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Mr Stefan Ingves

Chairman of Basel Committee on Banking Supervision

Email: baselcommittee@bis.org

Dear Sir

SAICA SUBMISSION ON THE BCBS CONSULTATIVE DOCUMENT ON EXTERNAL AUDITS OF BANKS

In response to your request for comments on the Basel Committee on Banking Supervision's (BCBS's) *Consultative Document on External Audits of Banks*, the Standards Department of the South African Institute of Chartered Accountants (SAICA) together with input from members on the SAICA Banking Project Group (BPG) hereby provides its comments (attached as Appendix A).

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully

Dukander

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SAICA SUBMISSION ON THE BCBS CONSULTATIVE DOCUMENT ON EXTERNAL AUDITS OF BANKS

General Comments

The general feedback is that the consultative document is well collated and written and is a useful compilation of the various pieces of legislation which includes Internationally Standards on Auditing which govern the audit of banks.

There is possibly an underlying negative thread throughout the document as to the poor quality of current bank audits. This is a generalisation and should be avoided.

Another point raised is that in many instances, the consultative document offers a blanket approach applicable to large banks which is not always relevant and scalable particularly to smaller niche banks. Paragraph 10 denotes that the document applies to all banks, where in some instances this may not be applicable in practice.

We do however take note of paragraph 11 which states that the implementation of the principles set out in the document should be proportionate to the size, complexity, structure, economic significance and risk profile of the bank. The practicality of adapting the principles to the size of the bank may be challenging. For smaller niche banks, some of the principles may not apply as they may not have audit committees, particularly if the bank forms a tiny part of a larger group where the audit committee function would be handled at a group level.

We have elaborated in Annexure A our specific comments with the proposals therein.

ANNEXURE A: BCBS CONSULTATIVE DOCUMBENT ON EXTERNAL AUDITS OF BANKS

Principle number	Principle	Paragraph reference	Comment on paragraphs relating to the 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 35 states that "Audit firms should have documented policies and procedures that set minimum competency criteria for members of a bank's audit engagement team."	While all firms have procedures in place to train, plan and allocate audit teams, there is no formal documentation which is being prepared as evidence. It was agreed that an audit firm would possibly have in place: (i) Industry specific training; (ii) A separate department/business unit that only performs financial institution/services audit and assurance work; and (iii) An industry specific mix of experience and expertise. As such, we would request a modification to this paragraph to be more of a principle-based process rather than a formal document that would need to be collated for each audit engagement.
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 43 states that "The external auditor of a bank must comply with the applicable jurisdictional and internationally accepted ethical standards. Furthermore, the Committee believes that the external auditor of a bank should comply with the more stringent independence standards for public interest entities. To the extent that any of the rules within any one of these standards on ethics is more restrictive than the corresponding rule in the other standards on ethics, the external auditor must comply with the more restrictive rule. Independence should be observed not only in the	Not all banks would meet the definition of public interest entities in terms of the IESBA Code. Some entities which have banking licences are small niche businesses which do not take retail deposits and have a limited number of customers. The suggestion that the auditor should comply with the more stringent independence standards for public interest entities does not take into account small niche banks with a low public interest that don't serve the general public and pose little or no threat to the banking industry. It is suggested that guidance should rather be included as to when a bank would be considered a public interest entity.

		context of the bank that is being audited but also with respect to the bank's related entities". Para 45 states that "The audit engagement team members, the audit firm and, when applicable, network audit firms should comply with the independence requirements of both the home jurisdiction and the overseas regulatory authority (in the case where the bank is ultimately regulated by an overseas authority)."	We were not in agreement with the wording of this paragraph. The current wording implies that the audit engagement team members and the audit firm should comply with the independence requirements of the overseas regulatory authority, in addition to those of the home jurisdiction. However, this would only be relevant where either the ultimate holding company is an audit client of a network audit firm or the audit firm has a group reporting responsibility to the auditor of the ultimate holding company and is required to confirm independence in terms of those requirements.
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.		No further comments.
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		No additional explanations required but again the risk profile of the bank would determine the extent of application of EQCR. Non-public interest entities, for example, would often not require an EQCR.

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 64 states that "certain financial statement items are used in the calculation of key metrics used by a wide range of users of the financial statements. For example, regulatory ratios such as the leverage ratio, liquidity ratio and capital adequacy ratio are calculated based on account balances in the financial statements or are derived from the financial statements."	Additional guidance would be required on the key metrics. More specifically we are looking for guidance on which ratios/ metrics would require a lower materiality as in practice materiality is not generally lowered for specific ratios. Guidance is also sought to the measurement of materiality when it comes to ratios.
		Para 68 states that "the volume of transactions by type of activity and/or presence of significant non-routine transactions" should be considered when identifying and assessing risks of material misstatement.	Regarding para 68, a comment was raised as to whether the "volume of transactions" is a factor which could contribute to misstatement.
		Para 72 states that "The external auditor's observations on and, where relevant, evaluation of a bank's internal audit function are of particular interest to the audit committee and the bank's supervisor given the role an effective internal audit function plays in maintaining a robust control environment in a bank."	Regarding para 72, guidance is required on reporting and procedures involving an assessment of internal audit where this may be relied on by the bank's supervisor, namely: • Should there be a specific report to assess internal audit? • What is expected of the external auditor when it comes to assessing internal audit (i.e. are these expectations greater than the procedures set out in ISA 610 which are performed only for purposes of external audit reliance, where applicable/appropriate)?

6.	The external auditor of a bank should respond appropriately to the significant risks of material misstatement in the bank's financial statements.	Para 74 refers to risk assessment and the responsibility of the auditor to assess these risks and consider managements bias.	The concern raised is that the audit committee needs to be aware of these risks and communicate this with the auditor (and not the other way around which is implied in this paragraph). We think the paragraph correctly reflects that the auditor should consider incentives for management bias. However, we said that this was one-sided and that the audit committee should also assess these risks (i.e. the principle should be expanded).
		Para 78-79 refers to loan loss provisioning	Further guidance is required from the regulator on the audit of these provisions (e.g. capital ratios).
		Para's 86-90 refers to disclosures	A comment was made that if the Pillar III public disclosures by the bank, for example, an unlisted bank is not included in the annual financial statements or otherwise subject to an audit requirement, the disclosure would not be the auditor's responsibility.
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 107-108 state that "The audit committee should maintain an understanding and knowledge of…significant issues and concerns raised by the relevant audit oversight body regarding the audit firm, and the auditor's action in addressing these concerns, to understand how these shortcomings may affect the quality of the audit of the bank".	In a South African context, the audit oversight body is the Independent Regulatory Board for Auditors' (IRBA). The reports issued by IRBA are not public; therefore, it would be difficult to implement this. There was a concern raised as to whether audit firms will now be expected to disclose their internal controls, EQCR processes and IRBA reports to clients.
8.	The audit committee should monitor and assess the independence of the external auditor.		No further comments.

9.	The audit committee should monitor and assess the effectiveness of the external audit.	Para 123 states that "The audit committee should discuss with the external auditor the findings of the latter's work. In the course of its monitoring, the audit committee should obtain an understanding of the rationale behind the final conclusions drawn by the audit engagement partner on significant accounting and auditing matters, particularly in those circumstances where the audit engagement partner's conclusions differed from those of the engagement quality control reviewer".	At present there is no framework for the audit committees to report on the effectiveness of the external audit.
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.		No further comments.
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.		No further comments.
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.	Para 160 refers to safe harbour.	Safe harbours are not applicable to South Africa.

13.	The external auditor should report to the supervisor matters that are likely to be of material significance to the functions of the supervisor.		No further comments.
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.		No further comments.
15.	There should be regular and effective dialogue between the banking supervisory authority and the relevant audit oversight body.		No further comments.
16.	The banking supervisory authority and the audit oversight body should observe appropriate confidentiality requirements when sharing information.		No further comments.

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