Meeting between regulators and bank auditors

I refer to the recent discussion in the House of Lords on 23 October 2013 with regards to mandating the frequency of auditor-supervisor meetings by statute under the proposed Amendment 92 to the Financial Services (Banking Reform) Bill.

We do not believe it necessary to mandate, in statute, a minimum number of meetings with audit firms for all PRA-regulated firms. Instead, we would support a principle-based objective in the Bill to promote an effective auditor-supervisor relationship and that the PRA be held accountable to it. The PRA should have the freedom to adopt an appropriate supervisory approach in meeting this objective, and we would welcome the opportunity to report to Parliament on the approach adopted.

In addition, we are concerned that prescribing annual, individual, meetings between auditors and supervisors will have resource implications for us and be a disproportionate cost burden on the smallest firms that we supervise without improving the quality of our supervision in a proportionate manner.

The rest of this letter outlines our current practice and future commitment to auditor-supervisor engagement.

Our approach

We strongly believe that an effective auditor-supervisor relationship is important to enhance supervision and to contribute to high-quality external auditing. We recognise that the absence of such relationships in the pre-crisis period was a weakness in the FSA’s supervisory approach and we are determined to learn from that experience. In our view that means not only many more meetings with auditors but also ensuring that those meetings are good meetings, having the right discussions at the right level and at the right time. It also means having the sort of relationship that encourages both parties to contact the other party outside meetings, to share thoughts and insights. The timely sharing of relevant information between supervisors and external auditors in a way that ensures the information is given appropriate context and emphasis is an essential element of what we need to achieve. We also recognise that both parties need to be proactively engaged and not defensive.

The FSA changed the way it interacted with auditors following the crisis and those changes have been extended in recent years. As a result, the auditor-supervisor relationship is much improved. However, further improvement is always possible and is something on which we will continue to work as we note below. It has also become very clear to us that the PRA’s engagement with the external auditor needs to be proportionate to the risks posed by each bank to the stability of the UK financial system.
A statutory PRA Code\textsuperscript{1} establishes the nature of the relationship between the supervisor and each firm’s auditor, including the form and frequency that communication between the two parties should take. For the UK headquartered banks that could have the most significant impact on financial stability, the PRA Code mandates at least three bilaterals a year between the supervisor and the firm’s auditor. For other firms whose failure could materially impact the UK financial system, the PRA Code mandates at least one bilateral a year.

In the year to 31 October 2013, there were at least seven bilaterals between the supervisor and auditor for each of the four UK headquartered banks that could have the largest impact on financial stability.

The PRA also undertakes broader engagement with the audit firms. For example, we have started to trial quarterly meetings with the risk partners of the six largest audit firms to try to ensure we understand fully the risks and vulnerabilities that affect individual firms, the sector and the system. We also hold ad hoc roundtables on a variety of ‘hot’ topics. In addition, we hold biannual bilaterals with the senior financial services partners of the six largest audit firms to, amongst other things, provide supervisory feedback on how auditors of the firms we supervise are engaging under the PRA Code, and receive feedback from the audit firms on how supervisors are engaging with the auditors. As a result of the implementation of the Code, and the system of feedback, we believe the quality of the dialogue has generally developed to be more co-operative and constructive.

Future Auditor-supervisor dialogue

We are fully committed to an effective auditor-supervisor dialogue, underpinned by meetings which are mandated under the PRA Code in line with the risks posed by the firm. The PRA will be reviewing the effectiveness of these meetings and reporting on them to the PRA board, on an annual basis, with the first report due in June 2014.

I hope the above clearly explains our position on these proposals and how we are delivering the objective of an effective auditor-supervisor relationship.

Yours sincerely,

Andrew Bailey

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\textsuperscript{1} Supervisory Statement (LSS 7/13) \textit{The relationship between the external auditor and the supervisor: a code of practice}, published in April 2013.