

23 September 2011

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

Dear Sir,

Ernst & Young welcomes the opportunity to comment on the Central Bank's Consultation Paper 56 "Protocol between the Central Bank of Ireland and the Auditors of the Regulated Financial Services Providers - 'The Auditor Protocol' ('the Protocol').

We support increased levels of cooperation between the auditor and the Central Bank because it can only benefit financial markets as a whole and improve the regulatory and statutory audit process. The Protocol is an important development in this regard.

Legal Foundation for Communication

We do however feel that such communication needs to be supported by a proper regulatory framework for such communication since the current contractual framework envisaged by the Protocol does not give sufficient protection to auditors.

As you know, auditors in the United Kingdom have a right and duty to communicate with the Regulator and to volunteer information which the auditor believes to be material to the Regulator. By contrast, in Ireland, an auditor only has an obligation to report to the Regulator in specific circumstances defined by law. An Irish auditor could therefore be accused of breach of duty if he/she was to communicate with the Central Bank in other circumstances without the client's permission. One solution would therefore be to extend the Irish statutory provisions in line with the UK practice.

The protocol document recognises the auditors' duty of confidentiality and seeks to address this duty by recommending that statutory auditors include terms in their letters of engagement permitting discussion with the Central Bank. We believe this contractual solution is unsatisfactory:

- Such provisions in the terms of engagement would only operate as between the client and the auditors and would not necessarily protect the auditing firm from a claim (based on negligence, defamation or breach of statutory duty) by a third party, which would not be bound by the terms of engagement and arising out of a communication to the regulator. The risk of such a claim could constrain the auditor from speaking freely.

- There could be competition issues arising if the leading audit firms and the professional bodies were to jointly impose such changes to all terms of engagement. Such breaches could breach Section 4 of the Competition Act 2002, possibly constituting a criminal offence under Section 6, 7 or 8 of that Act.
- The legal status, validity, enforceability and effect of the Protocol would be uncertain - under both Irish and European Union law, it is important that any regulatory requirements should be clear and transparently set out and properly rooted in law
- Finally, there is no guarantee that all clients would agree to the inclusion of such a term in the terms of engagement.

Therefore, while welcoming the opportunity for a framework allowing unrestricted communication with the Central Bank, we feel that this must be facilitated by way of a clear legal foundation. Promulgating a statutory instrument or amending the legislation to allow and require such communication between the auditor and the Central Bank could eliminate such risks.

Need for Communication to be Reciprocal

We welcome the statements in the Protocol envisaging such communications from the Central Bank. We accept that there will be information which the Central Bank cannot communicate, but it has greater visibility of the entire market and has access to information which in some respects extend far beyond the detail in the statutory accounts. Accordingly, it is important that the Central Bank should raise concerns and highlight issues with the auditors as well as receiving information from the auditors. If there are specific issues or concerns of which the Central Bank is aware, then it is appropriate that they should be raised with the auditors so that they can be given due consideration, in addition to the auditors' review of the financial statements as a whole.

Auditors' Role

We are keen to ensure that the Protocol does not give the impression that the auditors' role extends beyond our responsibility to provide an audit opinion in respect of historical financial statements. Whilst analysis of future risks or business models may be reviewed by the auditor as it affects the auditors' consideration of the going concern assumption, clarity should be provided so that a broader role is not envisaged than that provided for under Irish Law. In respect of Credit Institutions, paragraph 10 of the Practice Banking Note 19(I) usefully summarises the respective responsibilities of the auditors and the Central Bank:

"In many respects the Financial Regulator, as the banking supervisor and bank auditors have complementary concerns, although the focus of their concerns may be different. In particular,

- The Financial Regulator is primarily concerned with maintaining the stability of the banking system and fostering the safety and soundness of individual banks in order to protect the interests of the depositors. The Financial Regulator monitors the present and future viability of banks and may use their financial statements in assessing their condition and performance. The auditors' primary responsibility is to report to shareholders his opinion as to whether the financial statements present a true and fair view, in the course of which they consider the appropriateness of the use of the going concern concept as a basis for the preparation of the financial statements;*
- The Financial Regulator is concerned that banks maintain a sound system of internal control, including an adequately resourced, independent internal audit function, as a basis for safe and prudent management of the bank's business. The auditor is concerned with the assessment of internal control to determine the degree of reliance to be placed on the system in planning and performing the work necessary to express an opinion on a bank's financial statements; and*
- The Financial Regulator must be satisfied that each bank maintains adequate records prepared in accordance with consistent accounting policies and practices that enable it to appraise the financial condition of the bank. The auditor is concerned with whether adequate and sufficiently reliable records are maintained to enable the entity to prepare financial statements that do not contain material misstatements."*

Practice Note 19(l) also observes in paragraph 6:

"The scope of a statutory audit of a bank's financial statements is no different from that of the generality of companies in the Republic of Ireland. However, the Oireachtas has, in addition, placed responsibility on auditors to provide reports to the Financial Regulator if they encounter circumstances that, in their opinion, meet certain criteria set out in statute with the express purpose of making the Regulator aware of matters that might jeopardise the stability of the banking and financial system or interests of depositors and others".

Nature of Information to be Shared

We would welcome some further guidance and clarification in the Protocol in respect of what information would be regarded as relevant to the Central Bank, particularly as there is no reference to "materiality." The commitment expected from the auditors is vague and imprecise envisaging that the auditors shall "*share with the Central Bank any information that it believes may assist the Central Bank in the exercise of its supervisory functions.*" This could be interpreted as requiring the auditors to share a large amount of information, since it may be extremely difficult for the auditors to judge what information the Central Bank would consider would be of assistance to it in carrying out its statutory functions.

Finally, it would be useful for the Protocol to clarify if the intention is to cover Irish authorised entities only or whether it is also intended to cover subsidiaries of overseas entities.

We are grateful to the Central Bank for publishing such a draft Protocol and providing the opportunity for interested parties to provide comments. If you would find it useful, colleagues in this firm are available to discuss the Protocol or any points we have raised.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Dargan FitzGerald'.

Dargan FitzGerald
Audit Compliance Partner and Professional Practice Director

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