



Chairman

**Via e-mail**

Mr Jonathan Bravo  
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24 July 2018

**Public Comment on IOSCO Consultation Report on *Good Practices for Audit Committees in Supporting Audit Quality***

Dear Mr Bravo

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on the IOSCO Consultation Report on *Good Practices for Audit Committees in Supporting Audit Quality* (the consultation report).

In 2012, the Committee published *The internal audit function in banks*,<sup>1</sup> which provides its supervisory expectations for the internal audit function in banking organisations. In that paper, we set out our belief that a strong internal control system, including an independent and effective internal audit function, is part of sound corporate governance<sup>2</sup> and that an audit committee, or its equivalent, should oversee a bank's internal audit function.<sup>3</sup> The Committee's expectations have also been set out in its *Corporate governance principles for banks* published in 2015<sup>4</sup> as well as in its *External audits of banks* published in 2014.<sup>5</sup>

We appreciate and support the overall initiatives made by IOSCO to outline good practices for audit committees in promoting audit quality. Audit is essential to good governance and high quality financial reporting. We agree, therefore, that clear principles-based guidance in this area will promote IOSCO's objectives to protect

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<sup>1</sup> See <https://www.bis.org/publ/bcbs223.htm>. Note that Annex 2 of this document provides more details about the responsibilities of audit committees.

<sup>2</sup> Paragraph 3.

<sup>3</sup> Principle 10.

<sup>4</sup> See <https://www.bis.org/bcbs/publ/d328.htm>. Note that paragraphs 68, 69 and 70 provide guidance for audit committees at banks.

<sup>5</sup> See <https://www.bis.org/publ/bcbs280.htm>. Note that supervisory expectations are set by way of describing how audit committees can contribute to audit quality in their oversight of the external audit function.

investors; ensure that markets are fair, efficient and transparent; and reduce systemic risk.

In this letter, we highlight areas of support and recommend a number of enhancements for IOSCO's consideration. On the latter, we believe the enhancements will help to ensure that IOSCO's possible future report on good practices assists audit committees in the practical fulfilment of their obligations.

**Key areas of the consultation report the Committee supports include:**

- The recommendation on the selection of auditors by an audit committee that is independent of management; consideration of the reasonableness of audit fees such that audit quality is not compromised; the auditor's accountability and commitment to audit quality; and evaluating the sufficiency of the auditor's exercise of professional skepticism in key areas of risk such as significant accounting estimates.
- An audit committee's evaluation that the auditor has the appropriate level of resources, skills and expertise, including the sufficient involvement of senior audit team members, and the audit has adequate supervision, review, and quality controls.

**Our comments, including the suggested enhancements, are listed below:**

- The consultation report focuses primarily on the duties of the audit committee in relation to external auditors. We concur with this attention to external audit, but also note that the duties of an audit committee are broader and include exercising oversight of financial reporting and internal control functions, particularly internal audit. We recommend that the report emphasises that these broader duties are also highly important, but are outside the scope of the report.
- The consultation report rightly recommends that one member of the audit committee should have a good knowledge of financial reporting or audit. However, what constitutes 'good knowledge' is not defined. IOSCO could strengthen this recommendation by specifying that at least one member of the committee should hold a relevant professional qualification, recent financial expertise, and audit knowledge.<sup>6</sup>
- In 2002 IOSCO published *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* (IOSCO's 2002 publication).<sup>7</sup> This statement contains practical and rigorous recommendations to ensure that auditors of listed entities are independent, both in fact and appearance, of the entity being audited. Suggestions include the appropriate rotation of the audit engagement team and regular meetings between the auditor and audit committee without

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<sup>6</sup> It may be helpful to consider existing guidance on what attributes constitute an audit committee financial expert. As an example, see the US Securities and Exchange Commission's rules at 17 CFR Parts 228, 229 and 249.

<sup>7</sup> IOSCO, 'Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence: A Statement of the Technical Committee of the International Organization of Securities Commissions', October 2002, [https://www.iosco.org/publications/?subsection=public\\_reports](https://www.iosco.org/publications/?subsection=public_reports).

management present. We propose that the current consultation report could be significantly enhanced if aspects of IOSCO's 2002 publication were incorporated or referenced as there is considerable overlap in the topics covered.

- Some statements in the consultation report may be seen as confusing or open to challenge. For example, section 3.3 states: "management should not have sole responsibility for setting audit fees." The consultation report then explains that the process of setting audit fees should be managed by the directors, who are responsible for the overall fee, and the audit committee.

The consultation report then appears to contradict itself by recommending that 'the audit committee should take reasonable steps to ensure that any audit tender or other selection process is conducted independently of issuer management (i.e. using a panel of non-executive directors.)'

We suggest that management involvement in setting audit fees does not reflect agreed-upon industry best practice. It would be preferable **for the audit committee to have clear responsibility for assessing the auditor's fees, independent of management.** For example, when recommending the appointment of the auditor, the audit committee's evaluations of audit fees should be included in its recommendation. IOSCO's 2002 publication support this view. It states:

*"The audit committee should be established with a mandate that permits it to carry out its responsibilities free of any unreasonable restraints. Those responsibilities should include matters such as a evaluating whether the audit fees charged by the auditor appear adequate in relation to the work required to support an audit opinion without regard to fees that might be paid to the auditor for other services."*<sup>8</sup>

That the audit committee alone should evaluate audit fees is also suggested by the G20/OECD Principles of Corporate Governance, which state that: *"The audit committee or an equivalent body should provide oversight of the internal audit activities and should also be charged with overseeing the overall relationship with the external auditor..."*<sup>9</sup>

- The purpose of IOSCO's consultation report is to drive high objectives for audit committees and this aim could be enhanced by using less tentative and more robust language. The language in the consultation report frequently suggests the audit committee to "consider," "encourage," or "discuss," when a requirement to "ensure," "evaluate" or "challenge" would be better. One noteworthy example: 'The audit committee may also wish to consider encouraging the audit firm to consult with the audit committee.' For an audit committee to be effective, it must probe and challenge executive management, which should include the audit committee engaging the external auditors without management present. IOSCO has

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<sup>8</sup> Ibid, p. 6.

<sup>9</sup> OECD, 'G20/OECD Principles of Corporate Governance', 2015, <http://dx.doi.org/10.1787/9789264236882-en>.

the opportunity to emphasise this important mandate by using appropriately active language.

We would like to reiterate that the Committee welcomes the development by IOSCO of this report. Audit committees play an essential role in a firm's corporate governance framework. We are confident that by articulating good practices IOSCO will improve the manner and consistency in which audit committees discharge their responsibilities.

We hope you find our comments constructive and helpful. This letter has been prepared by the Committee's Accounting Experts Group, chaired by Fernando Vargas Bahamonde, Associate Director General of the Bank of Spain. If you have any questions regarding these comments, please contact Mr Vargas (+34 913 38 61 04), Nic van der Ende, chair of the Committee's Audit Subgroup (+31 20 524 91 11), or Ruby Garg or Masaya Hatoma at the Basel Committee Secretariat (+41 61 280 8463/+41 61 280 8577).

Yours sincerely



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