

Methodological Guideline
No 3/2017
of the Financial Market Supervision Unit of Národná banka Slovenska
of 13 March 2017
on communication between Národná banka Slovenska and the statutory auditor(s) and audit firm(s) carrying out the statutory audit of banks

The Financial Market Supervision Unit of Národná banka Slovenska, based on the provisions of Article 1(3)(a) point 3 and Article 3 of Act No 747/2004 Coll. on financial market supervision (and amending certain laws), as amended, Article 6(13), Article 40(7) and Article 45(6) of Act No 483/2001 Coll. on banks (and amending certain laws), as amended, and Article 29(1) of Act No 423/2015 Coll. on statutory audit (and amending Act No 431/2002 Coll. on accounting), as amended, has issued this Methodological Guideline:

Article 1
Purpose

(1) The purpose of this Methodological Guideline is to provide a basic framework for effective communication between Národná banka Slovenska (NBS) and the statutory auditor(s) and audit firm(s) (hereinafter ‘auditors’) carrying out the statutory audit of banks.

(2) This Methodological Guideline specifies principles for effective communication and sharing of information between NBS and auditors, as well as a list of areas (provided in the Annex) which may serve to aid such communication. This Methodological Guideline does not, however, provide an exhaustive list of facts and information that should be taken into account in such communication; other related information may be considered as the particular case requires.

Article 2
Definitions

For the purposes of this Methodological Guideline:

- (a) *in-depth communication* means communication with the auditors of global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) and other banks determined by NBS based on an assessment of the institution’s size and internal organisation and the nature, scope and complexity of its activities in order to obtain further insights about the institution for supervisory purposes;
- (b) *material information* means information obtained during the supervision or the statutory audit of a bank which could change or influence the assessment or decision of NBS or an auditor relying on that information for the purpose of exercising their respective tasks;
- (c) *institution-specific information* means information concerning an individual bank;
- (d) *industry-specific information* means information concerning the bank’s industry as a whole or part of that industry;
- (e) *informed person* means a staff member of NBS or the auditor who has sufficient and up-to-date information on the risk profile, size and complexity of a bank’s operations and related to particular issue under discussion;
- (f) *empowered person* means a staff member of NBS or the auditor who has the legal authority to act on behalf of their organisation so as to be able to share information and, where necessary, take appropriate decisions regarding a particular issue under discussion;
- (g) *supervisory team leader* means a staff member of NBS responsible for the organisation and coordination of the work within the supervisory team involved in the supervision of a bank;
- (h) *bilateral meeting* means a meeting between NBS and the auditor of a bank;
- (i) *trilateral meeting* means a meeting between NBS, the auditor and the bank.

Article 3

Principles of effective communication

(1) In its communication with auditors, NBS applies a proportionate approach in order to align the scope of information shared, form of communication, participants in the communication, frequency and timing of communication with the bank's size, internal organisation, and the nature, scope and complexity of its activities.

(2) The principles of effective communication include, but are not limited to the following:

(a) *Sharing of relevant information.*

This principle requires that NBS and auditors identify areas of common interest, by, for example, preparing a list of issues concerning the particular bank which NBS and the auditor should discuss, including any industry-specific information, current issues and emerging issues that may potentially have an impact on the supervision and the statutory audit.

(b) *Sharing of required information.*

This principle requires that information relevant to the supervision or statutory audit of a bank be shared between NBS and the auditor. Where in-depth communication is applied, NBS discusses with the auditor, at least, the audit approach, the audit report and the auditors' communication with the bank's management and supervisory bodies, senior management or audit committee. For its part, NBS communicates to auditors any changes in regulation or macroeconomic developments and results of thematic reviews performed across the bank's industry.

(c) *Sharing of information through appropriate communication channels.*

This principle requires the selection of an appropriate form of communication. Written communication is used in cases when there is a need to ensure clarity or for retaining a record of the communication. Written communication may also be used when communication relates to the following: an audit report and auditors' communication with the bank's management body, senior management or audit committee; findings and conclusions from audit procedures performed; complex technical matters; emerging issues; changes in regulation. Physical meetings between NBS and auditors are held to facilitate open and effective communication, particularly when in-depth communication is applied.

(d) *Sharing of information between informed and empowered individuals.*

This principle requires that the supervisory team leader and the key audit partner be the primary participants in the communication. Trilateral meetings are organised in particular where in-depth communication is applied and they are in addition to any bilateral meetings. Effective communication requires adequate safeguards for continuity of communication and therefore the keeping of internal records of the communication; such information may include, for example, minutes of communications or a summary of minutes, key issues discussed, and conclusions of discussions.

(e) *Timely sharing of information.*

This principle requires that NBS establish an appropriate frequency and timing of communication with auditors. In the case of emerging issues that need to be addressed immediately, communication may be held outside the schedule of regular meetings. When in-depth communication is applied, a bilateral meeting should be held at least on an annual basis.

(f) *NBS meeting auditors collectively.*

NBS and the auditors meet collectively at least annually and irrespective of the meetings organised on an individual basis between NBS and the auditor of one or more banks. By meeting collectively, NBS and auditors (meaning a group of auditors or a professional body representing auditors), aim to develop a common understanding of current and emerging developments of relevance to the supervisory tasks and the statutory audit of banks. Where necessary, NBS may invite, for example, relevant public authorities (such as those responsible

for the supervision of financial markets or for the public oversight of auditors) and other competent authorities and associations to such collective meetings, or inform these authorities and associations of the outcome of the discussions with the auditors.

(g) *Protection of shared information.*

This principle is applied to all communication between NBS and auditors. The disclosure in good faith to NBS by auditors, or to auditors by NBS, of any information emerging during this communication does not constitute a breach of any contractual or legal restriction on disclosure of information.¹ The information shared is subject to confidentiality requirements.²

Article 4
Common provisions

This Methodological Guideline incorporates guidelines of the European Supervisory Authority (European Banking Authority).

Article 5
Final provisions

This Methodological Guideline takes effect on the date of its publication in the Journal of Národná banka Slovenska. Legal acts related to the subject matter of this Methodological Guideline are available on the NBS website and on the website of the Official Journal of the European Union.

Vladimír Dvořáček
Member of the NBS Bank Board
and
Executive Director of the Financial Market Supervision Unit

¹ Article 12 of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC (OJ L 158, 27.5.2014).

² For example: Article 3(3) and (4) of Act No 747/2004 Coll. on financial market supervision (and amending certain laws).

**Non-exhaustive list of areas and issues on which information
could be shared between NBS and auditors**

1. External environment and risk profile of the bank

- The bank's external environment, performance, business model, corporate structure, risk concentration and risk appetite.
- Changes in regulation.
- Changes in accounting and auditing standards.
- Macroeconomic developments affecting the bank's industry.

2. Corporate governance and internal controls

- Culture, philosophy and operating style of the bank's governing body (including quality of corporate governance and concentration/sharing of power among the members of the governing body).
- Suitability of members of the bank's management body, senior management or audit committee, or a body performing equivalent functions within the bank, on significant matters related to financial reporting and control functions.
- Role of the audit committee, or a body performing equivalent functions within the bank, in the supervision of the financial reporting process.
- Quality of the relationship between the audit committee, or a body performing equivalent functions within the bank, with the auditors.
- Observations on the bank's internal control system and on its internal controls in relation to governance effectiveness, the financial reporting process, the control environment, the quality of key control functions, and IT systems.
- Significant deficiencies in internal control processes (for example material control weaknesses identified in the bank's financial reporting processes) and the auditor's observations on the effectiveness of the internal audit function, risk management function and compliance function (including compliance with the bank's internal regulations).

3. Ability of the bank to continue as a going concern

- Assessment of the risks related to the continuous functioning of a bank, including capital adequacy risks (such as credit, market and operational risks and minimum requirement for own funds and eligible liabilities, or MREL), large exposures, leverage, liquidity and funding risks.
- Observations on any areas of potential reputation risk and risk from non-compliance of the bank with relevant legal requirements (including any legal disputes and litigation).

4. Audit approach

- Materiality in planning and performing the statutory audit.
- Use of external experts in the statutory audit.
- Use of internal auditors' work in the statutory audit.
- Application of accounting policies and changes to them.
- Sources of potential management bias.
- Areas of significant risk identified.
- Specific work undertaken by the auditor on particular transactions.
- Significant difficulties encountered during the statutory audit (including disagreements between auditors and members of the bank's management body, senior management or audit committee.
- Circumstances that have led to a significant change in the audit planning.

5. Financial statements, valuation of assets and liabilities and disclosures

- Views and judgements on key risk areas and assumptions including significant transactions and valuations.
- Accounting practices and areas encompassing a significant degree of estimation uncertainty.
- Critical accounting estimates and indications of management bias, for example: where a bank consistently uses valuations that exhibit a pattern of optimism or pessimism; or where a bank undertakes transactions to achieve a particular accounting or regulatory outcome, such that the accounting or regulatory treatment is technically acceptable, but it obscures the substance of the transaction.
- Misstatements in the financial statements (corrected and uncorrected) identified during the statutory audit and the auditors' evaluation of them.
- Adequacy and reliability of disclosures in financial statements.

6. Audit report and auditors' communication with the bank's management body, senior management or audit committee, or a body performing equivalent functions within the bank, on significant matters related to financial reporting and control functions

- Audit report.³
- Additional report to the audit committee.⁴

7. The main findings of the audit procedures carried out and conclusions

- Issues identified during the statutory audit and communicated to the bank's management body, senior management or audit committee, or a body performing equivalent functions within the bank, such as deficiencies in internal control that merit management's attention.
- Significant issues which have been discussed with the bank's management body, senior management or audit committee, or a body performing equivalent functions within the bank.

8. NBS supervisory assessments and actions

- Supervisory measures imposed on a bank.
- Issues arising from recent institution-specific supervisory risk assessments and reviews (such as during the supervisory review and evaluation process, or SREP⁵).
- Results of thematic reviews and peer-group reviews performed by NBS across the bank's industry.
- Observations arising from a bank's regulatory reporting, including regulatory capital.
- Compliance with relevant legal and prudential requirements.

9. Others

- Issues discussed in previous years and meetings, if deemed to be still relevant.
- Issues related to the appointment, change, dismissal or resignation of the auditor appointed to perform the statutory audit.
- Additional matters arising from the statutory audit, such as matters arising from existing or new requirements foreseen provided for in European Union or national law.
- Feedback on the quality of communication between NBS and auditors and ways to improve communication.

³) Article 10 of Regulation (EU) No 537/2014 of the European Parliament and of the Council.

⁴) Article 11 of Regulation (EU) No 537/2014 of the European Parliament and of the Council.

⁵) The European Banking Authority's Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) (EBA/GL/2014/13).