

**Meeting:** IAASB Consultative Advisory Group (CAG)  
**Meeting Location:** New York, USA  
**Meeting Dates:** September 15–16, 2015

## Agenda Item D

### Special Audit Considerations Relevant to Financial Institutions

#### Objectives of Agenda Item

1. The objectives of this agenda item are to:
  - Inform Representatives and Observers on the Financial Institutions Working Group's (WG) activities to date, audit issues relevant to financial institutions, and the WG's recommendations on the way forward.
  - Obtain Representatives' and Observers' views on issues related to the financial institutions project and related WG recommendations.

#### Background

2. In the IAASB's *Work Plan for 2015–2016*,<sup>1</sup> (the Work Plan) the IAASB committed to a project on special audit considerations relevant to financial institutions. This project contributes to the IAASB's response to the key implementation issues identified from its ISA Implementation Monitoring project and to address auditing issues of importance to supporting global financial stability. To this end, Appendix 1 to this paper includes an extract from the Work Plan outlining the initiative.
3. At the start of 2015, the IAASB established a WG to explore issues involving auditing financial institutions.

#### Outreach Activities

4. Since its commencement, the WG has done significant outreach activities to identify issues involving financial institutions. The leadership of the WG and staff met with, amongst others, representatives of the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS) and the Basel Committee on Banking Supervision (BCBS) Accounting Expert Group. See Appendix 2 for a complete list of outreach activities to date.
5. The leadership and staff of the WG also met twice with the Global Public Policy Committee's<sup>2</sup> (GPPC) Banking IAASB Liaison Subgroup. This subgroup has been assembled by the GPPC to bring together expert financial institution auditors to act as a sounding board for the WG.
6. The IAASB's work in this area has received further input via letters from the IAIS and BCBS, as well as the findings of the ISA Implementation Monitoring project.

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<sup>1</sup> [www.ifac.org/sites/default/files/publications/files/IAASB-Work-Plan-2015-2016.pdf](http://www.ifac.org/sites/default/files/publications/files/IAASB-Work-Plan-2015-2016.pdf)

<sup>2</sup> The GPPC comprises the six largest international accounting networks: BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PwC.

## Project Status

7. The outreach activities identified above formed the basis of the WG's presentations to the March and June 2015 IAASB meetings. The key themes arising from the outreach activities included:
- Financial institution regulators and auditors alike believe that the IAASB should focus on the audit issues for financial institutions arising from the impending adoption of IFRS 9<sup>3</sup> ahead of its implementation for annual periods beginning on or after 1 January 2018. The area of most concern is the shift from an incurred loss model for loan loss provisioning to an expected credit loss (ECL) model, for example:
    - Impairment is based on 12 month ECL or lifetime ECL depending on the credit quality since initial recognition.
    - Management has to calculate lifetime ECL for all loans that have a more than insignificant deterioration in credit quality (underperforming credit) and loans that have objective evidence of impairment (non-performing credit). The calculation of the lifetime ECL is forward-looking and therefore substantially different from IAS 39.<sup>4</sup>
  - The International Accounting Standards Board's (IASB) insurance contracts project<sup>5</sup> may also require specific focus from the IAASB when finalized, which is expected in 2016, as it is intended to reduce the diverse practices that are used in accounting for insurance contracts.
  - The role and use of experts in the audit of financial institutions is an area of increased importance. For ECL provisions, using credit risk experts is key for both management and the auditor.
  - The importance of the IAASB engaging with stakeholders including regulators (such as the International Forum of Independent Audit Regulators, as well as the US Public Company Accounting Oversight Board in relation to their projects on auditing accounting estimates<sup>6</sup> and fair value measures and the use of specialists<sup>7</sup>), financial institution supervisors, financial institutions, and auditors of financial institutions.
  - The importance of an auditor-regulator dialogue for audits of financial institutions, particularly at the beginning and at the end of the audit.
8. Informed by this outreach, the WG presented its initial views on the issues identified and an initial view on the way forward at the March and June 2015 IAASB meetings. At its March 2015 meeting, the IAASB encouraged the WG to conduct further research on the issues to be addressed in relation to the audit of financial institutions, including IFRS 9, to determine a way forward, and also supported the development of an International Auditing Practice Note (IAPN) on the relationship between auditors and banking and insurance supervisors.

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<sup>3</sup> International Financial Reporting Standard (IFRS) 9, *Financial Instruments*

<sup>4</sup> International Accounting Standard (IAS) 39, *Financial Instruments: Disclosure and Presentation*

<sup>5</sup> An update on the Insurance Contracts project is available at [www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Documents/2015/High-level-project-update-January-2015.pdf](http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Documents/2015/High-level-project-update-January-2015.pdf).

<sup>6</sup> [pcaobus.org/Standards/Pages/SCP\\_Accounting\\_Estimates\\_Fair\\_Value.aspx](http://pcaobus.org/Standards/Pages/SCP_Accounting_Estimates_Fair_Value.aspx)

<sup>7</sup> [pcaobus.org/Standards/Pages/SCP\\_Specialists.aspx](http://pcaobus.org/Standards/Pages/SCP_Specialists.aspx)

9. At the IAASB's June 2015 meeting, the WG proposed refocusing the WG's efforts on the audit issues arising for financial institutions from the implementation of IFRS 9, particularly regarding the shift to an ECL model for loan loss provisioning. In general, the Board agreed with the WG's proposal but asked the WG to perform a gap analysis to determine whether and, if so, the extent to which, extant ISA 540<sup>8</sup> addressed the audit issues arising from IFRS 9.

#### *Audit Quality Enhancements Coordination Group*

10. Aspects of the Financial Institutions project is to be included in the Invitation to Comment (ITC) being prepared by the Audit Quality Enhancement Coordination Group for issues that have broader implications beyond audits of financial institutions. The particular areas being considered for inclusion in the ITC are certain broader issues related to auditing accounting estimates and using the work of experts such as actuaries and others – matters pertaining to IFRS 9 are not included so as not to delay that important work stream. A list of the topics that the Financial Institutions WG believes should be included in the ITC is included in **Agenda Item D.3**.
11. The work of the Audit Quality Enhancement Coordination Group will be discussed as part of **Agenda Item F**.

#### **Matters for CAG Consideration**

12. The Representatives and Observers are asked for their views on the matters for CAG consideration included in **Agenda Item D.1**.

#### **Material Presented – IAASB CAG PAPERS**

Agenda Item D.1	Financial Institutions – Issues and Working Group Recommendations
Agenda Item D.2	Gap Analysis – ISA 540 and IFRS 9 Audit Issues
Agenda Item D.3	Possible Topics for Inclusion in the Invitation to Comment

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<sup>8</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

## Appendix 1

### Extract from the IAASB's Work Plan for 2015–2016

*The following text is extracted from the IAASB's Work Plan for 2015–2016 and describes the planned work of the Financial Institutions Working Group.*

#### Special Audit Considerations Relevant to Financial Institutions

##### Issues that May Be Addressed

1. Issues identified from the ISA Implementation Monitoring project coupled with specific requests from banking regulators (and to some extent from insurance regulators), as well as responses to the Consultation Paper, relevant to financial institutions include:
  - (a) In relation to special considerations relevant to audits of banks—The need to clarify and enhance the relationship between the banking supervisors and the bank's external auditors, as necessary and appropriate in light of the related efforts of BCBS in this area; and address issues of particular significance in audits of banks or other depository or investment institutions. For example, the BCBS has suggested consideration should be given to these entities' use of fair value accounting and related estimates, including but not limited to impairment and loan loss provisioning, as well as other ISAs particularly relevant to the audits of banks and other financial institutions, including International Standard on Quality Control (ISQC) 1,<sup>9</sup> ISA 250,<sup>10</sup> ISA 260,<sup>11</sup> ISA 315 (Revised),<sup>12</sup> ISA 540, ISA 570<sup>13</sup> and ISA 620.<sup>14</sup>
  - (b) In relation to issues arising in the insurance industry—IAIS has highlighted the need for consideration of audit issues of particular relevance to insurers, particularly given the accounting developments in this area and the significance of these changes to insurers.<sup>15</sup>
  - (c) In relation to other ISA 540 issues—Further consideration may be needed as to whether the issues relating to ISA 540 that have been highlighted as particularly relevant to audits of banks and other financial institutions are more broadly applicable to other entities. In addition, other specific issues relating to ISA 540 identified include the application of professional skepticism (e.g., how auditors obtain audit evidence, challenge and test management's assumptions and considerations about possible management bias), work effort on accounting estimates and fair

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<sup>9</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>10</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

<sup>11</sup> ISA 260, *Communication with Those Charged with Governance*

<sup>12</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>13</sup> ISA 570, *Going Concern*

<sup>14</sup> ISA 620, *Using the Work of an Auditor's Expert*

<sup>15</sup> The IAIS notes that the accounting for technical provisions is expected to significantly change as the IASB and the US Financial Accounting Standards Board complete their work on the accounting standards addressing insurance contracts.

values that have not been identified as significant risks, fraud, and the implications of the use of third-party pricing sources.

### **Standards that May Be Addressed**

2. Possible amendments to ISA 540 and other ISAs as necessary.

### **Possible Other Outputs**

3. IAPN(s) or other non-authoritative guidance to address issues related to financial institutions, including the relationship between the banking supervisors and the bank's external auditors and matters relevant to the insurance industry.

### **Preliminary Views on the Approach to the Project**

4. Staff, and as necessary, a WG (including experts in this area), will initially focus on considering the suggestions of the BCBS on areas where more is needed to address audits of banks (including the relationship between banking supervisors and auditors). The wider applicability of these potential changes beyond financial institutions (including to ISA 540 or other ISAs as necessary, and to insurers) will also be considered as part of the initial information gathering activities. At the same time the IAASB will continue its discussions about issues arising from the insurance industry and the process to develop non-authoritative material, including IAPNs, to enable this WG to be in a position to be able to recommend an appropriate way forward to address special audit considerations for financial institutions.
5. Information-gathering activities will commence in 2014, with an initial discussion by the IAASB on the topic planned in early 2015.

## Appendix 2

### Financial Institutions WG Outreach Activities from Commencement–August 2015

#### February 2015

- Meeting with representative of the FSB – Basel, Switzerland
- Meeting with representatives of the IAIS – Basel, Switzerland
- Participation in the BSBC Accounting Expert Group meeting – Basel, Switzerland

#### May 2015

- Meeting with representatives of the IASB – London, UK
- Meeting with representatives of the Reserve Bank of India – Mumbai, India

#### June 2015

- Teleconference with an auditor of a large bank that has early adopted IFRS 9
- Meeting with representatives of the GPPC on the topic of financial institutions – London, UK
- Meeting with representatives of British Bankers' Association – London, UK
- Meeting with representatives of Bank of England – London, UK

#### July 2015

- Teleconference with representatives of the GPPC on the topic of financial institutions