Federation of European Accountants
Fédération des Experts comptables Européens

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel

E-mail: baselcommittee@bis.org

21 June 2013

Ref.: BAN/AKI/HBL/SRO

Dear Madam,
Dear Sir,

Re: FEE Comments on the Consultative Document on External Audits of Banks

(1) FEE[1] (the Federation of European Accountants) is pleased to provide you below with its comments on the Consultative Document on External Audits of Banks (the Document).

Liaison with the IAASB

(2) FEE welcomes the Basel Committee's consultation on external audits of banks that is aimed at further improving audit quality and enhancing the effectiveness of prudential supervision.

[1] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.
FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

(3) Based on our monitoring of the Basel Committee's work, we are aware of the Committee letter sent to the IAASB Chairman Arnold Schilder dated 21 March 2013[2] about the interrelation between the IAASB work programme and the guidance published by the Committee. In our view, the statements made in that letter are not in line with the Consultative Document, which could be misleading.

(4) We note indeed that many of the principles outlined in the Basel Committee public consultation that pertain to auditors' behaviour are already dealt with in the principles-based pronouncements of independent IFAC Boards (IESBA Code of Ethics, ISAs and ISQC1) and, therefore, need not be repeated without appropriate acknowledgement of this fact. Otherwise this could draw an artificial distinction between bank auditors and any other auditors.

(5) Furthermore, the detailed suggestions made to the IAASB underlying the 16 principles are generally rules-based, prescribing what the Basel Committee believes to be needed for adherence to the bank audit principles that we in substance support. This means that whereas the ISAs are principles-based, many of the Basel Committee's proposals, if followed, would result in detailed rules-based requirements applicable for the audits of all banks, which might not take into consideration the specifics of individual audited credit institutions. To tackle this issue, a thorough analysis of the recommendations pertaining to auditor behaviour comparing each of them directly to the relevant existing requirement of the applicable standards etc. would be extremely useful in order to differentiate:

a. The areas in which the Basel Committee is merely reaffirming the necessity for existing requirements; and
b. Those areas where the Committee is either calling for strengthening (revising) existing requirements or for additional guidance as to their application.

While we note that some references to ISAs and other standards have been included, such referencing has not been undertaken consistently.

(6) Finally, suggestions that relate to matters beyond auditor behaviour would need consideration by parties other than auditing standard setters. In other words, FEE would suggest the Basel Committee differentiates between what is already required, what is seen as firming up on existing requirements and what is really a new idea.

Support to enhanced supervisor – auditor dialogue

(7) We are supportive of the main principles enshrined in the Document and most of our comments address the more specific and detailed provisions underlying these principles.

(8) We particularly value the intention to foster more efficient dialogue between the supervisor, auditor and other relevant stakeholders. This dialogue is considered particularly important in order to assist the supervisor in maintaining the stability of individual banks and the banking system as a whole.

[2] http://www.bis.org/bcbs/commentletters/ifac45.pdf

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

(9) We agree that the supervisor can benefit from the results of the external auditor's work because, in many respects, the two parties have complementary objectives, although their focus is different. Similarly, the external auditor may benefit from insights that the supervisor can communicate to him based on an overview of the entire industry sector. The document sets out significant expectations about communications from the external auditor to the supervisor but provides minimal guidance on communications from the supervisor to the external auditor. Reciprocal communications from the supervisor to external auditors have an important role to play in supporting improved audit quality. It should be noted that in many EU Member States there is room for improvement in this communication, whereas we see good practices in others.

Scope

(10) With regard to the scope of the proposals in the Document, many banks and, in some jurisdictions all of them, are defined by the competent legislator (the European Union and EU Member States in our case) as public interest entities ("PIEs"). Once this is the case, the audit, quality control and ethical rules for PIE audits apply and should apply to them. However, where the competent legislator decides that certain banks are not PIEs, the need to apply all principles of PIE audits to such banks should be seriously considered.

(11) Indeed, the Document proposes the same level and type of requirements for the external auditor regardless of the relevant characteristics of the audited bank. We propose the Document highlights that the supervisor's expectations on external auditors should differ based on the risk, the complexity, the size and the type of the audited bank. Having regard to the scale of the differences in the current global banking industry, the "one size fits all" approach is clearly disproportionate and ineffective.

(12) The Document makes several references to additional work that the auditor performs for the supervisor, either as part of the statutory audit or as a separately defined specific engagement. We understand that, since ISAs are not industry-specific, the supervisors expect external auditors to tailor their audit work in response to specific risks associated with the banking business. We wish to stress that the role of the auditor in discharging his audit duties, as opposed to providing other professional services based on separate regulatory requests, needs to be clearly distinguished. Care must be taken to avoid creation of any existing or perceived conflicts between these roles.

(13) We therefore strongly recommend that the Basel Committee further clarifies the scope of the work and the audit procedures that are expected from the auditor for prudential regulatory purposes. This is particularly important, since none of the paragraphs defining supervisor's expectations of the auditor starts with the standard wording "during the course of the audit ...", which is the usual expression that highlights a procedure anticipated as part of the standard audit work.

(14) In this context, from our point of view, the title of the guidance 'External audits of banks' might be misleading. The principles set out in the guidance refer not only to the external auditor, but also to audit committees, supervisors etc. Accordingly, we suggest a title that would imply a broader perspective of the subject matter such as 'The basic principles for the external audits of banks'.

For our detailed comments on the proposed principles, please refer to the Appendix of this letter. In the case of any queries, please contact Hilde Blomme, Deputy Chief Executive at +32 2 285 40 77 or via email at hilde.blomme@fee.be from the FEE Secretariat.

Yours sincerely,

André Kilesse
President

Olivier Boutellis-Taft
Chief Executive

Principle 1: Knowledge and competence

(15) We agree with the proposed principle.

(16) In line with our comments above, it should be noted that auditors are already required to adhere to this principle. (IESBA Code Section 130, ISCQ 1. 29-30 and ISA 220.14).

Principle 2: Objectivity and independence

(17) The principle requires that "The external auditor of a bank should be objective and independent in fact and appearance with respect to the bank, consistent with the more stringent requirements applicable to public interest entities in internationally accepted ethical standards".

(18) As highlighted in the body of our letter, we believe that the definition of PIEs should determine the type of entities to which more stringent audit independence and objectivity rules in the IESBA Code of Ethics should apply, rather than making these rules uniformly applicable to the auditors of all types of banks. There are banks that would not necessarily fall under the scope of the existing definition of PIEs and the definition is usually a matter of national consensus, which is embedded into national legislation.

(19) Paragraph 45 requires that the external auditor/audit firm should comply with the independence requirements of both the home jurisdiction and the overseas regulatory authority. FEE is a long-term and consistent promoter of global standards that implement best practices and limit space for regulatory arbitrage. Saying that, we do not support cross-border effects of national legislation (so called "gold-plating"), since it could impose very complex regulatory environment. Therefore, we consider this proposal too stringent and potentially conflicting. The external auditor/audit firm should comply with the independence guidance and requirements which they are bound to follow by valid legal, professional and contractual obligations.

Principle 3: Professional scepticism

(20) We agree with the proposed principle.

(21) We are concerned that paragraph 49 may inadvertently imply, by drawing on the attention of professional scepticism, that an auditor can overcome the auditing issues associated with a lack of accounting evidence encountered in relation to accounting estimates. This may need further clarification to avoid widening the expectations gap.

(22) However, paragraph 50 extends the scope of the work that auditors should perform when investigating and challenging management assumptions and judgements that are related not only to the relevant financial reporting framework, but also to regulatory outcome of complex transactions. We also question the proposal that challenging management's assumptions and judgments would entail a requirement for the auditor to challenge evidence obtained from management that corroborates management's view, In our opinion, the need to challenge evidence would depend on the nature of the particular evidence in question.

(23) The auditor should be required to consider the regulatory outcome only if such consideration is within the scope of his engagement, since the content of a standard audit opinion currently does not include a report on regulatory outcomes.

Principle 4: Quality control

(24) The Committee expects the external auditor of a bank to comply with the most stringent requirements on quality control applicable in internationally accepted quality control standards (ISQC 1).

(25) As in our earlier comment raised on Principle 2: Objectivity and independence,, we believe that the more stringent requirements on quality control should be applied to those entities for which they were designed by the IAASB.

(26) The requirements, as proposed in paragraph 57, are covered by those required by the relevant ISAs (ISQC 1.37 and ISA 220.20 and the documentation in line with ISQC 1.42 and ISA 220.25) or similar national auditing standards. Therefore, we are not convinced for the Basel Committee to introduce explicit additional requirements in this respect, since the audit report clearly refers to the fact that the audit has been performed following the ISAs or relevant national auditing standards. Moreover, we do not see such requirement as being bank-specific.

Principle 5: Identifying and assessing significant risks of material misstatement specific to a bank's financial statements

(27) We agree with the proposed principle.

(28) However, paragraph 60 refers to "extensive tests of controls over financial reporting" that the external auditor should perform. We think this is confusing and the Committee should provide further clarification as to what they mean by extensive test of controls and whether this principle only stresses the existing requirements of ISAs or whether the intention is to go beyond them.

Principle 6: Responding to significant risks of material misstatement specific to a bank's financial statements

(29) We agree with the proposed principle.

(30) We think that the proposed specific requirement (Paragraph 79(f)) to compare the loan loss provisioning methodology used by the bank with methodologies applied across the banking sector will be particularly difficult to implement for small and medium-sized banks and should be addressed by the applicable financial reporting framework rather them by audit guidance. Therefore we recommend removing the last part of the sentence "and how it compares with methodologies applied across the banking sector".

(31) Further clarification is required of the last sentence in paragraph 82 - whether it refers to the financial reporting classification of an individual financial instrument, which can have an impact on the regulatory capital, or to the regulatory classification of the same instrument.

(32) Paragraph 85 implies that the auditor should focus on interests of the supervisor in that it refers to actual or suspected breaches of prudential regulations, to which the external auditor should be alert and notify the supervisor immediately when such issues are identified. It is not clear whether the intention is that such notification is that it should be performed as an inherent part of the audit procedures or outside the course of the audit as part of a special engagement or legal obligation. Further clarification will also be needed as to the scope of the work and the audit procedures that are expected from the auditor for regulatory purposes. In FEE's view, determining additional requirements as to these regulatory requirements is a matter to be addressed at national level as this would enable due consideration to be given to specific national circumstances.

Principle 7: Appointment of the external auditor

(33) We agree with the proposed principle. However, in paragraph 103, we recommend also highlighting the important role of the shareholders in the final appointment decision, which is becoming best practice.

(34) Paragraph 105 should clarify what supporting information on the tenure of the incumbent auditor should be included in the bank's annual report. We recommend including in the audit committee report the information on the length of service of the key audit partners on the audit engagement, which in line with existing international standards, would constitute a safeguard the auditor is already required to communicate to those charged with governance pursuant to ISA 260.17 in conjunction with ISA 260. A 23.

(35) With reference to paragraph 110, we doubt that 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 as a standard practice for the different following reasons. First of all, according to the current regulation in this regard, this role is kept in the hands of those charged with governance (the Board or the Supervisory Board in case of a two-tier system). In addition, in many circumstances, banks are not PIEs, and are therefore not obliged to establish an audit committee according to the 2006 Audit Statutory Directive.

Principle 8: Independence of the external auditors

(36) We agree with the proposed principle.

(37) We challenge the view that the length of an external auditor's tenure may have an impact on the audit quality and independence.

Principle 9: Effectiveness of the external audit

(38) We agree with the proposed principle.

(39) In respect of paragraph 123, while we believe it is important for the audit committee to be informed of significant accounting and auditing matters, including alternative treatments, we do not agree that it is necessary to attribute these views between members of the engagement team (i.e. between the engagement partner and the engagement quality control reviewer).

(40) Paragraph 124 requires that "the audit committee should also discuss with the external auditor the audit representation letters before signature by the board of directors/senior management and give particular consideration to matters where specific representation has been requested." We wish to highlight the fact that representation letters cannot be issued after the date of the auditor's report on the financial statements, so such requirement would potentially cause logistical obstacles in most cases. We are not sure whether such 'ex ante' discussion would add value. However, we acknowledge that the audit representation letter could be shared and discussed with the audit committee 'ex post'.

Principle 10: Relationship between the audit committee and the external auditor

(41) We agree with the proposed principle.

(42) Similarly to earlier comments, the scope of the work of the external auditor should be further clarified in the context of paragraph 132, which requires the audit committee to discuss with the auditor any matters arising from the audit that may have an impact on regulatory capital or disclosures. In FEE's view, determining additional requirements as to the regulatory capital or disclosures that should be discussed is a matter to be addressed at national level as this would enable due consideration to be given to specific national circumstances.

Principle 11: Reporting by the external auditor to the audit committee

(43) We agree with the proposed principle.

Principle 12: The supervisor and the external auditor should have an effective relationship

(44) We generally agree with the proposed principle, but, for this to be effective, we would welcome an explicit reference in the principle to the two-way communication.

(45) While we see advantages for both bilateral and trilateral meeting, the document should define the trilateral meeting as the standard model and further specify those situations where bilateral meetings are neither justified and/or preferable.

(46) Paragraph 146 mentions that neither the supervisor nor the external auditor 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. We recommend revising the text for the following reasons: in our view, confidentiality should be taken into account and mentioned. Moreover, this statement can be misinterpreted in a way that the possibility to use the work of the other is excluded.

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

(47) We believe that this principle should be combined with principle 12, since proper implementation of that principle fully includes such requirement.

Principle 14: There should be open, timely and regular communication between the banking supervisory authority, the audit firm and the accounting profession as a whole on key risks and systemic issues as well as a continuous exchange of views on appropriate accounting techniques and auditing issues

(48) We strongly agree with the proposed principle and are ready to promote such communication.

(49) We note, however, that the accompanying paragraphs 170 to 176 do not refer to an exchange of views on appropriate accounting techniques and auditing issues. In this context we would like to note that it would be appropriate for both financial reporting and auditing standard setters to be involved in discussions as to views on accounting techniques and auditing issues. This ought to be clarified in the paper.

Principle 15: There should be regular and effective dialogue between the banking supervisory authority and the relevant audit oversight body

(50) We agree with the proposed principle. There should be both a clear split of responsibilities between these bodies that avoids overlaps and blank spots and open communication protocols and practices.

Principle 16: The banking supervisory authority and the audit oversight body should observe appropriate confidentiality requirements when sharing information

(51) We agree with the proposed principle.

Annex 1

Guidance on the content of extended reports provided by the external auditors to supervisors

(52) Regarding the extended report, we believe the content and the scope of the report should be defined by national regulatory requirements after taking into account the relevant legal framework, professional standards as well as the views of supervisor and the audit profession on these matters. Therefore, we consider it impractical to set the report contents at a global level.

Annex 2

Guidance on the timing and content of meetings between supervisors and external auditors

(53) We consider the outline of potentially relevant topics as a useful tool to define agendas for such meetings. However, we believe that the list would benefit from adding items linked to a two-way communication, i.e. from the supervisors to external auditors.