Basel Committee
on Banking Supervision

External audits of banks

March 2014

BANK FOR INTERNATIONAL SETTLEMENTS

This publication is available on the BIS website (www.bis.org).

ISBN 978-92-9131-275-7 (print)

ISBN 978-92-9131-276-4 (online)

Contents

Acronyms

BCBS/the Committee	Basel Committee on Banking Supervision
Core Principles	Core Principles for Effective Banking Supervision, September 2012
EQCR	engagement quality control review
FSB	Financial Stability Board
GPPC	Global Public Policy Committee
IAASB	International Auditing and Assurance Standards Board
IAPN	International Auditing Practice Note
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IRB	internal ratings-based (approach)
ISA	International Standard on Auditing
ISQC	International Standard on Quality Control
IT	information technology
PIOB	Public Interest Oversight Board
SIB	systemically important bank
SPE	special purpose entity

External audits of banks

1. Executive summary

1. The recent financial crisis not only revealed weaknesses in risk management, control and governance processes at banks, but also highlighted the need to improve the quality of external audits of banks. External auditors of banks can play an important role in contributing to financial stability when they deliver quality bank audits which foster market confidence in banks' financial statements. Quality bank audits are also a valuable input in the supervisory process. The Basel Committee on Banking Supervision (the Committee, or BCBS) is issuing this document on external audits of banks to improve external audit quality of banks and enhance the effectiveness of prudential supervision, which contribute to financial stability. This document replaces the documents *The relationship between banking supervisors and banks' external auditors* (January 2002)[1] and *External audit quality and banking supervision* (December 2008).[2]

2. This document elaborates on Basel Core Principle 27[3] by setting out guidelines regarding:

- the audit committee's responsibilities in overseeing the external audit function; and
- the prudential supervisor´s relationships with external auditors of banks and the audit oversight body.

3. These guidelines reinforce the key role the audit committee plays in promoting quality bank audits through effective communication with the external auditor and robust oversight of the external audit process.

4. Building effective relationships between prudential supervisors and external auditors, and between prudential supervisors and audit oversight bodies, can enhance banking supervision. These guidelines underpin effective communication between prudential supervisors and external auditors. They also foster supervisory cooperation between prudential supervisors and audit oversight bodies in the discharge of their respective duties.

5. This document includes supervisory expectations and recommendations relevant to external audits of banks that the Committee believes will enhance the quality of these audits. The Committee does not have the authority to set professional standards for external auditors. However, as internationally accepted professional standards for external auditors are principles-based, the Committee expects the proper application of the standards to audits of banks to include appropriate tailoring of audit work in response to the risks and issues applicable to banks. For some areas of banks' audits, the Committee's recommendations go beyond what is currently required by the standards. The Committee sent a letter to the IAASB in March 2013 recommending enhancements to the international auditing standards and the international standard on quality control.[4]

1 BCBS website: www.bis.org/publ/bcbs87.pdf

2 BCBS website: www.bis.org/publ/bcbs146.pdf

3 Core Principle 27 of the Basel Committee's *Core Principles for Effective Banking Supervision* (September 2012) states that "[t]he supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function".

4 BCBS website: www.bis.org/bcbs/commentletters/ifac45.pdf

6. The supervisory expectations and recommendations contained herein also provide a frame of reference to assist audit committees in the governance and oversight of the external audit function.

2. Introduction

7. The Committee's *Core Principles for Effective Banking Supervision* (September 2012) provide a framework of minimum standards for sound supervisory practices and are considered universally applicable.[5] Basel Core Principle 27 focuses on prudential regulations and requirements for banks in relation to financial reporting and external audits.

8. A bank's board and management are responsible for ensuring that financial statements are prepared in accordance with the applicable financial reporting framework. They are also responsible for ensuring that annual financial statements have been audited and bear an independent external auditor's opinion.[6]

9. Under internationally accepted auditing standards, an audit is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

10. An external auditor conducts the audit of a bank's financial statements to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, and to report on the financial statements, and communicate as required by internationally accepted auditing standards, in accordance with the auditor's findings.[7]

11. External auditors play a vital role in maintaining market confidence in audited financial statements. In the case of the banking industry, this public role is particularly relevant to financial stability given banks' financial intermediation function within the economy as a whole. Audit quality[8] is key to the effectiveness of such public role. In addition, the external auditor has a duty to report directly to the supervisor (or, where not permitted, indirectly through the bank) on matters of material significance[9] arising from the audit of the bank.[10]

12. For these reasons, together with the usefulness of quality audits as an input in the supervisory process, supervisors have a keen interest in the quality with which external auditors perform bank audits. This document aims to enhance the quality of external audits of banks and the effectiveness of prudential supervision, which contribute to financial stability.

5 BCBS (September 2012), *Core Principles for Effective Banking Supervision*, paragraph 39.

6 Core Principle 27, Essential Criterion 1 and Essential Criterion 2.

7 International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 11.

8 IAASB (February 2014), *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*, highlights the importance of audit quality, and describes the key elements for the framework for audit quality, and the relevant interactions and the contextual factors for quality audits.

9 The term "material significance" requires interpretation in the context of the specific legislation relevant to the regulated entity. A matter or group of matters is normally of material significance to a regulator's function when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the regulator.

10 Core Principle 27, Essential Criterion 9. This Essential Criterion provides examples of matters of material significance.

13. A bank's audit committee has a key role in fostering a quality bank audit through the effective exercise of its responsibilities with respect to the external auditor and the statutory audit. The guidelines in this document promote an effective two-way communication between the audit committee and the external auditor to enable the audit committee to carry out its oversight responsibilities and to contribute to the effectiveness of the audit process. The guidelines also form the basis for the supervisor's assessment of the audit committee's oversight of the bank's external audit.

14. Building effective relationships with external auditors can enhance banking supervision. For example, the audit of a bank's financial statements may help identify weaknesses in internal controls relating to financial reporting which may, therefore, inform supervisory efforts in this area and contribute to a safe and sound banking system. These guidelines promote the establishment of open communication channels between the supervisor and the bank's external auditor.

15. In addition, the guidelines in this document should support the building of effective relationships between prudential supervisors and audit oversight bodies which are responsible for monitoring the quality of statutory audits, thereby promoting cooperation in the discharge of their respective legal duties.

16. This document also includes supervisory expectations and recommendations regarding what constitutes a quality audit, which provide a framework for the supervisor's interactions with the audit committee, the external auditor and the audit oversight body.

3. Key topics covered

17. This document is divided into two parts. Part 1 of the document (pages 10–23) provides guidelines[11, 12] on the role and responsibilities of bank audit committees in relation to external audits, and the engagement of supervisors with auditors and audit oversight authorities. It underpins the criteria for Basel Core Principle 27, which relate to financial reporting by banks and external audits of banks' financial statements. The principle also states that banks, and parent companies of banking groups, should have adequate governance and oversight of the external audit function. Part 1 also provides a framework for supervisors to assess the effectiveness of audit committees in their monitoring and assessment of external audits, and to establish an effective relationship with external auditors and audit oversight authorities. Part 2 of the document (pages 24–38) sets out the Committee's expectations and recommendations for enhancing the quality of external audits, which will assist audit committees in carrying out their responsibilities for monitoring and assessing external audits and facilitate supervisors' engagement with external auditors and audit oversight bodies.

[11] To enhance clarity, Part 1 is organised around nine principles, together with associated guidance. There is no difference in the status of the principles and the associated guidance. They all constitute guidelines which underpin the criteria for Basel Core Principle 27.

[12] Under the BCBS charter, guidelines elaborate the Committee's standards for the prudential regulation and supervision of banks, in particular internationally active banks. In areas where they are considered desirable, guidelines generally supplement the Committee's standards by providing additional guidance for the purpose of their implementation.

Part 1 (pages 10–23)

Section A – Audit committee's responsibilities in relation to the external audit and its relationship with the external auditor

18. Regular and effective engagement and communication between the external auditor and the audit committee contribute to audit quality.

19. Amongst its other responsibilities, the audit committee is responsible for overseeing the bank's external auditor.[13] A soundly constituted audit committee can play a key role in contributing to audit quality. Section A of Part 1 provides guidelines[14] for the audit committee's responsibilities in relation to the oversight of, and its relationship with, the external auditor.

Section B – Engagement between the supervisor and the external auditor

20. Effective communication between the supervisor and the external auditor enhances the effectiveness of supervision of the banking sector. This relationship will then also contribute to audit quality.

21. The supervisor and the external auditor have a mutual interest in building and maintaining an effective relationship, which fosters regular communication of useful information. Section B of Part 1 provides guidelines for facilitating an effective relationship between the supervisor and the external auditor at the levels of the supervised bank, the audit firm and the accounting profession as a whole.

Section C – Engagement between the banking supervisory authority and the audit oversight body

22. The banking supervisory authority and the relevant audit oversight body share a strong mutual interest in ensuring quality independent audits. Regular and effective dialogue between the banking supervisory authority and the audit oversight body at a national level can assist in identifying and dealing with key issues in relation to the conduct of bank audits. Section C of Part 1 provides guidelines for facilitating effective communication between these bodies.

23. As part of their work, supervisors may identify audit quality issues at both the industry and individual audit level. Regular and effective engagement between the supervisor and the relevant audit oversight body may enable the supervisor to provide timely feedback on such issues. Additionally, the supervisor may, if necessary, be able to take action to address issues raised by the audit oversight body.

Overview of the principles in Part 1

Principle 1: The audit committee should have a robust process for approving, or recommending for approval, the appointment, reappointment, removal and remuneration of the external auditor.

Principle 2: The audit committee should monitor and assess the independence of the external auditor.

Principle 3: The audit committee should monitor and assess the effectiveness of the external audit.

Principle 4: 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.

[13] BCBS (June 2012), *Internal audit function in banks*.

[14] See footnote 12.

Principle 5: 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.

Principle 6: 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.

Principle 7: The supervisor should require the external auditor to report to it directly[15] on matters arising from the audit that are likely to be of material significance[16] to the functions of the supervisor.

Principle 8: There should be open, timely and regular communication between the banking supervisory authority, audit firms and the accounting profession as a whole on key risks and systemic issues as well as a regular exchange of views on appropriate accounting techniques and auditing issues.

Principle 9: There should be regular and effective dialogue between the banking supervisory authority and the relevant audit oversight body.

Part 2 (pages 24–38)

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

24. Internationally accepted auditing standards provide an important foundation for audit quality, and for auditors to deliver an appropriate, independent professional opinion on the financial statements. Internationally accepted auditing standards require the external auditor to possess and demonstrate certain attributes while applying a rigorous audit process.

25. Internationally accepted auditing standards are principles-based and do not focus specifically on external audits of banks. Accordingly, Part 2 of this document describes the Committee's expectations and recommendations on how those standards should be tailored to the audit of a bank in response to the risks and issues applicable to a bank. Specifically, it describes the Committee's expectations with respect to the external auditor's knowledge and competence, objectivity and independence, professional scepticism and quality control over the bank's audit. In some areas in Part 2, the Committee has recommendations which go beyond current professional standards. Moreover, Part 2 of this document highlights the key areas where significant risks of material misstatement in banks' financial statements often arise. To achieve a quality audit, the Committee expects the external auditor to pay particular attention to these key areas, which include, but are not limited to, loan loss provisioning, financial instruments measured at fair value, liabilities (including contingent liabilities), disclosures and the assessment of going concern.

Overview of the expectations in Part 2

Expectation 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.

Expectation 2: The external auditor of a bank should be objective and independent in both fact and appearance with respect to the bank.

[15] Reporting should be conducted directly from the auditor to the supervisor, unless not permitted, in which case reporting should be conducted indirectly through the bank.

[16] See footnote 9.

Expectation 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.

Expectation 4: Audit firms undertaking bank audits should comply with the applicable standards on quality control.

Expectation 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 the bank's activities and the effectiveness of its internal control environment.

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

4. Application

26. This document applies to the following entities subject to a statutory audit:

- all banks, including those within a banking group; and
- holding companies whose subsidiaries are predominantly banks.

All of these structures are referred to as banks or banking organisations in this document.

27. This document has been prepared with the full awareness that significant differences exist in national, institutional, legislative and regulatory frameworks amongst jurisdictions, including accounting and auditing standards, supervisory techniques and institutional corporate governance structures. Some of these differences are outside the scope of banking supervision. Supervisors are nevertheless encouraged to be aware of legal and institutional impediments to implementing the guidelines contained in this document, and to take steps to foster effective processes where it is within their legal authority to do so. Where it is not, supervisors may wish to consider promoting legislative or other reforms that would enhance their authority and allow them to fully implement these guidelines.

28. Supervisors should clearly communicate the guidelines contained in Part 1 and the expectations and recommendations in Part 2 of this document to the banks they supervise and their respective external auditors and audit standard-setting bodies, as applicable. However, the implementation of these guidelines, expectations and recommendations should be proportionate to the size, complexity, structure, economic significance, risk profile and other facts and circumstances of the bank and the group (if any) to which it belongs. Furthermore, the guidelines in Part 1 and the expectations and recommendations in Part 2 should be applied in accordance with the national legislation and corporate governance structures applicable in each country. The Committee recognises that some countries have found it appropriate to adopt legal frameworks and standards (eg for listed firms), as well as accounting and auditing standards, which may be more extensive and prescriptive than the guidelines, expectations and recommendations set forth herein.

29. The Committee does not have the authority to set professional standards for external auditors. Part 2 of this document includes references to existing internationally accepted auditing standards (eg ISAs), quality control standards (eg ISQC 1), ethical standards (eg IESBA's *Handbook of the Code of Ethics for Professional Accountants*)[17] and expectations of how proper application of these principles-based standards should include appropriate tailoring of audit work in response to the risks and issues applicable to banks. In areas where the expectations are beyond what is required by the applicable international auditing, quality control and ethical standards, these are noted as the Committee's

[17] As of March 2014.

recommendations ("the Committee recommends") for how the standards could be enhanced for banking audits. These recommendations should be considered by independent external auditors when planning and performing bank audits, as they may enhance the quality of their work and be referred to by audit committees in assessing the external audit process. The recommendations on enhancements to the international auditing standards and the international standard on quality control were included in the Committee's March 2013 letter to the IAASB.[18] The Committee encourages other independent auditing standard-setting bodies to consider the recommendations and determine whether changes should be made to existing auditing and quality control standards to enhance the quality of bank audits.

30. The following terms are used in this document, with the meanings specified:

- **Financial statement audit**[19] – An audit of a bank's financial statements by an external auditor in accordance with internationally accepted auditing standards.[20]
- **Statutory audit** – An audit carried out to comply with the requirements of particular legislation or regulations. In some jurisdictions, this may entail only the financial statement audit. In other jurisdictions, this may also include extended reporting by external auditors on matters such as internal controls and regulatory returns.[21]
- **External auditor** – The audit firm and the individual audit engagement team members conducting the audit. Where relevant, specific references are made to the audit firm or the individual audit engagement team members in certain paragraphs.
- **Banking supervisory authority** – The body responsible for promoting the safety and soundness of banks and the banking system in a particular jurisdiction or group of jurisdictions, including the persons who are involved with supervisory policy setting and policy issues, including policies regarding accounting and auditing.
- **Supervisor**[22] – The group of supervisory personnel at a banking supervisory authority who are directly involved with the supervision/examination of a specific institution.
- **Board and senior management**[23] – The governance structure at a bank composed of a board and senior management. The Committee recognises that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, by contrast, use a one-tier structure in which the board has a broader role. Still other countries have moved or are moving to an approach that discourages or prohibits executives from serving on the board or limits their number and/or requires the board and board committees to be chaired only by non-executive board members. Given these differences, this document does not advocate a specific board structure. The terms "board" and "senior

[18] See footnote 4.

[19] BCBS Core Principle 27, Essential Criterion 2, states that the supervisor holds the bank's board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.

[20] International Standards on Auditing (ISAs) are an example of those internationally accepted auditing standards. In this guidance, all references to internationally accepted auditing standards will be to ISAs, although the references would apply equally to other equivalent internationally accepted auditing standards.

[21] See Annex 1 for more examples of the contents of extended reports which form part of the statutory audit in certain jurisdictions.

[22] See also BCBS Core Principle 27, footnote 83, where, for the application of Principle 6, the meaning of "supervisor" is broader than the meaning specified in paragraph 30 above.

[23] BCBS (October 2010), *Principles for enhancing corporate governance*, paragraph 12.

management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

- **Audit committee** – A specialised committee established by the board, the mandate, scope and working procedures for which are set out in a charter or other instrument. As stated in the Committee's *Principles for enhancing corporate governance* (October 2010), to increase efficiency and allow deeper focus in specific areas, boards in many jurisdictions establish certain specialised board committees – the audit committee being one of them. The October 2010 document further recommends that, for large and internationally active banks, an audit committee or equivalent should be required. It also outlines the overall responsibilities of the audit committee.[24]
- **Those charged with governance** – As defined by internationally accepted auditing standards, the person(s) or organisation(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.[25] Such person(s) or organisation(s) is (are) typically the board of directors.[26] Where the board of directors of a bank establishes an audit committee to assist it in meeting its responsibilities by charging the audit committee with specific tasks and responsibilities, the audit committee can be viewed as taking on the role of those charged with governance in relation to those specific tasks and responsibilities.[27]

5. The Committee's international engagement on external auditing

31. Approaches for dealing with supervisory concerns about the quality of the audit of an individual bank may differ across jurisdictions. In its effort to promote audit quality, the Committee will continue to engage in regular dialogue and discussion with the relevant international stakeholders (see paragraph 33)[28] on external audit matters.

32. The objective of this dialogue is to enable the Committee and the relevant international stakeholders to identify and discuss relevant issues and topics on a timely basis so that supervisors, external auditors and audit oversight bodies can take appropriate action. As such, these discussions should address not only current issues and topics, but also emerging areas and trends that raise concern.

33. These stakeholders include, but are not limited to, the following:

- the Financial Stability Board (FSB), whose objectives include the enhancement of the effectiveness of banking supervision;

24 BCBS (October 2010), *Principles for enhancing corporate governance*, paragraphs 50–51.

25 ISA 260, *Communication with those Charged with Governance*, paragraph 10(a).

26 See the meaning of "board" within this paragraph.

27 ISA 260, *Communication with those Charged with Governance*, paragraph 12, states: "If the auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the auditor shall determine whether the auditor also needs to communicate with the governing body."

The existence of both a board of directors and an audit committee does not impede the external auditor from reporting at two levels, both to the board of directors and to the audit committee, should the external auditor determine that it is necessary to do so for the purposes of complying with the requirements of internationally accepted auditing standards in relation to the specific tasks and responsibilities charged to the audit committee by the board of directors.

28 The Committee is a member of the FSB, the Monitoring Group and the consultative advisory groups of the IAASB and IESBA, and is an observer at the IFIAR. It also nominates one member to the PIOB.

- the Public Interest Oversight Board (PIOB), which is responsible for improving the quality and public interest focus of the international standards formulated by standard-setting boards operating under the auspices of the International Federation of Accountants (IFAC) in the areas of audit and assurance, education and ethics, including oversight of the public interest activities of three of the IFAC's independent standard-setting boards and their respective consultative advisory groups;
- the Monitoring Group, which is a group of regulatory and international organisations committed to advancing the public interest by supporting the development of high-quality international standards on auditing and assurance, accountant ethics and education, and which exchanges views relating to international audit quality and regulatory and market developments which have an impact on auditing;
- the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) as well as their consultative advisory groups, which are responsible for developing international auditing and ethics standards respectively;
- the International Forum of Independent Audit Regulators (IFIAR), which discusses issues and shares views relating to international audit quality and regulatory and market developments having an impact on auditing; and
- the Global Public Policy Committee (GPPC), which is comprised of representatives from the six largest international accounting networks and focuses on public policy issues for the accounting profession.

Part 1

Supervisory guidelines with regard to a bank's audit committee in relation to external audit, and the engagement of supervisors with auditors and audit oversight authorities

Section A – Supervisory guidelines with regard to a bank's audit committee and its relationship with the external auditor

34. The Committee's documents *The internal audit function in banks* (June 2012)[29] and the *Principles for enhancing corporate governance* (October 2010)[30] describe the main responsibilities of a bank's audit committee. The audit committee has, amongst others, a number of responsibilities with respect to the external auditor and the statutory audit. The audit committee approves, or recommends to the board of directors for approval, the appointment, reappointment, dismissal and compensation of the external auditor. The audit committee also monitors and assesses the independence of the external auditor.

35. The audit committee oversees the bank's statutory audit process. Key aspects of the audit committee's work encompass the assessment of the effectiveness of the external audit process. The audit committee should require senior management to take the necessary corrective actions to address the findings and recommendations of the external auditor in a timely manner.

36. The guidelines in this section focus on the audit committee's responsibilities in relation to the oversight of, and its relationship with, the external auditor, which include promoting and supporting the integrity, objectivity and independence of the auditor; the quality of the external audit; and the competencies that underpin that quality. To enable the audit committee to carry out its oversight responsibilities, which also contribute to the effectiveness of the audit process, these guidelines promote effective two-way communication between the audit committee and the external auditor. It is important to note that all the discussions below stem from an important overarching principle: there should be a frank, open working relationship and a high level of mutual respect amongst all parties involved.

37. These guidelines also form the basis for the supervisor's monitoring of the effectiveness of the audit committee in its oversight of the external auditor.

Appointment of the external auditor

Principle 1: The audit committee should have a robust process for approving, or recommending for approval, the appointment, reappointment, removal and remuneration of the external auditor.

38. The audit committee should have the primary responsibility for approving, or recommending to the board of directors for approval, the appointment, reappointment, removal and remuneration of the external auditor. In doing so, the audit committee should determine appropriate criteria for selecting the external auditor and should regularly assess the knowledge, competence and independence of the external auditor (see Principle 2 below) and the effectiveness of the external audit (see Principle 3 below),

[29] BCBS website: www.bis.org/publ/bcbs223.pdf

[30] BCBS website: www.bis.org/publ/bcbs230.pdf

having due regard to the supervisory expectations and recommendations for external auditors and the external audit of a bank as set out in Part 2 of this document.

39. The audit committee's procedures for approving or recommending the approval of the external auditor should also include a risk assessment of the likelihood of the withdrawal of the external auditor from the audit, and how the bank would respond to that risk.

40. The bank's annual report should include a section that explains the approach the audit committee has taken regarding the recommendation of the appointment or reappointment of the external auditor, and include supporting information on the tenure of the incumbent auditor.

41. If the board of directors has approval responsibilities with respect to the external auditor, but does not accept the audit committee's recommendation, the annual report, or any publications by the bank relating to the appointment/reappointment/dismissal of the external auditor, should include a statement explaining the audit committee's recommendation and the reasons why the board of directors has taken a different position.

42. The audit committee should assess the overall quality of the external auditor, before its first appointment and at least annually thereafter. The audit committee should consider the quality control standards applicable to the external audit and request that the external auditor report on its own internal quality control procedures, including the audit firm's engagement quality control process, and any significant matters of concern arising from these procedures. To that end, the audit committee should consider whether, as well as complying with the applicable jurisdictional quality control standards, the audit firm also complies with the quality control requirements applicable to listed entities in internationally accepted quality control standards (see paragraph 147). The audit committee should also consider, where available, the external audit firm's annual transparency report and any inspection reports on the audit firm issued by the relevant audit oversight body.

43. The audit committee should maintain an understanding and knowledge of:

- the structure and governance of the audit firm;
- the current nature of the audit environment, including in jurisdictions abroad where the bank operates;
- significant issues and concerns raised by the relevant audit oversight body regarding the audit firm, and the auditor's actions in addressing these concerns, to understand how these issues/concerns may affect the quality of the audit of the bank;
- the nature of banking regulatory actions and conditions that could have an impact on the external auditor's work on the bank, including any regulatory actions and conditions specific to the bank being audited, and any that the supervisor is imposing on all banks (for example, through newly implemented regulations and policies); and
- public lessons learned from any recent external audit failures associated with the bank's auditor, and other audit firms and how the audit firms have dealt with them so that similar audit risks are appropriately identified and limited.

44. The audit committee should satisfy itself that the level of the audit fees is commensurate with the scope of work undertaken. Where fee reductions are offered and accepted, the audit committee should seek assurance that these reductions do not imply an inappropriate increase in the materiality level to be applied by the external auditor, or an inappropriate narrowing of the external auditor's proposed scope of the audit, or an inappropriate reduction in the attention which will be given to each business component and the significant audit risks identified.

45. The audit committee should discuss and agree to the terms of the engagement letter issued by the external auditor prior to the approval of the engagement. Where relevant, the audit committee should agree to an engagement letter that has been updated to reflect changes in circumstances, such as those arising from changes in legal requirements and changes in the scope of the external auditor's

work as a result of revisions to internationally accepted auditing standards which have arisen since the previous year.

46. If the external auditor resigns or communicates an intention to resign, the audit committee should follow up on the reasons/explanations giving rise to such resignation and consider whether it needs to take any action in response to those reasons.

Independence of the external auditor

Principle 2: The audit committee should monitor and assess the independence of the external auditor.

47. The independence of the external auditor is one of the main prerequisites for an adequate level of audit quality. As such, the audit committee should understand the applicable independence requirements, and have procedures to monitor and assess the independence of the external auditor at least annually, taking into consideration relevant national laws, regulations and professional requirements. The assessment also involves a consideration of all relationships between the bank and the audit firm (including the provision of non-audit services), any inadvertent violations, and any safeguards established by the external auditor. To that end, the audit committee should consider whether, as well as complying with the applicable jurisdictional independence standards, the audit firm also complies with the independence standards applicable to listed entities in internationally accepted ethical standards (see paragraph 139).

48. Where the audit firm has been the external auditor of the bank for many years, there may be a risk that there is a familiarity or self-interest threat to the external auditor's objectivity and independence in its audit of the bank. However, when the bank changes its external auditor, there is a risk that the depth of understanding of the bank and its activities and systems will be lost. This may affect the new external auditor's ability to identify risks of material financial statement misstatements and respond to them appropriately, and hence may detract from the quality of the audit.

49. The audit committee should have a policy in place that stipulates the criteria for tendering the external audit contract. The policy should also call for the audit committee to consider periodically whether to put the audit firm contract out for tender. When making such considerations, the audit committee should take into account the length of the current audit firm's tenure and the risks it may pose to its objectivity and independence.

50. The audit committee should understand the audit firm's policy on rotation of members of the audit engagement team and the audit firm's compliance with any jurisdictional or other local regulatory independence requirements in this regard.

51. The audit committee should seek assurance that the audit engagement team members and their firm and, when applicable, the network external auditors have no personal, family, business, financial or other relationships with the bank which could adversely affect the auditor's actual or perceived independence and objectivity. The audit committee should seek from the external auditor, at least on an annual basis, information about the audit firm's policies and processes for maintaining independence and monitoring compliance with the relevant independence requirements.

52. The audit committee should develop a formal policy which governs the acceptance of non-audit services provided by the auditor, within the local jurisdictional framework.[31] Amongst other provisions, the policy should include criteria for the types of non-audit services that the external auditor may provide or is prohibited from providing, and rules stipulating when advance approval by the audit

[31] BCBS (June 2012), *The internal audit function in banks*, paragraph 67, states that, as a sound practice, banks should not outsource internal audit activities to their own external auditor. Any departure from this best practice should be limited to small banks and should remain within the bounds of the applicable ethical standards for the statutory or external auditor.

committee is required for the auditor's performance of non-audit services. The policy should be reviewed periodically and compliance should be monitored, taking into account the contents of Section A of Part 2 of this document.

53. Where non-audit services are provided by the external auditor, the audit committee should monitor the provision of such services to ensure that their performance does not impair the external auditor's objectivity and independence, taking into consideration various factors including the skills and experience of the external auditor, safeguards in place to mitigate any threat to objectivity and independence, and the nature of and arrangements for non-audit fees.[32]

54. Where the external auditor provides non-audit services to the bank, the bank's annual report (or other relevant publications) should explain to shareholders the nature of and the fee arrangements for the non-audit services received, and how auditor independence is safeguarded.

Effectiveness of the external audit

Principle 3: The audit committee should monitor and assess the effectiveness of the external audit.

55. Audit committees have a key role in contributing to audit quality by monitoring and assessing the effectiveness of external audits. At the start of each audit, the audit committee should consider whether the audit approach is appropriate, including considerations relating to the audit scope, the level of materiality, areas of focus and how the auditor proposes to address the areas of significant risks,[33] in particular those areas described in Section B of Part 2 of this document.

56. The audit committee should consider whether the proposed resources to execute the audit plan are reasonable given the scope of the audit engagement, the nature and complexity of the bank's operations, and its structure and activities. The audit committee should understand the nature and extent to which the external auditor intends to use audit work performed by network firm personnel and other audit firms.

57. The audit committee should obtain confirmation from the external auditor that there is adequate knowledge, competence and expertise within the audit engagement team and that the audit will be conducted in compliance with internationally accepted auditing standards, as well as any applicable laws and regulations.[34]

58. 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 external auditor's view on any significant matters that arose during the audit (including those matters that were subsequently resolved as well as those that have been left unresolved), in particular the external auditor's explanation of the significant judgments the audit engagement team made and the conclusions reached. This should include the discussions with management and the judgments involved, the range of possible outcomes and, where available, a comparison of the bank's position with its peer group (on an anonymous basis), including a comparison with previous periods;

[32] As set out in BCBS (June 2012), *Internal audit function in banks*, Annex 2.

[33] ISA 260, *Communication with Those Charged with Governance*, paragraph 15, requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. Paragraph A13 presents examples of matters the auditor may communicate with those charged with governance, including how the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.

[34] The Preface to the *International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, paragraph 3, states that "[i]n the event that local laws or regulations differ from, or conflict with, the IAASB's Standards on a particular subject, an engagement conducted in accordance with local laws or regulations will not automatically comply with the IAASB's Standards".

- obtain an understanding of the rationale behind the final conclusions drawn by the audit engagement partner on significant accounting and auditing matters; and
- review the nature and levels of misstatements identified during the audit, obtaining explanations from management and, where necessary, the external auditor as to why certain errors might remain unadjusted.

59. The audit committee should also discuss with the external auditor the statements provided by management in the representation letter to the auditor,[35] giving particular attention to any matters for which the external auditor requested specific written representations from the board of directors/senior management. The audit committee should consider whether the information provided for each item in the representation letter is complete and appropriate based on its own knowledge.[36]

60. As part of the ongoing monitoring process, the audit committee should discuss with the auditor the audit-related reports,[37] including any management letter (or equivalent), which the external auditor has provided to the bank. Such reports include, but are not limited to, written communications regarding matters that internationally accepted auditing standards require the auditor to communicate in writing to those charged with governance. In particular, the audit committee should discuss with the external auditor any significant deficiencies identified during the audit in the bank's internal control over financial reporting, which must be communicated in writing.[38]

61. Upon completion of the audit fieldwork, but before the external auditor issues the audit report, the audit committee should consider whether the audit firm has followed its audit plan and understand the reasons for any changes in the plan, including those resulting from changes in the identified risks of material misstatement and the work undertaken by the external auditor to address those risks. Promptly after the completion of the audit, if not done earlier, the audit committee should obtain feedback about the conduct of the audit from key bank personnel involved, eg the heads of finance and internal audit.

62. The audit committee should then assess the effectiveness of the external audit process, report on the effectiveness of the process to the board of directors, and discuss its findings and any recommendations with the board.

63. The audit committee should seek to obtain information from the external auditor, where relevant, on the main findings of audit quality reviews of the bank's audit and the audit firm's quality control systems by audit oversight bodies.

[35] ISA 580, *Written Representations*, requires the auditor to request management (ie management and, where appropriate, those charged with governance) to provide written representations that it has fulfilled its responsibilities for the preparation of the financial statements, for providing the auditor with all relevant information and access to the books and records, and for recording all transactions and reflecting them in the financial statements. Other ISAs require the auditor to request additional written representations from management if the auditor determines that it is necessary to support other audit evidence. The written representations must be in the form of a representation letter addressed to the auditor. It may therefore be appropriate for the audit committee to make management aware that the submission of such written representations to the external auditor will be expected.

[36] ISA 260, *Communication with Those Charged with Governance*, paragraph 16(c)(ii), requires the auditor to communicate to those charged with governance the written representations the auditor is requesting.

[37] As mentioned in paragraph 87, these reports could include extended audit reports issued by the external auditor which in certain jurisdictions may be a part of the external auditor's statutory audit work.

[38] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9.

Relationship between the audit committee and the external auditor

Principle 4: 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.

64. The foundation for an effective relationship is regular, timely, open and honest communication between the audit committee and the external auditor. Regular dialogue between the two parties should be held throughout the reporting cycle of the bank.

65. While both cooperation and challenge are needed between the external auditor and the audit committee for the external audit to be effective, the need for cooperation should never prevent robust challenges from being made when needed. Such challenges are a key responsibility of the audit committee and are part of the productive dialogue on key judgments that can result in stronger and deeper understanding of and views on the positions of all parties.

66. In order to reinforce the audit committee's effectiveness and enhance the quality of the audit, the audit committee should consider inviting the external auditor to attend audit committee meetings (except when discussing matters in relation to the assessment of the external auditor), even if there are no items explicitly relevant to the external audit on the agenda. The external auditor's attendance should facilitate the exchange of views on the bank's business performance, risk and other topics. Further, to enhance audit quality, 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 for the auditor's work.

67. The audit committee should have the right and authority to meet regularly – in the absence of executive management – with the external auditor. This will enable the audit committee to understand and discuss all issues that may have arisen between the external auditor and bank management in the course of the external audit and how these issues have been resolved. In addition, these meetings should address any other matters that the external auditor believes the audit committee should be aware of in order to exercise its responsibilities.

68. The audit committee should discuss with the auditor any matters arising from the statutory audit that may have an impact on regulatory capital or regulatory disclosures. This may include discussion of the interaction between the accounting information and the regulatory information, eg accounting impairment charges versus regulatory expected losses, or the consistency of the bank's prudential information (eg Pillar 3 reporting) with its annual report.

69. The audit committee should discuss with the external auditor any significant issues identified in the course of the audit, particularly in areas which could be relevant to future financial statements, to promote early discussion and planning. This includes upcoming changes in accounting standards or regulations and the consequences of material transactions for the financial reporting processes and performance of the bank.

70. The audit committee should also communicate to the external auditor matters that are likely to be of significant relevance to the conduct of the statutory audit. Such matters may encompass subjects that the audit committee believes warrant particular attention or may influence the audit of the financial statements, including significant communications with the supervisor.

Reporting by the external auditor to the audit committee

Principle 5: 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.

71. In some jurisdictions, as part of the statutory audit, the auditors are also required by law or regulation to express an opinion on the effectiveness of internal control over financial reporting and

provide additional reporting of matters identified in the audit of internal control. The text in the following paragraphs covers only reporting to the audit committee in the context of the financial statement audit.

72. Under internationally accepted auditing standards, an objective of the external auditor is to provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process.[39] The reporting by the external auditor should be aligned with the requirements set by internationally accepted auditing standards for matters to be communicated to those charged with governance,[40] the expectations and recommendations set forth in this document, and any additional requirements under applicable laws and regulations.

73. As part of the above, the audit committee should request that the external auditor report to it on certain significant matters, including the following:

- Significant difficulties encountered during the audit.[41]
- Key areas of significant risk of material misstatement in the financial statements, in particular on critical accounting estimates or areas of measurement uncertainty (eg loan loss provisioning and valuation uncertainties), including potential valuation bias and consequential effects on earnings, compensation structures and regulatory ratios.
- Areas of significant management judgment, including judgments pertaining to the recognition, de-recognition, measurement or disclosure of relevant items within the financial statements, judgments about events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern[42] (including consideration of liquidity/funding issues of the entity), and the auditor's view on these areas.
- The extent of requests made by the group auditor to another audit firm or member firm with respect to the performance of a group audit.
- Use of external experts to assist with the external audit.
- The auditor's approach to internal control.[43]
- The extent to which the auditor uses the work of internal audit.[44]
- Significant internal control[45] deficiencies identified in the course of the statutory audit.[46]
- Matters noted arising from the audit 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, including significant decisions or actions by senior management that lack appropriate authorisation.[47]

[39] ISA 260, *Communication with Those Charged with Governance*, paragraph 9(c).

[40] ISA 260, *Communication with Those Charged with Governance*, paragraphs 14–17.

[41] ISA 260, *Communication with Those Charged with Governance*, paragraphs 16(b) and A18.

[42] ISA 570, *Going Concern*, paragraph 23.

[43] ISA 260, *Communication with Those Charged with Governance*, paragraph A13.

[44] ISA 260, *Communication with Those Charged with Governance*, paragraph A14.

[45] Including the control environment, risk assessment process, information and communication systems and processes, control activities and monitoring of controls in the bank.

[46] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9.

[47] ISA 260, *Communication with Those Charged with Governance*, paragraph A25.

- Significant qualitative aspects of financial statement disclosures, eg how the bank's disclosures compare with those of its peers, and where the auditor believes they could be improved, including the results of discussions with management.
- Feedback on the auditor's relations with management, the internal audit function and the risk management function, where relevant.
- Any other significant matters discussed with or considered by the engagement quality control reviewer.

74. For the purposes of complying with the requirements of internationally accepted auditing standards, where significant matters are communicated to the audit committee, the external auditor should also determine if these matters need to be communicated to the governing body of the bank.[48]

75. Banking regulators often have access to written communications between the auditor and the bank. However, internationally accepted auditing standards (in particular, ISA 260) currently do not mandate that the auditor should always communicate in writing with those charged with governance. Given the importance of the auditor reporting to those charged with governance in contributing to audit quality, and to the work of the banking regulator, but without wishing to limit oral communications, the Committee recommends that the auditor always communicate in writing to those charged with governance all significant audit findings and reportable matters.

Section B – Supervisory guidelines: the relationship between the supervisor and the external auditor

76. This section sets out guidelines that promote effective relationships that will enable regular communication of mutually useful information in the context of a statutory audit between:

- the supervisor and the external auditor at the supervised bank level, regardless of whether the communication is mandatory (Principles 6 and 7); and
- the banking supervisory authority and the audit firm, and the accounting profession as a whole where the information is not specific to an individual bank (Principle 8).

77. From a supervisory perspective, the key objective of having effective relationships between the parties referred to above is to enhance the effectiveness of the supervision of the banking sector. This relationship will also contribute to the quality of external audits.

78. An effective relationship should enable each party to carry out its respective statutory responsibilities while not implying that either party is responsible for or should or can perform the statutory responsibilities of the other party.

(a) Effective relationship at the supervised bank level

79. The external auditor can provide the supervisor with valuable insight into various aspects of a bank's operations and management's attitude towards the application of key accounting policies, including the judgments made by, and any valuation models adopted by, management in carrying out these policies. Conversely, the external auditor may obtain helpful insights from information originating from the supervisor where the supervisor provides an independent assessment in areas significant to the external audit and may focus attention on specific areas of supervisory concerns. In certain jurisdictions,

[48] ISA 260, *Communication with Those Charged with Governance*, paragraph 12.

the supervisor may also request the external auditor to perform specific assignments that go beyond the statutory audit work of the auditor.

Principle 6: The supervisor[49] 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.

80. Supervisors and external auditors should have an open and constructive relationship. Information exchanged should be treated appropriately and confidentially.[50]

81. For an effective relationship to exist, the engagement between the supervisor and the external auditor should involve individuals who are knowledgeable, informed and empowered by their respective organisations to exchange information.

82. The supervisor may benefit from the results of the external auditor's work because in many respects the two parties have complementary concerns regarding the same matters although the focus of their concerns is different. Similarly, the external auditor may benefit from insights that the supervisor can communicate. However, in order to discharge their respective statutory responsibilities, neither party should use the work of the other as a substitute for its own work and the supervised entity should remain the main source of information for their respective work.

83. The scope and terms of this relationship can be determined in individual jurisdictions and should be clear to both the supervisor and the external auditor – for example, through guidance issued by the banking supervisory authority.

Access to communications with the bank

84. The external auditor's work gives rise to the auditor's report on the annual/consolidated financial statements which is also used for prudential supervisory purposes. When performing a financial statement audit in accordance with internationally accepted auditing standards, the external auditor should communicate with management and/or those charged with governance about significant matters relating to financial reporting or supplementary matters, and these communications may be accessed by the supervisor.[51] In the same manner, in certain jurisdictions, the external auditor may also have access to the supervisor's communications to the bank.[52]

85. Given the benefits that may ensue, when communicating with management and/or those charged with governance of the bank, both the supervisor and the external auditor should consider communicating with the bank in writing about matters that may also be of interest to each other. These written communications would then form part of the bank's records to which the other party should have access.

Direct communication at the supervised bank level

86. In addition, effective communication should be established through one or more direct written and/or oral communication channels or a combination thereof, as dictated by the circumstances.

49 In the context of Principle 6, see BCBS Core Principle 27, footnote 83, for the meaning of "supervisor", which is broader than the meaning specified in paragraph 30.

50 See paragraphs 95–98.

51 In certain jurisdictions, the supervisor may also have access to the external auditor's working papers.

52 The external auditor should review the supervisor's communications to the bank to help identify instances of non-compliance with laws and regulations that may have a material effect on the financial statements as required by ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 14(b): "The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements: [...] b. Inspecting correspondence, if any, with the relevant licensing or regulatory authorities."

87. Written communication channels may include extended audit reports on the audited financial statements, which are submitted to the supervisor and are not available to the public.[53] In certain jurisdictions, these reports may be part of the external auditor's statutory audit work and may also cover assignments related to prudential supervisory requirements.

88. Oral communication channels may include bilateral meetings between representatives of the supervisor and the external auditor, and may be formal or ad hoc. In addition to bilateral meetings, trilateral meetings involving representatives of the supervisor, the external auditor and the chair of the audit committee (or an alternate independent non-executive director) at the supervised bank can also be held.

89. Whilst not excluding any other effective communication channels, bilateral and trilateral meetings are examples of sound practice communication channels, particularly for systematically important banks (SIBs).

Communication of matters outside the scope of the external auditor's duty to report/alert

90. The communication channels described in paragraphs 86–89 can be a helpful source of information for the supervisor about matters that are outside the scope of the external auditor's duty to report/alert (see Principle 7) which external auditors may consider as important and of interest to the banking supervisors. Such issues may include current, emerging and thematic issues, and entity-specific and sector-wide issues.

91. In addition to discussing with the supervisor areas where there is often a significant risk of material misstatement in the financial statements, this document includes examples of areas where matters of interest to the supervisor may be identified by the external auditor in the course of the financial statement audit and are therefore relevant for communication to the supervisor. Examples of these matters are:

- Where a bank undertakes transactions to achieve a particular accounting or regulatory outcome such that the accounting treatment is technically acceptable, but it obscures the substance of the transaction.
- Where a bank consistently utilises valuations that exhibit a pattern of optimism or pessimism within a range of acceptable valuations or other indications of possible management bias.[54]
- Significant deficiencies in internal control processes and the external auditor's observations on matters that are 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. This may include, where relevant, their observations on the effectiveness of the internal audit function, the risk management function and the compliance function (where not already required by statute).
- Actual or suspected breaches of prudential regulations noted in the course of the audit that are likely to be of significance.[55]
- Indications that disclosures in financial statements are not consistent with published prudential information (eg Pillar 3 reporting).

[53] Ordinarily, such reports would be issued for the attention of the board of directors of the audited bank, but should be delivered to the supervisor as well (directly or through the bank).

[54] ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21.

[55] The external auditor should apply professional judgment in determining whether the identified breach is likely to be of significance to the supervisor. The Committee recommends that the external auditor report significant breaches directly to the supervisor (or, where not permitted, indirectly through the bank). However, if the breach is of material significance, it should be reported immediately as described in paragraph 99.

92. Annex 1 to this document provides examples of the potential content of the extended audit reports described in paragraph 87. Annex 2 to this document provides guidelines on the timing and examples of the potential content of the meetings between the supervisor and the external auditor, as circumstances may dictate.

93. Where bilateral and trilateral meetings are held, particularly in the case of SIBs, the timing and content of these meetings could be aligned with the typical phasing of the bank's external audit and/or the supervisory assessment of the bank. Of particular importance are the planning and concluding phases of the external audit. The meetings should focus on the significant risks and significant findings of the audit.

94. The form, frequency and content of the communication described in this document between the supervisor and the external auditor of the supervised entity will vary depending on the jurisdictional circumstances, the characteristics and circumstances of the bank, and the supervisory model adopted in the relevant jurisdiction.

Safe harbour available to external auditors

95. External auditors are required by internationally accepted ethical standards to treat much of the information received while carrying out their functions as confidential. Nevertheless, in jurisdictions where a legal provision protects external auditors from disciplinary proceedings, prosecution and liabilities when making disclosures in good faith to the supervisor (safe harbour), auditors may share information with the supervisor without contravening their duty of confidentiality.

96. On matters that fall outside the scope of the duty to report/alert discussed in Principle 7 but which may be of interest to the supervisor, where a safe harbour does not exist,[56] the external auditor communicates these matters indirectly through the bank to the supervisor or directly with the bank's consent.

Gateways available to supervisors

97. Subject to the confidentiality rules that are in place, the supervisor may communicate bank-specific information to the external auditor when the information-sharing will help in its supervisory work and in turn assist the external auditor in conducting a quality external audit.

98. Before disclosing any information to the external auditor, supervisors consider the sensitivity of the information and the extent to which disclosing the information to the external auditor would support the supervisor discharging its duties.

Principle 7: The supervisor should require the external auditor to report to it directly[57] on matters arising from an audit that are likely to be of material significance[58] to the functions of the supervisor.

Communication of matters within the scope of the external auditor's duty to report/alert

99. When required by the legal or regulatory framework or by a formal agreement or protocol, the external auditor should promptly communicate matters arising from the audit that may be of material

[56] In jurisdictions where one does not exist, supervisors should be encouraged to work towards achieving a safe harbour which would provide that no duty to which the auditor is subject shall be contravened by communicating in good faith to the supervisor any information or opinion on a matter that the auditor reasonably believes is relevant to any functions of the supervisor.

[57] Reporting should be conducted directly from the auditor to the supervisor, unless not permitted, in which case reporting should be conducted indirectly through the bank.

[58] See footnote 9.

significance to the supervisor (referred to as "duty to report/alert" matters). In jurisdictions with such a requirement, the disclosure in good faith to the supervisors by an external auditor of matters of material significance does not constitute a breach of the auditor's duty of confidentiality.[59]

100. On many occasions, the external auditor will have already identified and discussed these matters with the bank's management and/or those charged with governance as appropriate. However, when there is a duty on the part of the external auditor to report to/alert the supervisor directly on such matters, it is not sufficient for the external auditor to rely on the bank to notify the supervisor.

101. The following are examples of significant matters arising from an audit that many jurisdictions prescribe as within the scope of the external auditor's duty to report/alert:

- information that indicates the bank's failure to fulfil one of the requirements for a banking licence;
- a serious conflict within the bank's decision-making bodies or the unexpected departure of a manager in a key function;
- information that may indicate a material breach of laws and regulations[60] or the bank's articles of association, charter or by-laws;
- material adverse changes in the risks of the bank's business and possible risks going forward;[61] and
- circumstances requiring modifications to the auditor's opinion on the financial statements.

102. It is also a usual practice for the external auditor to notify the supervisor of the external auditor's resignation (or intent to resign) or the bank's removal of the external auditor from office.

(b) Effective relationships at the levels of the audit firm and the accounting profession as a whole

103. To assist in effective supervision of banks, it is important for the banking supervisory authority to identify system-wide, macroprudential risks which may have an impact on banks. In the course of their work, the banking supervisory authority and external audit firms obtain information which, when reviewed in its entirety, can assist in identifying changing and emerging key trends and developments that may be indicative of emerging systemic risk.

104. Audit firms may also identify emerging issues regarding inconsistent or inappropriate application of accounting standards which, if identified at an early stage, will permit external auditors and supervisors to take timely remedial action at the national level and also at affected banks to ensure the fair presentation of their financial statements.

Principle 8: There should be open, timely and regular communication between the banking supervisory authority, the audit firms and the accounting profession as a whole on key risks and systemic issues as well as a regular exchange of views on appropriate accounting techniques and auditing issues.

105. The banking supervisory authority and external audit firms should have regular discussions on existing and emerging key risks and systemic issues at the national level, as the exchange of such information is mutually beneficial. The communication should be open and take place in an environment

[59] BCBS (September 2012), *Core Principles for Effective Banking Supervision*, Principle 27, Essential Criterion 9.

[60] See paragraph 177.

[61] See paragraph 189.

that allows a frank exchange of views and ideas. If circumstances dictate, ad hoc meetings should be held to discuss matters requiring urgent action to allow each party to take appropriate action in a timely manner.

106. There should be periodic meetings at the national level between the banking supervisory authority and audit firms and professional accountancy bodies to discuss existing and emerging key risks and systemic issues.[62]

107. Key risks may be identified from discussions concerning:

- the appropriateness of accounting techniques for newly developed financial instruments, other aspects of financial innovation and securitisation; and
- issues such as market opacity and impairment evaluations for particular asset classes.

These discussions could be useful for identifying systemic issues. They could also help achieve banks' adoption of the most appropriate accounting policies and their consistent application.

108. It may be beneficial for banking industry associations to be involved in discussions on these topics.

Section C – Supervisory guidelines: the relationship between the banking supervisory authority and the audit oversight body

109. Supervisory authorities often use audited information, either directly or as a basis for regulatory information. In many jurisdictions, audit oversight bodies are responsible for independently monitoring the quality of statutory audits as well as audit firms' policies and procedures supporting audit quality. Therefore, banking supervisory authorities and audit oversight bodies have a strong mutual interest in ensuring quality audits by audit firms.

110. To promote effective dialogue between the banking supervisory authority and the audit oversight body, their respective roles should be clearly understood. The banking supervisory authority's focus is on the safety and soundness of the institutions under its supervision and the stability of the financial system as a whole. The audit oversight body's main role is to monitor the quality of audits in order to protect the interests of investors or further the public interest.

111. To facilitate effective dialogue between the banking supervisory authority and the audit oversight body, it is also beneficial to have an appropriate framework (eg through a memorandum of understanding between the two parties) for cooperation and information-sharing between the two bodies, subject to the confidentiality obligations of both parties and the relevant laws of the jurisdiction in which they are located. This may include the form, frequency and content of the dialogue. The cooperation framework should enable the banking supervisory authority to take appropriate actions to address the identified issues or topics.

Principle 9: There should be regular and effective dialogue between the banking supervisory authority and the relevant audit oversight body.

112. Where there is a relevant audit oversight body, the banking supervisory authority should establish regular dialogue with this body to deal with issues relevant to the conduct of audits of the banks under supervision.

[62] Meetings with audit firms and professional accountancy bodies should also be held at an international level through groups such as the Basel Committee (through the relevant group) (as described in Section 5 of this document), the European Banking Authority and the Association of Supervisors of Banks of the Americas.

113. Effective dialogue can be established through both formal (eg scheduled regular meetings) and informal channels (eg ad hoc discussions, telephone conversations). There should be an open and constructive two-way dialogue between the two parties.

114. Meetings between the banking supervisory authority and the audit oversight body should take place as frequently as deemed necessary to enable them to inform each other of topics or issues of mutual concern or interest arising from the performance of their duties that could be of relevance to the other authority, subject to relevant legal constraints.

115. Information exchanges between the two parties could include the robustness of the audit of certain areas particularly relevant to the banking supervisory authority, such as loan loss provisioning, or the auditor's consideration of the internal controls or risk management procedures of banks. The discussions may also include any issues or topics identified by the audit oversight body in the course of its inspections relating to audits of financial institutions (including audit deficiencies), and the audit oversight body's response to such issues, including follow-up with external audit firms and any corrective actions or other steps taken by the audit oversight body or external auditors to further strengthen external audits of financial institutions.

116. The banking supervisory authority may also discuss with the audit oversight body areas where there can be a significant risk of material misstatement and, where an appropriate framework for information-sharing is in place, the banking supervisory authority's concerns about the quality of the audit of a particular financial institution or any significant matters of concern in relation to the bank's external auditor or audit firms in general which may be relevant to the work of the audit oversight body.

117. Although identifying audit deficiencies is not a primary focus of the banking supervisory authority's work, on becoming aware of matters that may require action by the audit oversight body, the banking supervisory authority should consider communicating such matters to the audit oversight body.

118. The discussions should not be restricted to current issues or topics but should also include any significant thematic or emerging topics.

119. Depending on the outcome of the dialogue between the banking supervisory authority and the audit oversight body, where permitted, actions taken by the banking supervisory authority could include:

- raising issues identified by the audit oversight body with individual banks, their external auditors or the professional bodies representing external auditors and encouraging remediation of these issues where appropriate; and
- initiating a thematic review to analyse the impact of issues or topics identified by the audit oversight body from a prudential perspective.

120. Information shared between the banking supervisory authority and the audit oversight body is likely to be subject to legal confidentiality requirements. Where information is subject to a confidentiality requirement, the authority/body receiving the information should handle it in accordance with those requirements, and should consider:

- consulting the authority/body providing the information before disclosing the information to any third party; and
- notifying the other party if it receives a request or demand to provide the information on any basis potentially enforceable in law.

Part 2

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

121. External audits of financial statements performed in accordance with the relevant auditing standards enhance the confidence of all users, including supervisors, in the reliability of the audited financial statements and the quality of the information provided.

122. Though the Committee does not set competence, independence or auditing standards for auditors,[63] it does have expectations and recommendations as to what constitutes a quality audit. The Committee's expectations and recommendations should be referred to by audit committees in assessing the external auditor's knowledge, competence, objectivity and independence as well as the effectiveness of the audit process. These expectations and recommendations also facilitate the supervisors' engagement with external auditors and the relevant audit oversight bodies. The outcome of these interactions will help to inform the supervisors' views as to the quality of the external audit and contribute as such to the supervisory process.

123. Section A of this part of the document describes the supervisor's expectations and recommendations as a user of the bank's financial statements, specifically with respect to the external auditor's knowledge and competence, objectivity, independence, professional scepticism and quality control over the bank's audit. Section B of this part identifies areas where supervisors believe there is often a significant risk of material misstatement in a bank's financial statements and factors to which the Committee expects the external auditor to pay particular attention when auditing those areas.

124. This part of the document includes references to the existing internationally accepted auditing standards (eg ISAs), quality control standards (eg ISQC 1) and ethical standards (eg IESBA's Handbook of the Code of Ethics for Professional Accountants) for external auditors[64] to draw the reader's attention to specific requirements on certain topics. The Committee does not have the authority to set professional standards for external auditors. However, as internationally accepted professional standards for auditors are principles-based, the Committee expects the proper application of the standards to audits of banks to include appropriate tailoring of audit work in response to the risks and issues applicable to banks. For some areas of bank audits, this part of the document also includes the Committee's recommendations for audit requirements or procedures that could be enhanced in the current standards to address particular risks in audits of banks. These recommendations were included in the Committee's letter to the IAASB in March 2013 suggesting enhancements to the ISAs and ISQC 1.[65]

125. While the primary focus in this part is on the financial statement audit, the external auditor may identify matters in the course of the audit that are of interest to the supervisor and therefore should be considered for communication to the supervisor.[66]

126. In some jurisdictions, as part of the statutory audit, the external auditor may also undertake additional work to provide assurance on internal controls or other aspects of a bank's operations. The

[63] Various bodies (eg the International Accounting Education Standards Board, the International Ethics Standards Board for Accountants and the International Auditing and Assurance Standards Board) are responsible for setting standards for these respective areas.

[64] As of March 2014.

[65] See footnote 4.

[66] See paragraphs 141, 145, 166, 177, 183 and 189.

supervisory expectations set out in this part of the document provide a relevant reference for the performance of such additional work.

Section A – Supervisory expectations and recommendations for the external auditor of a bank

Knowledge and competence

Expectation 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.

127. Commensurate with the size, complexity and diversity of banking activities, and the legal and regulatory framework in which banks operate, the Committee expects that the external auditor of a bank has specialised knowledge and competence in auditing banks and uses experts as appropriate.

128. Knowledge and competence are particularly important in an external auditor's ability to exercise professional judgment and carry out key aspects of the audit, such as identifying and assessing the risks of material misstatement and designing and implementing appropriate responses to those risks.

Knowledge

129. Specifically for banking audits, the Committee expects that the audit engagement team, as a whole, has:

- proficient knowledge and understanding of, and practical experience with, the banking sector, associated banking industry and bank-specific risks, and the operations and activities of banks and bank audits. The audit engagement team may acquire this knowledge through specific training, participation in bank audits or work in the banking sector;
- proficient knowledge and understanding of applicable accounting, assurance and ethical standards, industry practice and relevant guidance such as International Auditing Practice Note (IAPN) 1000, *Special Considerations in Auditing Financial Instruments*;
- proficient knowledge of relevant regulatory requirements in the areas of capital and liquidity, and a general understanding of the legal and regulatory framework[67] applicable to banks; and
- proficient knowledge and understanding of IT relevant to bank audits.

130. In addition, given the complexity of the requirements of the applicable financial reporting framework pertaining to accounting estimates, the Committee expects the external auditor to consider whether the audit engagement team should involve individuals with specialised skills or knowledge in relation to accounting estimates,[68] including loan loss provisions, fair value measurements, and any areas known to be subject to differing interpretation, diversity in practice or newly developing practices.

[67] ISA 250, *Consideration of Laws and Regulations in the Audit of Financial Statements*, paragraph 12.

[68] ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 14.

Competence

131. The Committee expects that audit firms have documented policies and procedures that set minimum competency criteria for a bank's audit engagement team as a whole, which consider the role and experience of different team members.

32. Supervisors may have the ability to influence the competency requirements for external auditors. Where regulations and standards in particular jurisdictions do not include specific competency requirements for banks' external auditors, the supervisor may encourage professional and regulatory bodies to introduce requirements regarding training in, and experience with, bank auditing and accounting so that the audit engagement teams for bank audits are comprised of sufficiently competent staff.

Use of experts

133. In some instances, expertise in a field other than accounting or auditing may be required to support the audit engagement team. Examples of such areas are certain complex valuations that may affect accounting estimates (eg valuation of complex financial instruments, commercial property valuations), regulatory matters and the evaluation of highly complex IT environments, particularly in areas subject to significant risks of material misstatement.

134. Internationally accepted auditing standards set out requirements for the nature, timing and extent of audit procedures which the external auditor should perform to determine whether to use the work of an auditor's expert and, if using the expert, how to determine whether that work is adequate for the auditor's purposes.[69]

135. For some accounting estimates, banks may use complex valuation models. When these models are used, in addition to those considerations set out in paragraph A8 of ISA 620, *Using the Work of an Auditor's Expert*, the Committee recommends that the external auditor also consider the following when deciding whether to use an auditor's expert:

- whether there are new products or structures for the individual bank or the industry in general; and
- whether recent events either within the individual bank or in the industry in general have highlighted previously unidentified risks.

Objectivity and independence

Expectation 2: The external auditor of a bank should be objective and independent in both fact and appearance with respect to the bank.

Objectivity

136. Objectivity is a fundamental ethical principle and a key element of audit quality. It requires that the external auditor's judgment is not compromised because of bias, conflict of interest or the undue influence of others.[70] As objectivity is a state of mind that in most cases cannot be directly observed by users of financial statements, it is important for the external auditor to be independent in both fact and appearance.

[69] ISA 620, *Using the Work of an Auditor's Expert,* paragraphs 7–15.

[70] IESBA, *Handbook of the Code of Ethics for Professional Accountants*, paragraph 120.1.

Independence

137. Jurisdictional and internationally accepted ethical standards[71] lay out the frameworks to assist external auditors achieve and maintain independence.

138. Independence[72] is freedom from situations and influences, facts and circumstances where a reasonably informed third party would conclude that an external auditor's objectivity is impaired. It is important for the external auditor to be independent in both fact and appearance. In addition, independence should be observed not only in the context of the bank that is being audited but also with respect to the bank's related entities.[73]

139. The external auditor of a bank must comply with the applicable jurisdictional ethical standards. Whether or not the jurisdictional ethical standards are drawn from the internationally accepted ethical standards (eg IESBA), the Committee recommends that the external auditor of a bank also comply with the independence standards for public interest entities[74] in internationally accepted ethical standards.

140. When assessing whether any relationship or circumstance poses a threat to an external auditor's independence, the external auditor evaluates not just the specific rules on independence, but also the substance of the threat to independence, and how a reasonably informed third party would perceive the threat and its effect on the external auditor's objectivity. The provision of non-assurance services by the audit firm and, when applicable, network audit firms to the bank being audited may particularly affect a third party's perception of the external auditor's independence. Such situations should be evaluated for threats to the external auditor's objectivity and perceived independence.[75]

141. The external auditor considers potential threats to the auditor's independence, specifically the self-review threat, when advising management on accounting matters. For example, complex

[71] IESBA, *Handbook of the Code of Ethics for Professional Accountants*, Section 290.

[72] IESBA, *Handbook of the Code of Ethics for Professional Accountants*, paragraph 290.6, states: "Independence comprises:

(a) Independence of mind

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism.

(b) Independence in appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised."

[73] IESBA, *Handbook of the 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 in this section include related entities of the client (unless otherwise stated). For all other audit clients, references to an audit client in this section include related entities over which the client has direct or indirect control. 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."

[74] Public interest entities are defined in IESBA, *Handbook of the Code of Ethics for Professional Accountants*, paragraph 290.25, as:

"(a) All listed entities; and

(b) Any entity:

(i) Defined by regulation or legislation as a public interest entity; or

(ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator."

[75] IESBA, *Handbook of the Code of Ethics for Professional Accountants*, paragraphs 290.156–290.219, provide guidance on the provision of non-assurance services to audit clients and include prohibitions on the provision of certain non-assurance services to audit clients that are public interest entities.

transactions may be structured to achieve a particular accounting treatment and/or regulatory outcome. When an external auditor provides advice and recommendations to management on such matters, the external auditor must exercise care so as not to assume a management role or responsibility.

Professional scepticism

Expectation 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.

142. Professional scepticism is defined as "an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence".[76] Professional scepticism should manifest itself not only through the auditor obtaining corroborating evidence for management's assertions, but also challenging management's assertions, considering whether there are alternative accounting treatments that are preferable to those selected by management, and documenting the auditing approach, the evidence obtained, the rationale applied and the conclusions reached. Throughout the audit, the auditor "adopts a questioning approach when considering information and in forming conclusions".[77]

143. Exercising appropriate professional scepticism is critically important in audits of banks because of the number and significance of accounting estimates and the potential for limited objective evidence supporting those estimates. Professional scepticism is particularly important when auditing areas that:

(a) involve significant management estimates and judgments, especially those measurements involving a wide range of measurement uncertainty;

(b) involve significant non-recurring or unusual transactions; or

(c) are more susceptible to fraud and errors being perpetuated due to weak internal controls.

144. It is of particular importance that professional scepticism is exercised by the external auditor of a bank in the following areas: impairment calculations, fair value measurements and going concern assessments, including assessments of solvency and liquidity (see paragraph 187 for details). Other examples are complex transactions lacking substance or a sound business purpose that management has structured to achieve a particular accounting treatment and/or regulatory outcome where the audit engagement partner has or ought to have reasonable doubt that the proposed accounting treatment and/or regulatory outcome is consistent with the relevant financial reporting framework or regulatory requirements. In this context, the Committee expects the external auditor to challenge management's inputs and assumptions and form independent views. This includes challenging evidence obtained from management that corroborates management's view.

145. Where a bank consistently utilises valuations that exhibit a pattern of optimism or pessimism within a range of acceptable valuations, the Committee expects that the external auditor, in reviewing the judgments and decisions made by management of the bank, will consider the risk of management bias.[78] The Committee also recommends that the external auditor consider other areas with the potential to be affected by management bias, such as accounting estimates and classification of financial instruments, that are used in the calculation of banks' regulatory capital measures (see paragraph 157) as

[76] IAASB, *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements, Glossary of terms*.

[77] IAASB (February 2012), *Staff Questions & Answers – Professional Skepticism in an Audit of Financial Statements, Question 1*.

[78] ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21.

part of the risk assessment. The auditor informs those charged with governance, where appropriate, of any indicators of possible management bias.[79]

146. The evidence of the extent of professional scepticism exercised should be demonstrable and understandable through audit documentation that describes what conclusions were reached by the external auditor and how. In this regard, internationally accepted auditing standards establish minimum requirements for audit documentation.[80]

Quality control

Expectation 4: Audit firms undertaking bank audits should comply with the applicable standards on quality control.

147. Audit firms should comply with the applicable jurisdictional standards on quality control. Whether or not the jurisdictional standards are drawn from the internationally accepted standards on quality control (eg ISQC 1), the Committee recommends that audit firms undertaking bank audits also comply with the quality control requirements applicable to audits of listed entities in internationally accepted quality control standards.

148. The Committee recommends that the audit of a bank be subject to an engagement quality control review (EQCR)[81] and that the EQCR reviewer be involved from the early stages of the audit, rather than only at the end. The EQCR reviewer should have the technical qualifications required to perform the role, including the necessary experience and authority,[82] and should review how the engagement team has demonstrated professional scepticism during the course of the audit. Such considerations should be documented in the audit working papers. It is also important for the EQCR reviewer to address the degree to which the audit engagement team has considered accounting and relevant regulatory information.

149. EQCR is part of a broader firm-level system of quality control that emphasises quality and consultation and creates a culture of compliance with auditing and ethical standards and applicable legal and regulatory requirements (see ISQC 1.11(a)).

150. The Committee recommends that the EQCR reviewer's involvement at the group audit level not be restricted to the review of the audit of the parent or holding company, but that it also consider the quality control procedures performed at the component levels.

151. The involvement of the EQCR reviewer throughout the audit, and the outcome of the EQCR, should be evident in the audit working papers.[83] The Committee also recommends robust documentation of the engagement documentation reviewed and that the discussions between the EQCR reviewer and the audit engagement team on all matters of significant judgment be included in the working papers. Thus in jurisdictions where the supervisor has access to the external auditor's working papers, the extent and results of the EQCR would also be at the supervisor's disposal.

[79] ISA 260, *Communication with Those Charged with Governance*, Appendix 2.

[80] For example, ISA 230, *Audit Documentation*.

[81] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraph 35.

[82] ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraphs 39(a) and A47. Also, the technical qualifications of the engagement quality control reviewer should be consistent with supervisory expectations for the audit team as a whole as described in Expectation 1 and related explanatory text.

[83] ISA 220, *Quality Control for an Audit of Financial Statements*, paragraph 25.

Section B – Supervisory expectations and recommendations for the audit of a bank's financial statements

Identifying and assessing significant risks of material misstatement specific to a bank's financial statements

Expectation 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 the bank's activities and the effectiveness of its internal control environment.

Identifying potential risks

152. Banks are exposed to a variety of risks that can potentially affect the results of their operations or financial condition. These include, but are not limited to, credit risk, market risk, liquidity risk, operational risk, regulatory risk and solvency risk. New risks may emerge or the significance of each risk may change over time as a result of various factors that may be driven by changed circumstances or developments both internal and external to the bank.

153. In designing and performing the audit of a bank, the external auditor identifies and assesses the risks of material misstatements at the financial statement and assertion levels. The external auditor also gains an understanding of internal controls that are relevant to the audit, including the control environment of the bank.

154. To respond to the assessed risk of material misstatement, an external auditor follows an audit strategy that includes both substantive procedures and control testing. Given the nature of bank activities, including those involving a high volume of transactions, banks implement controls designed to address risks posed to the organisation where appropriate. As a result, the Committee expects the external auditor of a bank to perform appropriate tests on the relevant controls over the significant financial reporting process to assess whether, and to what extent, the auditor can rely on them.

Materiality

155. The external auditor needs to apply the concept of materiality appropriately in planning and performing the audit.[84]

156. The determination of what is material to the financial statements as a whole is a matter for the external auditor's professional judgment about misstatements that could reasonably be expected to influence economic decisions of users taken on the basis of the financial statements.

157. 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 reported in the financial statements or are derived from the financial statements. The Committee expects the auditor to consider these ratios as an input to the determination of materiality thresholds for the audit.

158. The external auditor exercises caution when evaluating identified misstatements even if they are below the materiality for planning purposes. These misstatements could be an indicator of more extensive control deficiencies within the bank that could potentially lead to material misstatements in the financial statements as a whole.

[84] ISA 320, *Materiality in Planning and Performing an Audit*, paragraph 8.

Assessing the risks of material misstatement

Internal control and its components

159. According to internationally accepted auditing standards, the components of internal control as they relate to a financial statement audit are the control environment; the entity's risk assessment process; the information system, including the related business processes, relevant to financial reporting, and communication; control activities; and monitoring of controls.[85]

160. As noted in the Committee's March 2013 letter to the IAASB suggesting enhancements to the ISAs and ISQC 1, [86] given the nature of banks' activities, their fiduciary and custodial duties, and the high volume of monetary transactions typically carried out by banks, some of which may be complex, a robust internal control environment is critical to the strength of a bank's governance system and its ability to manage risk. Consequently, when obtaining an understanding of the bank's internal control environment relevant to the statutory audit, the Committee expects the external auditor to, amongst other considerations:

- assess the "tone at the top", ie whether management, with the involvement of those charged with governance, is promoting a robust control environment;
- assess whether the same or a similar control environment extends to all types of operations and service offerings and encompasses all subsidiaries and branches of the banking group;
- understand the bank's approach to outsourcing/offshoring of business activities and functions and assess how internal control over these activities is maintained;
- obtain an adequate understanding of the organisation of key control functions within the bank and its subsidiaries. At a minimum, key control functions include the internal audit, risk management, compliance and other monitoring functions; and
- assess whether there are any material gaps in the bank's control systems and understand the level of risk tolerance defined by those charged with governance.

161. Compensation arrangements at a bank may be a good indicator of the culture within the organisation because they can influence the attitude towards risks of the bank's personnel and the quality of corporate governance. The Committee expects the external auditor to pay particular attention to the risks of material misstatement in the financial statements due to fraud,[87] especially where banks employ compensation arrangements that may encourage excessive risk-taking or other inappropriate behaviour amongst their personnel.

Control activities

162. Internationally accepted auditing standards require the external auditor to obtain an understanding of control activities relevant to the audit, which are those activities the auditor judges it necessary to understand in order to assess the risks of material misstatement[88] and to establish the audit strategy. An understanding of the control activities over the financial reporting process is critical for the design of further audit procedures in response to assessed risks. The Committee expects the external

[85] ISA 315 (revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, Appendix 1.

[86] See footnote 4.

[87] ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

[88] ISA 315 (revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 20.

auditor to take account of the following factors when identifying and assessing risks of material misstatement and assessing controls in a bank:

- the knowledge and competence of those in charge of financial reporting and of other control functions having an impact on financial reporting;
- the nature of hedging strategies employed by the bank which, if complex, improperly structured or inadequately monitored, can have accounting and solvency implications;
- the use of complex financial instruments involving estimates of fair value based on significant unobservable inputs;
- the provision of custodial services to retail and/or institutional clients and the procedures in place to avoid co-mingling of client and proprietary assets;
- the volume of transactions by type of activity and the presence of significant non-routine transactions;
- the use and monitoring of internal accounts;
- the structure and complexity of IT systems for conducting business and for facilitating efficient business and financial reporting, as they may lead to increased risk of fraud or error, particularly where there is potential for individual override of the control system or for fraudulent transactions to go undetected due to the sophistication and complexity of the IT systems;
- the number, scope and geographical dispersion of subsidiaries and the necessity for complex consolidation procedures;
- the existence of significant transactions with related parties; and
- the use of off-balance sheet financing arrangements, such as special purpose entities (SPEs) and other complex structures.

163. Bank management and those charged with governance, such as the audit committee, need to be satisfied that the bank's system of internal control is commensurate with the nature, volume and complexity of the bank's activities and is organised in accordance with regulatory and legal requirements. The internal control structure of a bank must be robust and reliable in order to cope with stressed environments.

Internal audit

164. The internal audit function is an important element of the overall internal control environment. It supports the board of directors and senior management by helping them to protect the organisation and its reputation through providing independent assurance on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes.[89] The work of internal auditors can help external auditors assess the quality of the internal control processes and identify risks.

165. When, based on the external auditor's preliminary understanding of the internal audit function, the external auditor expects to use the work of the internal audit function in obtaining audit evidence for the purposes of the financial statement audit, internationally accepted auditing standards require the external auditor to determine whether, in which areas, and to what extent, the work of the internal audit function can be used.[90] Irrespective of the external auditor's decision on whether to use internal audit work, the Committee expects the external auditor to engage with, and seek information on key internal audit findings from, the internal audit function. This may provide valuable input into the external

[89] BCBS (June 2012), *The internal audit function in banks*, Principle 1.

[90] ISA 610 (revised), *Using the Work of Internal Auditors*, paragraph 13 - 17.

auditor's understanding of the entity and its environment and aid in identifying and assessing risks of material misstatement. The external auditor reads relevant internal audit reports if the information obtained from engaging with the internal auditors indicates issues that may have an impact on the financial statement audit.

166. The Committee recommends that the external auditor provide written feedback about the audit engagement team's relations with the bank's internal audit function, including, where relevant, its observations on the adequacy of the work of the internal audit function, to those charged with governance. This information is also of particular interest to the bank's supervisor given the role an effective internal audit function plays in maintaining a robust control environment in a bank.

Responding to significant risks of material misstatement specific to a bank's financial statements

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

167. Having identified and assessed the risks of material misstatement, whether due to fraud or error, at the financial statement level and the assertion level, where the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, under internationally accepted auditing standards, the auditor designs and implements appropriate responses to those risks, including testing controls in the current period that the auditor plans to rely on[91] and performing substantive procedures that are specifically responsive to that risk.[92] Paragraphs 170–191 below set out key areas of a bank's financial statements where there may be a significant risk of material misstatement.

168. In addition to the areas set out in paragraphs 170–191, there are other items in a bank's financial statements whose regulatory treatment could give rise to incentives for management bias in the recognition or measurement of such items. As a consequence, there may be a greater risk of material misstatement of these items in the financial statements. This may lead to the inclusion of inappropriately measured items as inputs when applying regulatory rules and a material misstatement of the bank's capital position. Examples of such items are deferred tax assets, investments in unconsolidated entities, pension fund assets, and the classification of financial instruments. The Committee expects external auditors to be alert to any likelihood of the treatment of such items in the financial statements being influenced by management bias towards a desired regulatory outcome and consider this in their risk assessment of the bank. External auditors should also be aware that management bias may change over time depending on, for example, the extent to which the bank is able to meet its regulatory requirements. The Committee expects external auditors to evaluate areas within the financial statements which may be subject to that bias. Further, the Committee expects external auditors to evaluate any identified audit differences, errors and adjustments and consider their impact on regulatory capital or regulatory capital ratios, consistent with paragraph 156.

169. As the categories of what may be a significant risk for a bank may change over time, the list of audit areas provided in paragraphs 170–191 below are areas where there is often a significant risk of material misstatement. The list is not intended to be comprehensive.

Loan loss provisioning

170. Loan loss provisioning is generally material for a bank's financial statements and the calculation of capital and key performance metrics. The measurement of loan loss provisions in accordance with

[91] ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 15.

[92] ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 21.

internationally accepted accounting principles involves complex judgments about credit risk which may be subjective in nature.

171. The Committee expects the external auditor to consider the following factors in identifying and assessing the significant risks of material misstatement in relation to loan loss provisioning and the related allowance for loan losses. This list is not intended to be comprehensive.

(a) The estimation techniques used to compute provisions and how the techniques vary within and amongst banks (where possible).

(b) Whether an appropriate degree of caution has been exercised by management in judging anticipated cash flows and making other assumptions.

(c) All known and relevant impairment indicators for loan exposures which include previously unexpected adverse developments in the market or economic environment, adverse movements in interest rates, restructurings, inadequate underwriting policies adopted by the bank, overdue payments, failure of the borrower to meet budgeted revenues or net income, covenant breaches and forbearance.

(d) Whether the bank has sought perspectives and data from different functions within the bank, including risk management, credit and internal audit, as well as reliable sources external to the bank, including peer data and regulator perspectives so as to consider all relevant and available information in assessing impairment.

(e) Financial accounting rules for provisioning may differ from the provisioning rules that apply for regulatory reporting or capital purposes. It may therefore be customary for banks to have different processes and systems to generate loan loss provisions for financial accounting purposes and for regulatory purposes. Further, there can be material differences in the application of the same set of financial accounting and regulatory rules by individual banks. Nevertheless, large differences between provisions for financial accounting purposes and for regulatory capital purposes should be investigated by the auditor to ensure there is not a risk of material misstatement of the loan loss provision reported in the financial statements. In addition, whilst for regulatory capital purposes under the Basel framework the accounting loan loss provision for internal ratings-based approach portfolios is replaced by the regulatory expected loss provision, the level of the accounting provision may nevertheless have an impact on the level or the composition of regulatory capital, due to the treatment of the tax effect of provisions and the allocation of any excess provision to capital tiers. External auditors are alert to any management bias in this area.

(f) Disclosures should enable users to assess the loan loss provisioning methodology applied by the bank, regarding how it relates to credit risk for that bank, and how it compares with methodologies applied across the banking sector.

Financial instruments, including fair value measurements

172. A bank's portfolio of financial instruments measured at fair value can range from "plain vanilla" financial instruments that are frequently traded in liquid markets with observable market prices, and involve less measurement uncertainty, to those that are customised, complex, and where the valuation is based on significant unobservable inputs requiring a substantial amount of management judgment. Financial instruments measured at fair value also include financial instruments that are subject to an impairment assessment which may be a key area of judgment.

173. Where there are changes in the composition of a bank's portfolio of financial instruments – whether due to changes in customer demand, the bank's approach to managing risk and liquidity, or changes in prudential regulation – the bank will need to evaluate any accounting implications of the changes.

174. Accounting standards for financial instruments contain requirements for recognition; initial and subsequent measurement (including impairment); reclassification from fair value to amortised cost; derecognition; presentation; and disclosures.[93] Because these requirements are complex, they may be difficult to interpret and apply, and therefore the external auditor often needs to utilise more complex and wider-ranging audit procedures to obtain sufficient appropriate audit evidence to obtain reasonable assurance that the financial statements are not materially misstated. The accounting classification of an individual financial instrument may be particularly important for achieving a favourable regulatory outcome.

175. In adopting a sceptical approach to management's assumptions regarding the valuation of financial instruments for which there are significant unobservable inputs, IAPN 1000, *Special considerations in auditing financial instruments*, sets out specific audit procedures that may be followed in auditing financial instruments measured at fair value.

Liabilities including contingent liabilities arising from non-compliance with laws and regulations, and contractual breaches

176. Non-compliance with, or material breaches of, the prudential framework, conduct requirements, legal requirements or contractual agreements could lead to legal or supervisory actions against a bank, thereby exposing the bank to potential litigation and/or the imposition of substantial penalties. Such events may require recognition of provisions, contingent liabilities and/or qualitative disclosures in the bank's financial statements. Further, any adverse impact on the bank's reputation resulting from this non-compliance could have consequences for the bank's going concern assessment.

177. Internationally accepted auditing standards require the external auditor to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of identified or suspected non-compliance with laws and regulations to the auditor's attention.[94] As noted in paragraphs 91 and 101 above, if the external auditor identifies any such breaches of material significance[95] to the bank's supervisor, the auditor directly notifies the supervisor immediately (or, where not permitted, indirectly through the bank).

Disclosures

178. A number of factors have contributed to an increased demand from users of financial statements for more relevant and extensive qualitative and quantitative disclosures. This increased demand results from the greater complexity of business transactions, including off-balance sheet transactions and non-recognition of assets and liabilities, and the greater use of fair value and other accounting estimates, with significant uncertainties and changes in measurement attributes.

179. While accounting standards may specify disclosure objectives, the standards may not always prescribe in all circumstances specific disclosures to meet those disclosure objectives. Therefore, the external auditor may need to exercise a substantial amount of judgment in assessing whether disclosures are presented fairly in accordance with the disclosure objectives in the relevant accounting framework.

180. Increased transparency through fairly presented public disclosures enhances market confidence. It is therefore important that the bank provide disclosures that present the bank's financial condition, identify and describe the risks to which the bank is exposed and how they are managed, and are meaningful and responsive to changes in market conditions and perceived risks.

[93] See also BCBS (April 2009), *Supervisory guidance for assessing banks' financial instrument fair value practices*.

[94] ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 8.

[95] See footnote 9.

181. In responding to the significant risks of material misstatement in this area of an audit, the external auditor has an important role to play in evaluating whether the bank's disclosures are consistent and meaningful and, when taken as a whole, present the bank's financial condition in a way that is informative and understandable to users of financial statements.

182. The Committee recommends that the external auditor evaluate whether the disclosures included in the financial statements, both quantitative and qualitative, are sufficient, and are consistent with his/her understanding of the bank's risk profile, activities and strategy, in particular with regard to:

(a) the bank's overall objectives and strategies;

(b) the bank's control framework for managing its key business risks;

(c) the uncertainties associated with its key business risks; and

(d) all other related information included in the financial statements.

183. For banks in some jurisdictions, certain regulatory ratios may be published with the financial statements and are material to a wide range of users in assessing the performance of banks, eg capital ratios. In the course of its audit work, the Committee expects the external auditor to be alert to any indications that the regulatory ratios published with or included in the financial statements may not be consistent with the auditor's understanding of the bank's risk profile, activities and strategy.

Going concern assessment

184. Under internationally accepted auditing standards, the external auditor is responsible for obtaining sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.[96] Accordingly, the external auditor should remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on this ability to continue as a going concern.[97]

185. The work the external auditor performs to assess the going concern status of a bank is different from that likely to be performed for a non-bank entity because of the contractual terms of bank assets and liabilities (maturity mismatch) and the significant exposure to credit risk and the effect that provisioning may have on a bank's profit and loss and capital. In addition, the potential for regulatory intervention, and the impact that the signalling of any uncertainty over the bank's ability to continue as a going concern could have on the short-term viability of the bank, give rise to difficult and sensitive issues related to the reporting and disclosure of the bank's going concern status.

186. Examples of reasons that make the going concern assessment of a bank unique are as follows:

(a) Current emerging risks and concerns specific to the bank or the banking industry as a whole may have an adverse impact on projections normally based on the bank's own historical experience and trends such that the historical trends may not reflect the likely results over the next year. For example, during periods of market turmoil, normal sources of funding may no longer be available, as deposits payable on demand may run off more quickly than historical experience would suggest and such deposits may be difficult to replace.

(b) As banks are highly leveraged, a small change in asset valuation may have a substantial impact on the adequacy of a bank's regulatory capital. Market risks may be such that financial instruments held at fair value may be subject to substantial changes in value in the short term and significant volatility over the longer term. In addition, a significant increase in credit losses

[96] ISA 570, *Going Concern,* paragraph 6.

[97] ISA 570, *Going Concern*, paragraph 11.

due to deteriorating economic conditions may result in the need for substantial additional provisions by the bank. These may contribute to a significant decrease in regulatory capital and may result in a downgrade by rating agencies, making funding more expensive and possibly harder to obtain.

(c) Banks generally derive a significant amount of their funding from short-term deposits and other short-term liabilities. A loss of confidence by depositors and other creditors in a bank's solvency can quickly result in a liquidity crisis.

187. Given these and other risks, banks are required to meet liquidity requirements and capital ratios set by the bank supervisory authority. There should be appropriate emphasis on the evaluation of liquidity and solvency of the bank for the period over which the going concern assumption has been assessed:

(a) Liquidity:[98] Factors to assess include the reasonableness and reliability of the cash forecast for at least 12 months after the date of the financial statements, liquidity risk disclosures, regulatory or contractual restrictions on cash, loan covenants, and pension funding.

(b) Solvency:[99] Given the potential adverse impact of capital adequacy concerns on the confidence in a bank and, as a consequence, on the bank operating as a going concern,[100] the Committee expects the external auditor to consider the robustness of the bank's system for managing capital in response to the credit, market and other risks to which the bank is exposed.[101] In addition, the external auditor considers the capital position in relation to the current and any known future capital requirements, definitions of capital components, and challenges in raising capital. This is particularly critical where capital levels are strained, access to capital resources is restricted or where, for example, the bank's annual report or internal capital projections include ambitious projections of improvements in capital levels.

188. In responding to the significant risks of material misstatement in this area of the external audit, and in assessing management's assertion that a bank is a going concern, the Committee expects the external auditor to consider at least the following factors:

(a) the effectiveness of the bank's own systems and controls for managing liquidity, capital and market risk;

(b) the prudential information that is reported to supervisors covering the bank's solvency and capital;

(c) any external indicators that reveal liquidity or funding concerns; and

(d) the availability of short-term liquidity support.

189. 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

[98] See BCBS (December 2010, revised June 2011), *Basel III: A global regulatory framework for more resilient banks and banking systems*; and BCBS (December 2010), *Basel III: International framework for liquidity risk measurement, standards and monitoring*. See also the Committee's January 2014 papers on leverage ratio, net stable funding ratio and liquidity coverage ratios.

[99] See footnote 98.

[100] Non-compliance with capital requirements is one of the examples noted in ISA 570, *Going Concern*, paragraph A2, under other events or conditions that may cast significant doubt about the going concern assumption.

[101] The bank's system for identifying and measuring its regulatory capital and assessing the adequacy of its capital resources should be applied in relation to the bank's risk exposures and established minimum ratios, including management's process for stress testing.

continue as a going concern, the external auditor should promptly communicate this fact directly (or, where not permitted, indirectly through the bank) to the supervisors.

Securitisations – SPEs

190. The banking sector is involved in activities such as sponsoring (or originating) structured products/transactions that support maturity, credit and liquidity transformation risks more often than other industry sectors. The sponsoring bank may be exposed to risks such as reputational risk in the event that the sponsored entity encounters financial or operational difficulties.

191. The Committee expects that these activities would merit special consideration by the external auditor and are of interest to the supervisor for the following reasons:

(a) Accounting concern – Accounting frameworks are often principles-based, which may require significant management judgments and may result in different treatments of each of these complex transactions. In addition, because these are highly structured products, their accounting treatment may vary based on the facts and circumstances of each transaction, eg where SPEs are tailored to remain off the sponsoring bank's balance sheet. In these instances, it is necessary for the auditor to evaluate the judgments made by the sponsoring bank's management and consider whether the accounting treatment is appropriate and the disclosures are sufficient.

(b) Regulatory concern – Because of the complexity of many securitisation transactions and the chain of financial intermediation, the sponsoring bank may misstate the real risk transferred or the risk retained on its balance sheet (including reputational risk which might incentivise it to support its securitisations, and conflicts of interest in case of defaults on the securitised assets). Even so, the originator may be able to benefit from an off-balance sheet accounting treatment for the assets underlying these transactions, and may not be required to hold regulatory capital against its securitisation exposures unless specifically required by the supervisor or the relevant regulatory rules.

Annex 1

Examples of the contents of extended reports provided by external auditors to supervisors

In certain jurisdictions, it is a well-established practice that external auditors submit to the supervisor an extended report (the so-called long-form audit report) on the audited financial statements of banks. These reports form part of the statutory audit work. The following is a list of examples of the potential content of such reports, but the list is not meant to be exhaustive.

Contents relating to the audit of the financial statements

- Description of the annual audit mandate, the audit strategy and the audit procedures.
- Description and assessment of the significant accounting and valuation methods, including structured and complex accounting activities (eg asset-backed securities transactions, sale and leaseback transactions, use of special purpose entities, and barter transactions).
- Description of significant events that took place during the year under review.
- Description of material changes to the legal, financial and organisational basis of the bank (eg changes to the legal form, the capital structure, the company structure, the organisational structure, the composition of the board, the structure of banking operations and financial services provided, the lines of business, and the relations with affiliated parties).
- Description of the internal controls over significant procedures and internal control functions (eg risk management, compliance, internal audit, audit committee, and management information systems).
- Assessment of business performance.
- Assessment of the development of the net asset position, especially the nature and extent of off-balance sheet assets and liabilities.
- Comments and explanation on individual balance sheet items and profit and loss accounts, taking the principle of materiality into consideration.
- Comments on whether the balance sheet items have been properly valued, the valuation adjustments and provisions are appropriate, and the reporting requirements have been fulfilled.
- Description of material agreements and pending legal disputes where these may have adverse effects on the net asset position.
- Description of the contents and assessment of the enforceability of letters of comfort issued.
- Assessment of the earnings position, including a description of the most important sources of and factors for generating earnings.
- Assessment of the risk situation, the procedures for determining risk provisioning and the adequacy of risk provisioning.
- Description of major features and material risks of the lending business, including risk concentrations and the way they are dealt with within the bank.

- Description of general credit lines and noteworthy loans (eg significant non-performing loans, loans for which sizeable loan loss provisions are necessary or were necessary in the concluded financial year, significant loans to board members, and loans for which an exceptional type of collateral has been provided).
- Follow-up on serious irregularities and weaknesses observed during previous audits.
- Summary of the key findings and results of the audit.

Contents relating to special prudential supervisory requirements

- Assessment of the adequacy of risk management, including the internal control system and the internal audit and compliance functions.
- Analysis of the bank's exposure to credit risk/counterparty risk, market risk, interest rate risk, settlement risk, foreign exchange risk, liquidity risk, profitability risk and operational risk.
- Analysis of the amount and composition of the bank's own funds that have to be reported to the supervisor.
- Assessment of the appropriateness of procedures for the preparation of prudential returns.
- Assessment of the appropriateness of measures taken by the bank to determine the level of own funds, its liquidity ratio and its solvency ratio.
- Assessment of the liquidity position and the liquidity management system of the bank.
- Description and assessment of the provisions for preventing money laundering and terrorist financing.
- Description and assessment of the provisions on conduct of business rules.

Annex 2

Guidelines on the timing and examples of content of meetings between supervisors and external auditors

This annex provides guidance on the timing and examples of the potential content of meetings between supervisors and external auditors, as circumstances may dictate. The examples include types of matters of supervisory interest on which external auditors can reasonably be expected to form views, but which fall outside the usual "duty to report/alert" obligations.

Planning stage

- Risk assessment and scope – assessments in light of the external environment and the bank's performance, business model and risk appetite.
- Recent supervisory risk assessments and other supervisory reviews if appropriate confidentiality rules are in place.
- Audit strategy/approach and views on materiality.
- Observations on internal controls (eg governance effectiveness, control environment, application controls and monitoring controls).
- Fraud due to deficiencies in the control environment.
- Views and judgments on key risk areas based on audit/supervisory work performed to date (where confidentiality rules permit), including specific significant transactions, material valuations and impairment decisions, and methodologies and assumptions.
- Assessment of risks relating to the going concern assumption.
- Accounting policy application and changes.
- Sources of potential management bias.
- Culture and tone set from the top.
- Audit issues from previous years and how the firm has addressed them.
- Extent of work on internal controls over regulatory reporting, including capital.

Pre-close

- Update on all areas covered in previous meetings.
- Adequacy and reliability of disclosures in light of statutory reporting requirements and risks, transactions, judgments, and assumptions discussed in the present meeting and previous meetings.
- Critical accounting estimates and indications of management bias.
- Analysis of management's going concern assessment.

- Content of (anticipated) reporting to those charged with governance.
- Unadjusted differences and the auditor's evaluation in light of materiality.
- Material control weaknesses identified in the bank's financial and regulatory reporting processes.
- Views on the control environment around regulatory reporting and calculation of capital resources.
- Possible modifications to the audit report.
- Additional matters arising from the audit.

Other

Additional meetings may be held as appropriate during the audit phase, and after the conclusion of the audit to debrief on matters considered during the annual audit cycle and to consider any assessment of risks and anticipated issues.