



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

**Chairman**

Mr Arnold Schilder  
Chairman  
International Auditing and Assurance  
Standards Board  
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25 May 2016

**Invitation to Comment: *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits***

Dear Arnold

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on the International Auditing and Assurance Standards Board's (IAASB) December 2015 Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (the ITC). The Committee has a strong interest in promoting high-quality auditing and ethical standards for auditors and is supportive of the work of the IAASB to promote such standards.

**Introduction**

In March 2013, the Committee sent a letter to the IAASB in relation to revisions to the Committee's guidance on *External Audit of Banks*. In its letter, the Committee identified areas in the international auditing and ethical standards where requirements for auditors could be enhanced, particularly in the following areas: auditing accounting estimates, demonstrating professional scepticism, and ensuring quality control. Therefore, the Committee welcomes the ITC and commends the IAASB for creating a Task Force on the revision of ISA 540 regarding auditing accounting estimates and for creating a Task Force to assess the need for enhancements to ISA 315 regarding risk assessments. The Committee strongly encourages the IAASB and the International Ethics Standards Board for Accountants (IESBA) to complete these enhancements to the auditing and ethical standards which are expected to improve audit quality and strengthen public confidence in the auditing profession.

**Project interrelationships**

The Committee welcomes the IAASB's decision to prioritise the revisions to ISA 540 because of its significance for external audits of banks. Notwithstanding the interrelationships between the ISA 540 project and the ITC projects, particularly professional scepticism, we would like to emphasise the importance of completing the revisions to ISA 540 on a timely basis so that auditors can be better prepared for (including by providing appropriate staff training) and adequately plan for 2018

audits when important new accounting standards become effective (eg IFRS 9). We recommend that aspects of ISA 540 dealing with professional scepticism be designed to align, to the extent possible, with revisions resulting from the work of the combined Task Force on Professional Skepticism. Similarly, revisions to the requirements regarding auditing accounting estimates and demonstrating professional scepticism should be aligned with the enhancements to ISA 315. Therefore, we encourage the IAASB to consider the interrelationships between projects, including those of the IESBA, when proposing revisions to a given standard.

### **Public interest dialogue structure**

Although high-quality auditing, ethical and educational standards are key factors contributing to high-quality performance by auditors, such standards by themselves are not sufficient. Robust application and enforcement of the standards are critical elements as well. Moreover, there is a need for a process to identify aspects from practice that warrant attention from relevant parties, including other standard setters. We strongly encourage the IAASB in concert with the IESBA and the International Accounting Education Standards Board to further develop the dialogue structure with relevant parties such as auditors, regulators and the International Forum of Independent Audit Regulators (IFIAR). Notwithstanding any applicable requirements regarding confidentiality and independence, the Committee believes that auditors should be encouraged to participate and contribute to this dialogue structure.

### **Professional scepticism**

The Committee believes the requirements in the standards should ensure that auditors are able to demonstrate professional scepticism throughout the audit process, from start to finalisation.

The Committee supports the work that is underway at the IFIAR to survey the quality of audits of Globally Significant Financial Institutions (GSIFIs) and to take steps to improve audit quality. The most recent survey of GSIFIs found the highest number of deficiencies related to internal control testing, auditing of allowance for loan losses and loan impairments, auditing the valuation of investments and securities, and use of experts and specialists. These are issues where professional scepticism is particularly relevant, and the Committee believes that improvements to auditing standards and guidance on these issues that take account of the lessons of the financial crisis could significantly improve audit quality.

The application of professional scepticism should be reflected in the auditor's working papers and in the procedures performed by the auditor throughout the audit, based on requirements in the standards. This includes documenting and providing evidence of the auditor's exercise of professional scepticism, including evidence of discussions with management and those charged with governance. Furthermore, evidence of the auditor's exercise of professional scepticism should also be documented and reflected in connection with the audit firm's compliance with its audit quality control structure. The Committee would welcome the alignment of the definitions in the standards and enhancements to the standards that would improve auditors' actual and perceived professional scepticism. The Committee believes that auditors should not only assess management's evidence but also should actively look for other evidence that is contrary to management's

evidence, weighing even-handedly evidence that supports and evidence that contradicts management's assertions. In addition, requirements should contain steps to ensure that auditors do not give more weight than they should to management representations as a form of evidence.

We believe professional scepticism should be consistently addressed in ethical and educational standards. We encourage the IAASB to interact with the other standard setting boards in this regard. Finally, the roles of the engagement partner, quality review partner, and those charged with governance within a firm with respect to fostering an attitude of professional scepticism in the firm's audit staff should be enhanced and clarified.

### **Quality Control**

The Committee welcomes the concept of a *Quality Management Approach* (QMA). We strongly believe that the objective of conducting high-quality audits must be first and foremost in an audit firm's strategy and operations and that this objective also must be incorporated in its internal governance structure. A firm's internal governance structure should be characterised by a tone at the top that attaches the highest priority to full adherence to ethical standards and, amongst other features, promotes compliance with proactive and robust audit procedures that enable auditors to demonstrate their due professional care in performing high-quality audits. As a corollary, auditing and ethical standards should require that accounting firms demonstrate that all audit engagements have been performed in accordance with strict adherence to both the letter and the spirit of the requirements. Audit procedures for areas that require the exercise of a high degree of judgment, such as auditing accounting estimates (eg accounting provisions measured on the basis of expected credit losses), warrant suitable quality control arrangements over auditors' professional judgments so that similar situations do not result in decisions with high variances. The documentation of communication between the engagement partner and the EQC reviewer should cover matters other than those where there are differences of opinion between the partner and reviewer, including discussion of key audit matters, matters involving significant professional scepticism and significant professional judgment.

Audits of internationally active banks are performed primarily by the largest networks of firms. Although the Committee is well aware of legal and cultural issues that can arise in connection with managing a network of firms but are not likely to be present in a more unified corporate structure, supervisors expect an acceptable level of quality controls at each individual firm within the network. Because of these jurisdictional limitations, the ITC displays a reluctance to extend the scope of quality control requirements to networks (paragraph 71 of the overview document). Nevertheless, the Committee believes that network firms should be expected to uniformly apply the requirements set forth in the auditing and ethical standards across the network. For that reason, the Committee encourages the Task Force to broaden the scope of quality control standards to include network firms.

### **Group audits**

Auditing standards for group audits are highly relevant for the banking industry. In performing high-quality group audits, it is important that all audit procedures to be applied within the group are based on a common set of requirements. Similarly, communication structures within the group, particularly communication between

the engagement and component partners, are important for a high-quality group audit. The Committee encourages the Task Force to be explicit in terms of requirements for engagement partners and component partners. In particular, in all group audits, what work has been performed and by whom should be adequately documented; communication should go both ways, from the component auditor to the group auditor and vice versa; and the group auditor should actively assess the competence and capabilities of the component auditors, as well as the quality management of their contribution to the group audit.

We hope you will find our comments constructive and helpful. This letter has been prepared by the Committee's Accounting Experts Group, which is chaired by Fernando Vargas, Associate Director General of the Banco de España. If you have any questions regarding the above comments, please feel free to contact Mr Vargas (+34 913 38 61 04), Nic van der Ende, chair of the Committee's Audit Subgroup (+31 20 524 91 11), or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Stefan Ingves', is centered on the page.

Stefan Ingves