as well as the safeguards that the current auditor has in place to mitigate self-review and familiarity threats, such as quality controls and rotation of members of the audit engagement team. These factors should periodically be considered rather than imposing an absolute limit on tenure.</p> <p>In addition, if the audit is submitted to tender, the audit committee should apply the same rigour in assessing quality and independence for all respondents.</p> <p>The question of audit tendering is a complex one that is being considered by various regulatory and legislative bodies and we do not believe that it would be appropriate for the Committee to make more rigid recommendations while these debates are ongoing.</p> <p>This paragraph also could be read as asserting that there is an audit quality issue with the long tenure of an external auditor. We do not believe there is evidence to</p>

	support such an assertion and suggest that the paragraph is reworded.
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**Principle 9:** *The audit committee should monitor and assess the effectiveness of the external audit.*

Para	Observation
121	To “rely upon” audit work of others is not consistent with the ISAs, which consider the ‘use of’ the work of others. Moreover, it would seem more useful for the auditor to explain what audit firms are doing what work and how the lead engagement partner will monitor and supervise the overall audit effort.
123	<p>We believe explaining the range of possible outcomes and, if available, comparison with its peer group should be the responsibility of management.</p> <p>Consistent with our comment on paragraph 57, the statement “particularly in circumstances where the audit engagement partner’s conclusions differed from those of the engagement quality control reviewer” reflects some misunderstanding on how an EQC review is conducted. If the EQC reviewer is not satisfied with conclusions reached by the audit engagement partner, the audit cannot be completed until such differences have been resolved following the firm’s applicable policies and procedures. Rather than this point, it may be more useful to suggest the external auditor considers significant matters discussed with the EQC reviewer when identifying other items listed. Please refer to our comments on paragraph 57 above.</p> <p>ISA 450 requires the auditor to request all uncorrected misstatements be corrected. Accordingly, we do not believe it is appropriate for the external auditor to explain “why certain errors might remain unadjusted” but rather this is the responsibility of management.</p>

**Principle 10:** *The audit committee should have effective communication with the external auditor to enable the audit committee to carry out its oversight responsibilities and to enhance the quality of the audit.*

Para	Observation
Principle 10	Under ISAs, the external auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. However, it is not reasonable to expect auditors to take responsibility for expressing opinions on matters other than what their audit was designed for. We acknowledge that an integral part of effective communication is regular dialogue between the external auditor and the audit committee as suggested

	by paragraph 128. However, the paragraphs that follow, paragraphs 129 to 132, suggest more than a dialogue relating to a financial statement audit conducted in accordance with ISAs.
130	<p>The reference to “exchange of views on business performance... and other topics” should be more focused on the roles of the external auditor and the audit committee. The auditor’s role does not encompass providing advice on business performance – however, business performance may be discussed in terms of understanding drivers of changes in the financial statements and accounting and internal control implications.</p> <p>The statement that the audit committee should “consider, if necessary assisting the external auditor to gain access to any other committee meetings that the external auditor determines to be relevant” should be clearer in terms of when it is intended to apply. If the auditor needs access to information to perform the audit and management or the audit committee does not provide it, there would a limitation on the scope of the auditor’s work that would preclude issuing a clean audit opinion. We believe that the Document should include a principle that management shall provide the external auditor with full cooperation and access to all information necessary to perform the audit since this is fundamental to the ability to perform an effective audit.</p>
132	It is unclear why the audit committee should discuss such matters as the interaction between the accounting information and regulatory information with external auditors. Consistent with our comments on Principle 5, if bank supervisors are concerned with non-compliance with regulatory requirements and they wish the scope of the audit to be expanded, they should say so clearly and comprehensively.
133	The “consequences of material transactions” required to be discussed should be limited to financial reporting and internal control implications as opposed to wider commercial considerations.

**Principle 11:** *The audit committee should require the external auditor to report to it on all relevant matters to enable the audit committee to carry out its oversight responsibilities.*

Para	Observation
138	The suggestion that the audit committee should request the external auditor report to it in writing on other significant matters, including 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” would involve extending the scope of the external audit.

	A requirement to report on disclosures relative to peers would also extend the scope of the audit and is likely to be challenging given that peers tend to report at the same time. In addition, rather than the audit identifying disclosures that “could be improved,” a more substantive threshold that is tied to identified deficiencies in financial statement disclosures would be more useful and consistent with ISAs.
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### **The relationship between the supervisor and the external auditor**

<b>Para</b>	<b>Observation</b>
Section 6	Supervisors also can play a role in supporting and enhancing audit quality by being clear with regard to additional work or reporting they would like external auditors to perform as well as recognising that information they would like to be provided often goes beyond that of a financial statement audit in accordance with internationally accepted auditing standards. As discussed in the covering letter, we recommend that the Committee provide a framework for supervisors to evaluate whether and to what extent they should consider requiring banks in their respective jurisdictions to engage external auditors to undertake additional work or reporting. The terms of reference and the basis for reporting, for any additional work or reporting requested should be agreed at the outset between the supervisor, the bank and the external auditors, along with other pertinent aspects of the work such as timelines and format of deliverables.
141	This stated objective is one-sided, focusing on the effectiveness of the supervision of the banking sector. As discussed in our covering letter, we believe enhancing the quality of both external audits and financial supervision in the banking sector are important.
143	The purpose of a financial statement audit is not to address specific areas of supervisory concern. If bank supervisors wish, they may separately identify other work the external auditor could be asked to perform in order to help address such concerns.

**Principle 12:** *The supervisor and the external auditor should have an effective relationship that includes appropriate communication channels for the exchange of information relevant to carrying out their respective statutory responsibilities.*

<b>Para</b>	<b>Observation</b>
148	We believe supervisors should take steps to ensure that communications from them to the bank that are relevant to the audit are made available to the external auditor.

151	As stated in our covering letter, whether and how the supervisor or the bank engages the external auditor to perform additional procedures is a wider issue that we believe should be discussed separately in the Document rather than suggesting the formal reporting on such engagements is merely an element of communication between the auditor and the supervisor.
154, 155	It is not reasonable for supervisors to expect external auditors to assume responsibility for forming or expressing views on matters other than what their audit was designed for. These paragraphs could instead indicate that the external auditor may have acquired information or insights about such matters in the course of performing the audit of the financial statements that it could share with the supervisor.
156	<p>Movements in the valuation utilised within a range of acceptable valuations may also be indicative of management bias.</p> <p>In order to be consistent with footnote 80, we suggest that the wording in the fourth bullet is revised to “actual or suspected <u>significant</u> breaches of prudential regulations.” In addition, we believe “noted in the course of the audit” should be removed from this bullet given that all the bullets only refer to matters that the auditor may become aware of during the course of the financial statement audit.</p>
Footnote 80	Consistent with our comments on paragraph 85 and Principle 13, we recommend that supervisors formally communicate with external auditors what matters they deem to be of “material significance”.
160	While the Document acknowledges the effect on communication of the availability of a safe harbour to an external auditor, we believe greater emphasis should be placed on the importance of jurisdictions working towards achieving a safe harbour that is reflected in local laws and regulations, if not already in place. This would be consistent with protections afforded to external auditors in disclosures to audit regulators. We believe safe harbours should extend to ensuring that communications are kept confidential and protected against disclosure to third parties. The safe harbour enables auditors to communicate more frankly with supervisors than might otherwise be the case.
161	<p>We believe this paragraph should be revised to indicate clearly that if the auditor is constrained by a duty of confidentiality, communication of these matters can only be made through the bank or directly with the bank’s consent.</p> <p>We believe that the safe harbour referred to in paragraph 160 should extend to communication on all matters pertaining to the external audit.</p>
Footnote	As noted in previous comments, given the importance of the existence of a safe

81	harbour to enabling effective communication, we believe greater emphasis should be placed on this statement and recommend including it in the main body of the text, rather than as a footnote.
162	We do not believe this statement is reflective of the two-way communication necessary for effective dialogue to occur between the supervisor and external auditor. If the supervisor believes communication of bank-specific information to the auditor will help in its supervisory work and assist the external auditor in conducting a quality external audit, such information sharing should be required.
163	Similar to the above comment, this statement is not reflective of a two-way flow of information. The supervisor should consider whether the information may assist the external auditor in performing a quality audit.

**Principle 13:** *The external auditor should report to the supervisor matters that are likely to be of material significance to the functions of the supervisor.*

Para	Observation
Principle 13	<p>As discussed in the covering letter, in order to emphasise the importance of open and effective communication and dialogue between the supervisor and the external auditor, we believe an additional principle should be added to the Document that requires the supervisor to report matters to the external auditor that are likely to be of relevance to the audit.</p> <p>What is deemed of “material significance to the functions of the supervisor” is not clear. An auditor’s determination of materiality is a matter of professional judgement and affected by their perception of the financial information needs of users of the financial statements. Accordingly, bank supervisors should formally communicate with external auditors what matters they deem to be of material significance.</p>
164	<p>This paragraph should be clarified to indicate that the ‘duty to report/alert’ relates only to matters that come to the auditor’s attention during the course of the audit.</p> <p>Similar to previous comments, the effectiveness of such a requirement will be dependent on the supervisor explaining how the ‘duty to report/alert’ matters are defined.</p>
166	The first sentence indicating that “laws or regulations provide that external auditors who make any such disclosure in good faith to the supervisor cannot be held liable for breach of a duty of confidentiality” cannot be assumed to be the case in all jurisdictions.

	The wording of the bullet point “a refusal to certify the financial statements or the expression of reservations in the audit report (other than a clean opinion) by the external auditor” is not consistent with the terminology of ISAs. In addition, the wording should be extended to capture including emphasis of matter paragraphs in the audit report.
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**Principle 14:** *There should be open, timely and regular communication between the banking supervisory authority, the audit firm and the accounting profession as a whole on key risks and systemic issues as well as a continuous exchange of views on appropriate accounting techniques and auditing issues.*

Para	Observation
Principle 14	We support this principle. However, it would be more practicable and effective to refer to “timely” or “regular” exchanges of views on accounting issues rather than “continuous exchange.”

#### **The relationship between the banking supervisory authority and the audit oversight body**

Para	Observation
Section 7	We believe that regular, open tripartite communication between the external auditor, supervisor and audit oversight body is key to helping prevent confusion by improving the parties’ understanding of matters discussed and the consistency of resulting communication. In addition, protocols between the banking regulator and relevant audit oversight body should be established that address what information would be shared between the parties and the manner in which the information would be shared.

#### **Annexes**

Para	Observation
Annex 1	The information provided here is a list of items that might be included rather than “guidance.” Numerous items listed under “Contents relating to the audit of the financial statements”, such as an assessment of business performance or an assessment of the risk situation (see our first comment on paragraph 130 above), are not clearly defined and would appear to extend the scope of an external audit beyond the requirements of ISAs. As discussed in our covering letter, to the extent that the Committee believes that supervisors and other stakeholders may benefit from having

	<p>auditors of banks undertake additional work, supervisors should ensure that any requirements for additional work by auditors are separately identified and clearly understood and agreed between relevant parties in their respective jurisdictions.</p> <p>In addition, it should be noted that when considering utilising external auditors to perform additional procedures or engagements, potential threats to independence or objectivity should be taken into consideration.</p>
Annex 2	<p>Please refer to our comments on paragraphs 154 and 164 with regard to similar statements made in the introductory paragraph.</p> <p>We suggest the wording of the first bullet is revised to “in light of the external environment and the <u>bank</u>’s performance, business model and risk appetite”.</p> <p>It should be made clear that responsibility resides with the supervisor to put in place confidentiality rules in order for recent supervisory risk assessments and other supervisory reviews, as well as views and judgements on key risk areas based on audit/supervisory work performed to date, to be communicated.</p> <p>It is not clear whether “issues from previous year and how the firm had addressed them” is intended to refer to previous year bank-specific issues or audit firm related issues.</p> <p>We note that it may be challenging for pre-close items to fit into the typically very compressed timeframe between the issues listed being near to final resolution and the audit report being issued.</p>