

June 21, 2013

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

Response e-mailed to www.baselcommittee@bis.org

RE: Response to the Basel Committee on Banking Supervision
Consultative Document – “External audits of banks”

Dear Sir/Madam:

The Institute of Internal Auditors (IIA) appreciates the opportunity to provide comments on the Consultative Document entitled “External audits of banks” dated March 2013. Our comments are based on thorough analysis and discussions, utilizing a core team of audit and banking experts who serve on The IIA’s Professional Issues Committee. These professionals include Certified Internal Auditors, Certified Public Accountants, and Chartered Accountants, among others, with extensive experience in financial institutions across the globe.

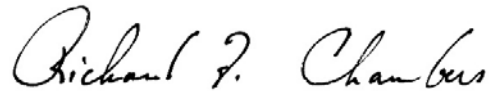
Our principal comments regarding the Consultative Document are below. Detailed responses are summarized in Appendix A.

The recent global financial crisis brought attention to weaknesses in risk management and governance processes in banks and underscored the necessity to, among other things, assess the quality of external audits of banks and the interaction of audit committees with external auditors.

The need to reinforce the importance of effective dialogue and regular communication between the banking regulatory/supervisory authorities and the external auditor became apparent. Furthermore, it became evident that the quality of the external audits of bank financial statements should be examined as part of efforts to help restore market confidence. In particular, the external audits of banks should also focus on enhancing and validating the going concern concept of a bank, by including stress tests, tests on liquidity, capital adequacy requirements, provisions for losses, as well as, the treatment of anticipated losses from these tests in the financial statements in accordance with recognized accounting standards.

The IIA is well-equipped to support those Basel Committee projects that are related to the core competencies of internal auditing: governance, risk management, and internal control. We value the opportunity to collaborate, share, contribute and learn. We welcome further discussion on any of these recommendations and offer our assistance in the continued development of such projects.

Best Regards,

A handwritten signature in black ink that reads "Richard F. Chambers". The signature is written in a cursive, flowing style.

Richard F. Chambers, CIA, CGAP, CCSA, CRMA
President and Chief Executive Officer

About The Institute of Internal Auditors

The IIA is the global voice, acknowledged leader, principal educator, and recognized authority of the internal audit profession and maintains the International Standards for the Professional Practice of Internal Auditing (*Standards*). These principles-based standards are recognized globally and are available in 29 languages. The IIA represents more than 180,000 members across the globe and has 109 affiliates in 190 countries that serve members at the local level.

Section two – Introduction

- Paragraph 4 states “the banking sector is unique among sectors...” We suggest including further definition of the unique attributes and risks associated with this sector. Nearly all sectors have unique characteristics and additional clarification of those attributes evidencing the banking sector’s particular uniqueness might be helpful.

Section two – Application

- Paragraph 10 includes three bullet points, of which bullet point two and three are similar and require further explanations to highlight the difference between “holding companies whose subsidiaries are predominately banks” and “holding companies subject to prudential supervision whose subsidiaries are predominately banks.”

Section three – Overview of the principles

- Principles five and six state that “external auditor of a bank should identify and assess the risks of material misstatements...” and the external auditor “should respond appropriately to the significant risks...” We suggest including a statement that external auditors should also identify material gaps in the bank’s control systems and understand the level of risk tolerance defined by the bank’s board of directors.
- Principle thirteen requires “the external auditor to report to the supervisor matters that are likely to be of material significance to the functions of the supervisor.” This statement could be enhanced by acknowledging the reciprocal benefits of having supervisors also alert the external auditors on matters of material significance.

Section four – Supervisory expectations relevant to the external auditor and the external audit of financial statements

- Paragraph 26 – We believe internationally accepted auditing standards already require external auditors to “tailor their audit work in response to the significant risks and issues applicable to banks.” The wording of this paragraph implies current auditing standards do not have this requirement.
- Paragraph 31 – We fully support communication between the supervisor and the external auditor. However, the statement that “The outcomes of these interactions will inform the supervisor’s views as to the quality of the external audit and contribute to the supervisory process” implies the communications alone are adequate to assess the quality of the external auditor’s work.

Section four B – The supervisor’s expectations of the external auditor of a bank

- Paragraph 66 – The second bullet point is unclear when it states “determine whether the control environment extends...” By definition there are control environments for all of the bank’s operations, service offerings, subsidiaries and branches. If the intention of the statement is to describe the consideration of whether the same or similar control environment attributes extend to all of these parts, the wording could be clarified.

- Paragraph 71 - We suggest requiring external auditors to assess whether internal auditors comply with an internationally recognized body of internal audit standards such as the International Standards for the Professional Practice of Internal Auditing (*Standards*) issued by The Institute of Internal Auditors (IIA), inclusive of an assessment of conformance with such standards (known as a quality assessment).

Section six A – Relationship at the supervised bank level

- Paragraphs 154 and 155 imply the responsibility is on the external auditor to determine the issues that are important to the supervisors. This may result in an extremely difficult position for the external auditor who may not fully know or be aware of all the interests of the supervisor. The wording should qualify this expectation to those matters the external auditor understands or believes are of interest and importance to the supervisor, based on prior discussions and other relevant communications.