

Saudi Arabian Monetary Agency

Summary of comments by Banks operating in Saudi Arabia on BCBS Consultative Document on External Audits of Banks:

General Comments:

1. The BCBS's review of their previous papers, "The Relationship between banking supervisors and banks' external auditors" (January 2002), and "External audit quality and Banking Supervision" (December 2008) is timely and the intention to bring these two strands together into one document is welcomed. The enhanced focus on improving the quality of audit services by external auditors and the overarching responsibility of bank management for the financial statements and managing the relationship with external auditors is well received and understood. It is appreciated too that implementation of the principles is flexible, allowing for a proportionate response by each bank dependent on size, structure risk profile and jurisdiction. That said, we believe that the principles, thus reviewed, are comprehensive and will provide the benchmark for standards globally.
2. The sixteen principles are clear and well explained. The Bank's view is that current practices and regulatory requirements already cover to a great extent the requirements derived from these principles. Principles 1 and 4 requiring external auditors to have minimum standards for staff engaged in auditing banks and the need for more stringent quality control is particularly desirable and essential given the complexity and diversity of banking products and operations. The role of the Audit Committee in monitoring this will be a useful support to management.
3. The Document's proposed guidelines are intended to enhance the quality of external audits of Banks. In Saudi Arabia, SAMA's implementation of the principles included in these guidelines could serve to enhance the confidence of the users of Saudi Arabian Bank financial statements and could also further strengthen the sustainability of the banking system in Saudi Arabia.
4. These would include bi-lateral and tri-lateral communication and sharing of information between the external auditor, the regulator, and the Bank. It also would include on-going dialogue between banking supervisory authorities and the relevant audit oversight bodies the objective of which would be to enhance the overall quality of Bank audits. We also note that the Consultative document encourages local regulatory bodies to adopt appropriate principles and concepts relevant to the local jurisdiction.
5. Most of the guidance provided in this document appears to have been implemented in Saudi Arabia, however, in our opinion Central bank's role may evolve in overseeing the Quality Control (QC) aspect existing in the External Audit Firms. While the internationally affiliated big-four audit firms operating in Saudi Arabia have their own QC functions, it is

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particularly important in case of local audit firms who may or may not have the QC function within their firms to the extent desired by this document.

6. Regulatory interaction with external audit firms responsible for auditing Saudi Banks appears to be enhanced by this document specifically through increased dialogue and overseeing the conduct and affairs of the external audit firms.
7. The document also stresses a more regular, effective and proactive role between Banking Supervisor and Audit oversight body to enhance audit quality issues. (principle 15).
8. The document requires that the Audit of banks should be performed in accordance with internationally accepted auditing standards (paragraph 26). This is true for Saudi Banks at the consolidated level but may vary for some consolidated subsidiaries of Saudi Banks which are audited under local auditing standards.
9. In our opinion, the regulatory bodies have to ensure that Audit firms have documented criteria to set the required level of competency for the members of Audit teams. (paragraph 35, 36).
10. Bank is in agreement with the four supervisory expectations and the 16 principles as detailed in the document. SABB is of the view that the oversight role of audit committee is particularly important, with the responsibility to ensure that external auditors use adequate resources, that the audit adheres to professional standards, and that the committee meet with the external auditors at least twice during the audit cycle, at the planning and concluding stages of the audit.
11. Bank is of the view that for the appointment of an external auditor, the term of the appointment should be subject to local regulatory regulations.
12. This should be referred here or referenced to Para 147 of the consultative document.
13. Bank notes that Para 72 specifies that the role of an effective audit function is maintaining a robust control environment in the bank, in contrast to the emphasis The Principles for Enhancing Corporate Governance places on the audit function's role to provide independent assurance that this control environment is being maintained by business and other control functions.
14. The comment that we have on this consultative document is on paragraph 119 on page 24. It requires the bank to disclosed in its annual report the nature and the fee arrangement for the non-audit services provided by the auditors. We think that disclosure should only be required if it is of a significant nature only.

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15. SAMA would then introduce some threshold for this disclosure such as if the fee for the non-audit services exceed 50% of the audit fee.
16. Guidelines should be tailored to specific facts, jurisdictions etc. therefore principles should be worked on by local bank regulators together with their local audit body. For example the long form report contents outlined in Annex 1 are not currently applicable in many jurisdictions and while they might be further considered, flexibility is important.
17. The word 'should' be removed throughout the document. The word 'should' is seen as an ambiguous term that implies that something 'would' normally be applied but does not necessarily 'have to' be followed (IFAC clarity conventions). IAASB has eliminated its use and instead applies 'shall' when something must always be followed and 'may' when it is recommended best practice. Since this is a principles based guidance document tailored to jurisdictional situations the use of the word 'may' would typically be most appropriate. Paragraph 68 is a good example of the confusion - are all of these procedures to be done in every audit ?
18. The guidance appears to treat all banks as the same e.g. by effectively applying the Public Interest Entities (PIEs) designation to all banks. However, the banking systems are varied across jurisdictions and so the PIE designation will vary. Consider some level of scale or complexity threshold for PIE designation. Potentially one global threshold and then jurisdiction by jurisdiction below that. Could follow the Global Systematically Important Banks (SIBs) designations and the National SIB designations.
19. The guidance focuses a lot on communications from the external auditor to the supervisors but provides limited discussion of communication the other way. For example Annex 2 is largely focused on the audit process informing communications to the supervisor rather than regulatory examinations informing the auditor. Reciprocity of discussions would be important if the aim is to improve audit quality. Concerns regarding the confidentiality of information under relevant legal / professional codes would mean this should be tailored on a jurisdiction basis.
20. The guidance on communication provides limited information to enable the auditor to determine what should and what should not be communicated to the supervisor - greater clarity or a framework would be important.
21. ISAs provide a consistent framework to be applied globally. International Auditing Practice Notes (IAPNs) can be used to expand the guidance for specific industries rather than expanding the International Standards on Auditing (ISAs) indirectly through this type of published framework. The framework should provide greater clarity about when they are quoting from an ISA, suggesting further guidance on a matter that was addressed in an ISA or suggesting additions to an ISA.
22. The importance of collective Board responsibility and audit engagement team responsibility appears to be undermined in the framework guidance

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with focus on points of diversity in views between the AC and the Board, or the Engagement Quality Control Reviewer (EQCR) and the engagement leader. The concept of collective responsibility should be re-enforced.

23. Inclusion in various places of regulatory reporting could confuse the paper since there is variety in practice regarding auditor responsibilities; cleaner to keep this to the external audit of financial statements and avoid statements that risk being perceived as extending the auditors responsibilities within the financial statement audit.

Specific comments on Principle:

Principle 1:

- Para 33 - third bullet - Why does the engagement team as a whole need 'proficient' knowledge of regulatory requirements ? We consider that 'sufficient' knowledge would be more appropriate given that the overall principle states 'additional regulatory requirements that may be part of the statutory audit' and the importance of that knowledge is in the context of completing their audit responsibilities
- Focus on reflecting the range of complexity and scale of the bank when considering individual competency e.g. there are different requirements for working on a small local bank with core commercial banking operations, than on a global bank with investment, commercial, retail banking, wealth management and capital markets activities
- Minimum training requirements may be more workable than subjective competency requirements.

Principle 2:

- All banks should not be considered as PIEs (see main comment theme#1)
- Consider making last sentence of para 42 clearer that auditor should apply the more restrictive of their local standards or the IESBA standards - if that is what is meant
- Para 43 is more prescriptive than the citation it links to - consider using language more in line with the cite i.e. only need to be independent if there is a reason to believe that it could impact independence
IESBA Code of Ethics for Professional Accountants, paragraph 290.27, states – “In the case of an audit client that is a listed entity, references to an audit client [...] include related entities of the client (unless otherwise stated). When the audit team knows or has reason to believe that a relationship or circumstance involving another related entity of the client is relevant to the evaluation of the firm’s independence from the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.”
- Para 45 - independence rules are already very complex in many jurisdictions; international code exists that could be leveraged (IESBA); national rules could conflict. Why should the independence requirements be driven by both the home jurisdiction and the overseas regulatory authority ? We consider it would be more useful to comply with the guidance relevant to where the audit report is issued

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- The challenges of achieving and maintaining independence are substantially more complex and costly for banks than companies in other industries. The independence rules are complex and inconsistent around the world. Major international banks typically provide banking services to firms that are not their auditor, and often provide impermissible services to their partners, employees, and their spouses and other relatives. Banks cannot provide these services to their audit firm no matter how insignificant the value. A change of auditor would require the new audit firm, its partners and many of its employees, to establish alternative banking arrangements. For large global banks, this may rule out one or more audit networks. This would further limit the choice of alternative audit providers and increase costs to the banks, perhaps significantly.

Principle 3:

- Para 50 - The scepticism of the auditor should not be extended to the regulatory outcome of complex transactions unless they are specifically auditing the regulatory capital calculation on a stand alone basis
- Para 51 - this should be applicable to all estimates not just valuations

Principle 4:

- Para 54 - agree that an EQCR is appropriate if the entity is a PIE but see earlier comments regarding whether all banks should be PIEs
- Para 56 - Referring to 'this document' is confusing. Suggest either refer to complying with firm's network policies for applying consistent quality control processes or be explicit – possibly by referring back to para 53 and explaining any additional application recommendations.

Principle 5:

- Para 60: This requires the external auditor of a bank to perform "extensive" tests of controls over financial reporting. Extensive is not defined, and ISA guidance is probably sufficient here - consider guidance in ISA 330.9 and how it relates to a bank. If still felt as required, then need to define extensive and put in the context of what areas of controls are being considered here; or change to 'will likely perform'. The ISA framework allows for appropriate judgment here - tests of controls for audit purposes are unlikely to align with tests of controls for supervisory purposes anyway
- Para 63 - consider referring to ISA requirements to evaluate such misstatements on the Summary of Unadjusted Misstatements on a collective basis.
- Para 66 - second bullet - ISA would not require this for entities that are scoped out based on materiality - suggest revising language
- Para 68 - fourth bullet - procedures to avoid co-mingling of client & proprietary assets. Client asset rules are not typically part of a financial statement audit but in most jurisdictions are a separate regulatory audit. Suggest this bullet is deleted to avoid confusion.
- Para 69 - last two sentences should be qualified to make it clear that this only refers to matters auditors have become aware of during the course of their audit (i.e. no obligation to go looking outside the audit work) - see text of ISA 260 A25 below which is referenced by them

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- Para 71 - reference should be made to the recent changes to ISA 315 with respect to reading internal auditor reports relevant to the audit – the recent standard changes largely address the points that are suggested

Principle 6:

- Para 79 - consider saying 'may' instead of 'need to' in the intro
- Para 79f - this has strayed into what the preparers need to consider with respect to their disclosures but many preparers may not know how the methodologies compare across the banking sector - especially smaller companies. Therefore consider removing or changing to consider the adequacy of the disclosures in the context of the FS as a whole, taking into consideration the applicable financial reporting framework.
- Para 85 - Material breaches and the applicable prudential regulations should be defined.
- Para 90 - there may be good reason why these amounts are different e.g. due to different underlying measurement bases
- Para 93 - consider some reference to the public/market confidence and how quickly this can be lost; also in this concept around going concern what about the supervisor's role in providing input into the auditor's assessment ?
- Para 96 - consider editing to be clearer about cause and effect to:
96. Given the above risks and the possible systemic implications, if there are any material uncertainties related to events or conditions that may cast significant doubt over the bank's ability to continue as a going concern, and if the external auditor considers referring to the going concern issue in the audit report, the external auditor should promptly communicate this fact to the supervisors.
- Para 98b - include a requirement for regulators to notify external auditors of situations where they have made a bank hold additional capital since external auditors may not be aware of it for this or for the going concern assessment
- Para 98c - not sure how this is relevant to the standalone bank audit - would include in the macro risk discussions

Principle 7:

- Para 104 - new requirement for audit committees to assess risk of external auditor no longer being able to carry on as auditor. Appears focused on business continuity of auditor relationship but very difficult for an AC to assess the likelihood of withdrawal.
- Para 105 - believe this should be limited to the facts of the tenure of the external auditor and the conclusion of the assessment performed by the AC. Not always in the annual report but could be in proxy materials too.
- Para 106 - The Audit Committee is only a committee of the Board and hence considering the principle of collective Board responsibility, this information disclosure should not be required.
- Para 108 - unclear what is meant by the 'current nature of the audit environment' and also suggest including 'significant' before 'overseas jurisdictions'

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- Para 109 - suggest adding 'an inappropriate' before '[a] narrowing' and '[a] reduction'; also the term 'audit risks' as used in this context should more appropriately be 'risks of material misstatements of the financial statements' - suggest replacing here and para 126
- Para 110 – Although in substance the audit committee should approve the scope and the fees, it is better that the terms of the engagement is delegated to the management for a number of reasons.

Principle 9:

- Para 121: This implies there is no difference between work performed by members of the audit firm's network and other firms. It needs to be reworded – what is written is appropriate where other firms are involved but where network firms are involved audit firms have network quality control processes which they rely on. Consider including reference earlier in Principle 7 to network firms EQCRs and amending para 121 to
- Para 124 - while this suggestion seems reasonable it may not always be realistic to share the final draft representation letter with the AC and this isn't required under ISAs.