BANKING REGULATION AND POLICY DEPARTMENT

GUIDELINES ON EXTERNAL AUDIT OF BANKS

VERSION 1.1

2016

BANGLADESH BANK

PREFACE

This Guidelines on External Audit of Banks focused on function of external auditors of banks to improve quality of external audit. This Guidelines is prepared based on Financial Reporting Act, 2015 in the light of Core Principle 27 of the Basel Committee's Core Principles. In accordance with the said Act and Core Principle 27 of the Basel Committee’s *Core Principles for Effective Banking Supervision*, it is expected by Bangladesh Bank that banks maintain internationally accepted accounting policies, publish information bearing an independent external auditor's opinion, have adequate governance in banks & within its groups. The assurance of a properly conducted audit serves to provide an independent view of the financial statement's reliability, which becomes more important in light of the increasing scope of management's judgment.

Table of Contents

INTRODUCTION

1. Objectives

Pursuant to Section 39 of the Banking Companies Act, 1991 (amended upto 2013), an External Auditor conducts the statutory audit of bank's financial statements with a view to provide reasonable assurance about the reliability of the statements as a whole; and also certify whether those are prepared in accordance with all applicable accounting, auditing and reporting standards. External auditor plays an essential role in the regulatory framework; as properly conducted audits foster market confidence and contribute significantly towards greater financial stability.

This Guidelines primarily focuses on the roles and responsibilities of the external auditor(s), the regulatory requirements relating to overall performance of the audit functions, and sets out the terms of an audit engagement, appointment procedures, and reporting obligations to be observed by a bank.

2. Effective Date

The Guidelines will come into effect from January 01, 2016 and will be applicable for appointment of External Auditor(s) for financial years beginning on and after January 01, 2016.

3. Definitions

(1) **Statutory Audit** - An audit carried out to comply with the requirements of Section 39 of the Banking Companies Act, 1991, conducted in accordance with section 40 of Financial Reporting Act, 2015 for the purpose of providing assurance of accountability, giving credibility to the financial statements and other management reports, identifying weaknesses in internal controls and financial systems, and making appropriate recommendations for improvement.

(2) **Audit Committee** - A committee established by and amongst the board of directors of a bank as required under Section 15Kha of the Banking Companies Act, 1991, for the purpose of overseeing the accounting and financial reporting processes and audits of the financial statements of the bank and ensuring the adequacy and efficiency of the bank's internal control systems.

(3) **Engagement Letter** - The contract between the external auditor(s) and the bank detailing the scope of services, remuneration, tenure, responsibilities and obligations of both the parties, and other terms and conditions.

(4) **Engagement Quality Control Review** - As defined in the Bangladesh Standard on Quality Control 1 (BSQC 1) 2009, a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and conclusions they reached in formulating the report.

(5) **Engagement Quality Control Reviewer** - As defined in the Bangladesh Standard on Quality Control 1 (BSQC 1) 2009, a partner, other person in the firm, suitably qualified

external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

(6) **Council -** Council means the Financial Reporting Council which is established through gazette notification published by the government as mentioned in section 3 of Financial Reporting Act, 2015.

APPOINTMENT OF EXTERNAL AUDITOR

4. Essential Qualifications

(1) An external auditor should be enlisted by the Council formed by the Government under the Section 3 of Financial Reporting Act, 2015.

(2) An external auditor must be enlisted in the Panel of Auditors maintained by Bangladesh Bank pursuant to Section 39(1) of the Banking Companies Act, 1991.

5. Panel of External Auditors

(1) The panel of external auditors is prepared and maintained by Bangladesh Bank, as required under Section 39(1) of the Banking Companies Act, 1991, on the basis of eligibility criteria as defined in the next section.

(2) The audit firms desirous of being listed are to apply for enlistment to the Banking Regulation and Policy Department of Bangladesh Bank along with necessary information and supporting documents as prescribed in Annexure-1.

(3) After scrutiny, physical verification and evaluation, Bangladesh Bank publishes the list of eligible audit firms in its website. Selected audit firms are classified into two categories (A & B) and ranked.

(4) The enlisted firms are to inform the Banking Regulation and Policy Department of Bangladesh Bank in case of any change of nomenclature, address and credentials of the firm within two weeks of any such occurrence.

(5) If an auditor or partner of an audit firm (listed by Bangladesh Bank) resigns from its firm or joins in a firm, it should be communicated to Bangladesh Bank within a week after communicating the same to the Council.

(6) The panel is reviewed and updated in every three years. However, interim revisions may be done by Bangladesh Bank if necessary to accommodate changes due to disqualification, down-gradation, delisting, and inclusion of previously disqualified firm.

6. Criteria for Enlistment

In addition to the aforesaid requirement the following suitability and propriety criteria shall be used by Bangladesh Bank in evaluating/assessing auditing firms for enlistment:

(1) **Knowledge and Competence** - The external auditor(s) must possess resources and level of knowledge, expertise, experience and skills as determined by Bangladesh Bank to perform their duties with professional competence in conformity with domestic legal and regulatory stipulations as well as international accounting and auditing standards.

(2) **Integrity and Ethical Standard** - All audit firms enlisted on panel of auditors should possess and maintain high standard of integrity, honesty & financial discipline, and abide by the Code of Ethics of International Ethics Standards Board for Accountants (IESBA) for the

practicing chartered accountants and its members all the time. The audit firms are required to fulfill the following requirements for their partners/directors and members of the audit team:

a) not been adjudged insolvent or bankrupt by a court;

b) not convicted by any court in any criminal offence, fraud/forgery, financial crime or other illegal activities;

c) not a loan defaulter of any bank or financial institution;

d) not a defaulter of tax.

(3) **International Affiliation** - International affiliation of the audit firms will be given due weight and value in terms of its nature of affiliation, level of exchanging resources, support & consultancy arrangements on International Accounting and Auditing Standards and Techniques with respect to banking & financial matters, technical & human resource sharing, and international standing/position and experience of international firm.

7. Rotation of External Auditor

(1) An external auditor shall not audit the same bank for more than three consecutive years. It may resume the role as external auditor with the same bank after a lapse of two years from the last audit engagement. The audit firm/partners of the firm individually shall not provide a bank any type of services within the period of two years immediate after the last audit engagement in that bank.

(2) An audit firm should have a policy to rotate the members of its audit engagement team for a period of every seven years to avoid familiarity threat.

8. Disqualification

(1) Bangladesh Bank, under Section 39Kha of the Banking Companies Act, 1991, may declare any enlisted auditor from its Panel of Auditors disqualified to audit any banking company for a period not exceeding two years on the ground of negligence or failure in discharging the responsibilities. In this regard, Bangladesh Bank shall:

a) properly mark the firm in the list of auditors published in its website;

b) notify the firm about such disqualification;

c) promptly inform banks regarding the disqualification through a circular letter.

(2) If an audit firm is declared disqualified or banned for a specific period by the Council or any other regulatory authority, the firm will not eligible to conduct audit of a bank for the same period.

9. Down-gradation & Delisting

(1) Bangladesh Bank may down-grade a firm from Category-A to Category-B in the following cases after giving due opportunity of being heard:

a) if the information, facts and figures submitted to Bangladesh Bank when applying for enlistment are found fabricated or false afterwards;

b) any material divergence is made by the audit firm from the National and International Standards on Auditing during the audit engagement of any bank;

c) during the course of Bangladesh Bank inspection, if certain material facts in contradiction to external auditor's findings are observed and found convincing;

d) if material misstatement of facts and figures is observed in the audited financial statements or reports submitted to Bangladesh Bank.

(2) Bangladesh Bank shall delist an audit firm from its Panel of Auditors if the firm's membership is cancelled by the Council, or the firm has been declared disqualified to conduct audit by a competent Court/Authority.

10. Appointment Process

(1) Bank shall appoint external auditor(s) in line with the relevant clauses of Section 210 of the Companies Act, 1994, Section 39 of the Banking Companies Act, 1991 and other related regulatory requirements, including those set forth in this guidelines.

(2) State owned commercial banks, problem banks and banks under Early Warning System (EWS) are to be audited by the audit firms placed under Category-A of Panel of Auditors.

(3) After scrutinizing and evaluating the proposals from aspirant auditors, the Audit Committee of the bank shall select suitable firm(s), determine/negotiate remuneration for the task, and recommend to the Board of Directors for subsequent approval for appointment at the Annual General Meeting.

(4) The bank must ensure that audit fee is commensurate with the scope of audit assignment and the skills, knowledge, time and resources employed by the auditor.

(5) The bank shall then apply to Bangladesh Bank in no later than 31 July for each calendar year in prescribed format (Annexure-1) to obtain NOC in favor of the selected external auditor(s) and furnish the following documents:

a) resolution of the Annual General Meeting regarding the appointment of the external auditor(s) explicitly mentioning the agreed remuneration;

b) declaration by the bank to the effect that the selected external auditor(s) or any of its partner or any member of the audit team has no relationship with bank whatsoever, excepting that of a depositor;

c) declaration by the auditor(s) describing the penalties imposed or punitive actions taken within three years from the date of declaration, if any, by any other regulatory authority against the audit firm or any of its partner or any member of the audit team.

(6) External auditor(s) shall be appointed for a calendar year at a time.

(7) After getting Bangladesh Bank's approval, the bank shall issue an engagement letter to the auditor(s) detailing the scope of service, remuneration, tenure, and other terms and conditions.

(8) The auditor(s) so appointed shall notify the Registrar of the Joint Stock Companies about the appointment as stipulated in Section 210(2) of the Companies Act, 1994.

11. Conflict of Interest

(1) The external auditor(s) appointed by a bank may at no time within the engagement period provide any service to such bank other than services specified in Section 39 (1), (2) and (3) of the Banking Companies Act, 1991 or any other functions that the Bangladesh Bank may specify.

(2) The external auditor(s) of a bank or any member of the audit firm or any member of the audit team shall not be a bank-related person or a significant shareholder or an agent or representative of the bank and shall not have any financial interest in the bank, with the exception of holding a deposit in the bank.

(3) Pursuant to Section 38 of the Financial Reporting Act, 2015, during the statutory audit of a bank, a listed audit firm shall not involve in any activities which create conflict of interest with its statutory audit function.

12. Removal of External Auditor

(1) The bank can remove an appointed external auditor complying with the relevant clauses of Sections 210, 211 & 212 of the Companies Act, 1994.

(2) After such removal, same shall be communicated to Bangladesh Bank within two weeks time.

AUDIT ENGAGEMENT

13. Audit Planning

(1) Immediate after receiving appointment, an audit team shall be formed with adequate number of members considering the scope of audit engagement. The audit team leader must be a qualified Chartered Accountant and possess at least three years experience as an auditor of banks.

(2) The audit team shall chalk out a work plan to complete the audit function within the stipulated time and submit the same to the bank's Audit Committee so that the committee can supervise the progress.

(3) The external auditor should exercise professional skepticism when planning and performing the statutory audit of a bank, having due regard to the specific challenges in auditing a bank.

(4) The external auditor needs to apply the concept of materiality appropriately in planning and performing the audit.

(5) Required number of branches shall be brought under the purview of statutory audit according to Section 18 of General Instructions under Directions for Preparation of Financial Statements of the First Schedule of the Banking Companies Act, 1991.

(6) In designing and performing the statutory audit of a bank, the external auditor shall take account of the following factors to identify and assess risks of material misstatement and assess controls in a bank:

a) the knowledge and competence of those in charge of financial reporting and of other control functions having an impact on financial reporting;

b) the volume of transactions by type of activity and the presence of significant non-routine transactions;

c) monitoring of internal accounts;

d) the structure and complexity of IT systems for conducting efficient business and financial reporting, as they may lead to increased risk of fraud or error;

e) the number, scope and geographical dispersion of subsidiaries and the necessity for complex consolidation procedures;

f) the existence of significant transactions with related parties; and

g) the use of off-balance sheet financing arrangements, such as special purpose entities (SPEs) and other complex structures.

(7) The auditor should design and implement appropriate responses to those identified and assessed risks, especially for the following key areas of a bank's financial statements where there may be significant risk of material misstatement:

a) the correctness of classification of loans and advances and measurement of loan loss provisioning in accordance with the Guidelines of Bangladesh Bank;

b) accounting standards for financial instruments, including fair value measurements for more complex instruments where the valuation is based on unobservable inputs requiring a substantial amount of management judgment;

c) liabilities including contingent liabilities arising from non-compliance with laws & regulations and contractual breaches;

d) sufficiency and consistency of the disclosures in the financial statement, both quantitative and qualitative, with respect to bank's risk profile, activities and strategy;

e) evidence of events or conditions that may cast significant doubt on the ability to continue as a going concern.

14. Audit Standard

(1) External audits of financial statements performed in accordance with the relevant auditing Standards describing in the Financial Reporting Act, 2015 enhance the confidence of all users, including Bangladesh Bank, in the reliability of the audited Financial statements and the quality of the information provided. For this purpose, financial statements should be prepared in accordance with Section 38(1)(Ka) & 38(1)(Kha) of the Banking Companies Act, 1991. Guidance may be taken from relevant provisions of Bangladesh Standard on Auditing (BSA), South Asian Federation of Accountants (SAFA) Code of Ethics, International Ethics Standards Board for Accountants (IESBA) Code of Ethics for professional accountants.

(2) Audit firms should comply with Bangladesh Standard on Quality Control 1 (BSQC 1). The audit of a bank should be subject to an Engagement Quality Control Review (EQCR).

REPORTING REQUIREMENTS

15. Statutory Reporting

The external auditor(s) must perform the auditing and reporting responsibilities assigned under Section 39(3) of the Banking Companies Act, 1991 and Section 213 of the Companies Act, 1994 and section 40 of FRA, 2015 in conformity with Bangladesh Accounting Standard (BAS) and Bangladesh Financial Reporting Standard (BFRS). The involvement of the EQCR reviewer throughout the audit, and the outcome of the EQCR, should be evident in the audit working papers in conformity with BSQC 1.

16. Additional Reporting

The external auditor(s) should also give comments in the financial reports on the following issues:

a) whether the existing laws and regulations have been followed in sanctioning and disbursing of loans and advances;

b) whether the directives issued by Bangladesh Bank from time to time on Loan Classification, Provisioning and Interest Suspense have been followed;

c) whether the Capital & Reserves and Cash & Liquid Assets have been maintained according to the rules prescribed by Bangladesh Bank from time to time;

d) if there exists any maturity mismatch between assets and liabilities that would adversely impact the liquidity position of the concerned bank;

e) whether any irregularities conducted or window-dressing has been used for ballooning profits;

f) whether necessary corrective measures have been taken to address the irregularities detected in the comprehensive/special inspection report of Bangladesh Bank;

g) whether the directives issued by different departments of Bangladesh Bank have been followed accordingly;

h) whether the directives issued by the concerned bank have been followed accordingly;

i) whether directives issued by other regulatory bodies have been followed accordingly;

j) whether irregularities detected in the bank's internal control & compliance report or external auditor's report of the previous year have been rectified properly.

k) whether taxes or excise duties have been collected and transferred to the Government Treasury in accordance with the laws and regulations of the land;

l) the degree of risks emanating from forward foreign exchange transactions, guarantees, all contingent liabilities including letters of credit and off-balance sheet items considering their amounts and nature.

17. Special Reporting

(1) Pursuant to Section 39(4) of the Banking Companies Act, 1991, the external auditor(s) of a bank shall immediately notify Bangladesh Bank, if the auditor:

a) come into know that there has been a serious breach or non-compliance with the provisions of the Banking Companies Act, 1991;

b) come into know that a criminal offence involving fraud or other dishonesty has been committed;

c) come into know that losses have been incurred which will reduce the capital maintained by the bank below 50% of the required capital as defined in Section 13(1) of the Banking Companies Act, 1991;

d) come into know that serious irregularities have occurred in the affairs of the bank, particularly such irregularities that jeopardize the security of depositors and creditors;

e) is unable to confirm that the claims of depositors and creditors are still covered by the assets of the bank (the bank is or may be insolvent).

(2) Pursuant to Section 36 of the Financial Reporting Act, 2015, the external auditor(s) of a bank shall take necessary action if required.

RESPONSIBILITIES OF THE AUDIT COMMITTEE

18. Appointment of Auditor

(1) The audit committee should have a process for recommending of approval, appointment, reappointment, removal and remuneration of the external auditor.

(2) The audit committee should have a policy in place that stipulates the criteria for tendering the statutory audit contract. The policy should be reviewed periodically.

(3) If the external auditor resigns or communicates an intention to resign, the audit committee should follow up the reasons/explanations behind such resignation and consider whether it needs to take any action in response to those reasons.

19. Independence of Audit

(1) The audit committee should understand the applicable independence requirements (jurisdictional and internationally accepted ethical standards) and have procedures to monitor and assess the independence of the external auditor.

(2) The external auditor's judgment should not be compromised because of bias, conflict of interest or the undue influence of others. The external auditor must be independent in both fact and appearance.

20. Effectiveness of Audit

(1) The audit committee should consider whether the audit approach is appropriate relating to audit scope, level of materiality, areas of focus and auditor's focus on significant risk areas.

(2) The audit committee should consider whether the proposed resources to execute the audit plan are reasonable. The committee should understand the nature and extent to which the external auditor intends to use audit work performed by network firm personnel.

(3) The audit committee should obtain confirmation from the external auditor that there is adequate knowledge, competence and expertise within the audit team.

(4) It should discuss the followings with the external auditor about the findings of the latter's work in course of its monitoring:

a) significant matters that arose during the audit including those matters that were subsequently resolved as well as those that have been left unresolved;

b) rationale behind the final conclusions drawn by the audit team on significant accounting and auditing matters; and

c) nature and levels of misstatements identified during the audit, and explanations of the management on those issues.

(5) Before the external auditor issues the audit report, the audit committee should consider whether the audit firm has followed its audit plan and understand the reasons for any changes in the plan.

(6) The audit committee should then assess the effectiveness of the external audit process, and report the same to the board of directors, and discuss its findings and any recommendations.

21. Relationship with Auditor

(1) The audit committee should have effective communication with the external auditor to enable the audit committee to carry out its oversight responsibilities and enhance the quality of the audit. Regular dialogue between the two parties should be held throughout the reporting cycle of the bank.

(2) The audit committee should meet regularly with the external auditors prohibiting presence of executive management in those meetings. This will enable the audit committee to understand and discuss all issues that may have arisen between the external auditor and bank management in the course of the audit.

22. Reports to Audit Committee

The audit committee should require the external auditor to report to it on all relevant matters, including the followings, to enable the audit committee to carry out its oversight responsibilities:

a) significant difficulties encountered during the audit;
b) key areas of significant risk of material misstatement in the financial statements;
c) judgments about events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern (including consideration of liquidity/funding issues of the entity)
d) use of external experts to assist with the external audit;
e) the auditor's approach to internal control;
f) the extent to which the auditor uses the work of internal audit;
g) significant internal control deficiencies identified in the course of statutory audit;
h) significant qualitative aspects of financial statement disclosures;
i) any other significant matters discussed with or considered by the engagement quality control reviewer.

COMMUNICATION WITH BANGLADESH BANK

23. Meetings

(1) Before finalizing the Audited Financial Statements, a tripartite meeting shall be held among Bangladesh Bank, the bank concerned and the external auditor(s). The meeting shall be arranged by the concerned bank at their premises with prior consent from the concerned inspection department of Bangladesh Bank where representatives from concerned Department of Banking Inspection must participate. Representative(s) from Department of Off-site Supervision may also attend the meeting. Bank shall be represented by a team including at least a member from the Audit Committee.

(2) In case of Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank, a quadripartite meeting shall be arranged including participation of Ministry of Finance, Bangladesh Bank, the bank concerned and the external auditor(s) before finalizing the Audited Financial Statements.

(3) Matters to be discussed in the tripartite/quadripartite meeting shall include issues mainly related to asset quality and provisional figure of provision requirement, the results of the annual audit, presentation and content of the annual accounts, identified weaknesses in internal controls, detection of irregularities and/or frauds, and compliance with legal and other prudential requirements.

(4) Bangladesh Bank may call bipartite or tripartite meetings, as and when necessary, to bring a matter to the attention of a bank and/or its auditor(s), if the matter is of such importance that the auditors' knowledge of it could significantly affect the form of their audit or the way in which they carry out their reporting responsibilities.

(5) In addition, the external audit firms, individually or in a body, are encouraged to have regular discussions with Bangladesh Bank on different existing and emerging key risks & systemic issues as well as on appropriate accounting techniques and auditing issues at national level.

24. Report Submission

The banks shall submit the Audited Financial Reports to the Department of Off-site Supervision of Bangladesh Bank according to Section 40 of the Banking Companies Act, 1991 within the stipulated time. The same shall be submitted to the Council.

It should be noted that before finalization and approval of the audit report the external auditor will not share the report or any part of the report with any other party excluding the parties mentioned in the Section 36(2) of the Financial Reporting Act, 2015.