



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2011

**Consultation Paper 56:
Protocol between the Central Bank of
Ireland and the Auditors of Regulated
Financial Service Providers – ‘The Auditor
Protocol’**



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Background

1. The traditional role of the external audit has been to provide confidence to investors and other stakeholders as to whether the financial statements prepared by individual institutions present a 'true and fair' view - a role critical to the effective functioning of markets. In a regulatory context, the ability of regulators to rely on the audited information furnished by the firms they regulate is an integral part of the supervisory process.
2. The financial crisis prompted a widespread debate on the role of the external auditor specifically with regard to firms, and whether this role could or indeed should be enhanced. This has manifested itself in a range of domestic and international publications which have looked at the perceived weaknesses in the existing audit framework or have proposed policy on how the audit process could be improved.¹
3. Of particular interest to the Central Bank of Ireland is the Nyberg Report which states:
"In part because they must form a view on banks' financial sustainability, bank auditors should have regular, compulsory dialogue with its client's senior management and boards on the bank's business model, strategy and implementation risks. The results of such discussions should also, at least when clearly relevant, be communicated to the Financial Regulator".

¹ For example, the European Green Paper on "Audit Policy: Lessons from the Crisis", the Report of the Commission of Investigation into the Banking Sector in Ireland, 'Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland', March 2011, (the 'Nyberg Report') and the House of Lords Economic Affairs Committee 2nd Report "Auditors: Market concentration and their role".

4. Against this background, the Central Bank of Ireland met with representatives of the relevant accounting and auditing bodies with a view to developing an 'Auditor Protocol', the broad objective of which is to provide terms of reference for more structured communications between supervisors and auditors of individual firms.

The Auditor Protocol

5. The aim of the Auditor Protocol is to provide a framework which will allow the Central Bank and the auditing profession to exchange relevant information on a timely basis with a view to enhancing both the regulatory and statutory audit processes.
6. The framework will govern communication between the Central Bank and auditors while also providing a structure for bilateral meetings (i.e. meetings between the Central Bank and auditors) and trilateral meetings (i.e. meetings between the Central Bank, auditors and the audit committee or Independent Non-Executive Director). The Protocol will be subject to annual review and will be updated to reflect changes in legislation, auditing practice and other relevant developments.

Purpose of Consultation

7. The purpose of this consultation is to obtain comments on the draft Auditor Protocol attached at Appendix 1.

Proposed Scope and Implementation

8. The Central Bank is minded to apply the Protocol, in the first instance, to those firms which are rated High Impact under the Central Bank's new regulatory risk model, PRISM which will be rolled out over the course of 2011 and 2012. The categorisation of firms as High Impact reflects their relative size and potential to harm the economy, consumers or the wider financial system. Categorisation will be based on metrics such as balance sheet size, turnover, client base and so forth.
9. Once the final Auditor Protocol is published, an implementation plan will be agreed with the auditing profession, to commence no later than the beginning of the new audit cycle for relevant firms in 2012.

Making submissions

10. Please make your submissions in writing electronically as a Word document or a .pdf document by email on or before 23rd September 2011. We intend to make all submissions available on our web-site. We shall not publish any information which we deem potentially libellous or defamatory.
11. Submissions should be marked 'Auditor Protocol' and, ideally, sent by email to auditorprotocol@centralbank.ie.

12. Written responses should be sent to:

Governance, Accounting and Auditing Policy Division
Policy and Risk Directorate
Central Bank of Ireland
PO Box 559
College Green
Dublin 2

Governance, Accounting and Auditing Policy Division
August 2011

Appendix 1

Protocol between the Central Bank of Ireland and the Auditors of Regulated Financial Service Providers - Draft

Introduction

1. The aim of this Protocol is to enhance the information sharing between the Central Bank of Ireland ('the Central Bank') and auditors of regulated financial service providers ('firms') thereby improving the regulatory and statutory audit process.
2. This Protocol is in addition to the statutory requirements on auditors of firms to report to the Central Bank under Irish legislative requirements e.g. under 'prescribed' enactments and under Sections 27B and 27C of the Central Bank Act, 1997. However, the Protocol does not extend in any way the nature and purpose of the statutory audit as required under legislation.
3. The Protocol covers the following areas:
 - bilateral meetings; and
 - trilateral meetings.

The General Framework

4. To facilitate both the Central Bank and the auditors of firms to achieve the effective fulfilment of the two parties' statutory powers, communication channels between both parties should always be open

and an environment that facilitates frank discussions should exist. These goals can be achieved through the adoption of the following measures:

- Firms shall advise the Central Bank of the contact details of the audit partner responsible for the audit.
 - Firms shall advise its auditor of the contact details of its lead examiner in the Central Bank.
 - Meetings between the Central Bank and auditors shall be governed by the following principles:
 - (a) The Central Bank shall endeavour to share all information, which it believes would lead to higher quality audits, with the auditor;
 - (b) The auditing firm shall endeavour to share with the Central Bank any information that it believes may assist the Central Bank in the exercise of its supervisory functions;
 - (c) All communications between the Central Bank and auditors shall be deemed confidential under Section 33AK of the Central Bank Act, 1942 (as amended).
5. Material information (i.e. information which is deemed would be of immediate interest to the other party) shall be shared between both parties at the earliest instance even if a meeting between both parties is not planned.
6. Barriers to the sharing of information should be identified and, where possible, removed with a view to maximising the effectiveness of communication between both parties.

7. Contractual agreements between auditors and firms should not hinder information sharing. Specifically, the terms of the audit engagement shall include a provision that acknowledges that the Central Bank and the firm's auditors can discuss any issue that is of relevance to their oversight of the firm and that this communication will not be determined to be a breach of duty by either party.
8. In order for any meetings between the auditor and the Central Bank to be mutually beneficial, it is envisaged that the auditor will be represented by the Lead Partner and the Central Bank by the Senior Examiner.

Bilateral Meetings

9. It is expected that there will be at least two formal bilateral meetings per year. These meetings will take place at the pre audit stage and the post audit stage.

Pre Audit Meeting:

10. It is envisaged that this meeting will be held as part of the Trilateral Meeting process (see below) but it could also be held as a bilateral meeting if both the Central Bank and the auditor believe that it would be more beneficial to do so.
11. It is expected that this meeting will have an Agenda which covers, inter alia, the following issues:
 - (i) The risk profile of the firm – e.g. changes in business lines, drivers of income, strategy.

- (ii) Weaknesses identified in previous audits.
- (iii) Overview of weaknesses identified through the supervisory process.
- (iv) The audit approach and the application of the materiality concept.
- (v) Changes in the corporate governance and internal governance structures of the firm.
- (vi) Observations on the control functions of the firm (e.g. risk management function, internal audit, compliance).

Post Audit Meeting:

12. It is envisaged that this meeting will be arranged after the audit report is signed off. However, this meeting may occur before audit sign off if it is deemed more beneficial.
13. It is expected that this meeting will have an Agenda which covers, inter alia, the following issues:
- (i) An update on the items outlined in the pre audit meeting.
 - (ii) Discussion on the audit findings as originally presented to the firm and the adequacy of the firm's response to these findings.
 - (iii) Discussion on areas where management of the firm applied significant judgement and its impact on the auditor's view of the financial statements and on the risk profile of the firm. This discussion would include the level of professional scepticism applied by the auditor.

- (iv) Any issues that affected communications between the auditor and/or the Central Bank and/or the firm during the year that could be improved.
- (v) The future strategy of the firm and the impact that it may have on audit and regulatory issues.

Trilateral Meetings

14. The Central Bank, through its Corporate Governance requirements, places a significant onus on the Audit Committee to monitor the effectiveness and adequacy of the firm's internal control, internal audit and IT systems. It is because of this reliance that the Central Bank believes that trilateral meetings should take place between the Central Bank, the auditor and the Chair of the Audit Committee or, if an Audit Committee is not in place, an appropriate Independent Non-Executive Director, to discuss areas of concern and/or mutual interest regarding the firm. The Trilateral Meeting will, in the normal course of audits, be conducted at the planning stage of the audit process. These meetings should cover all issues that the parties consider may be of interest to the other parties in carrying out their statutory or fiduciary functions.

Continuous Review

15. This Protocol will be subject to annual review and will be updated to reflect changes in legislation, auditing practice and other relevant developments.

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