The Role of the Auditor

Seminar for Senior Bank Supervisors from Emerging Economies

November 1, 2000

Craig Dabroski, National Technical Director for Depository Institutions
The Role of the Auditor

- Internal auditors
- External auditors
Internal Auditors

- Responsibilities
- Reporting lines
- Professional affiliations
IA - Responsibilities

- Compliance checking
- Compliance communication
- Transaction checking
- New product/service planning
- Operational efficiencies
- Assist regulators/external auditors
IA – Reporting Lines

- Board of directors
- Chief executive officer
- Chief operating officer
- Chief financial officer
IA – Professional Affiliations

• Certified Public Accountant

• Certified Internal Auditor

• Other professional organizations
External Auditors

- Objectives
- Reporting lines
- Profession
- Interactions with others
EA - Objectives

• Express an opinion on the consolidated financial statements
• Express an opinion on management’s FDICIA control assertions
• Report to the Board
The objective of our audit is to provide you with our auditors’ report expressing an opinion on the financial statements referred to above. We will conduct our audit in accordance with U.S. generally accepted auditing standards. Accordingly, we will examine, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assess the accounting principles used and significant estimates made by management and evaluate the overall financial statement presentation.
Objective of the external audit (2)

- Concurrent with our audit, we will examine, in accordance with standards established by the American Institute of Certified Public Accountants, management’s assertion about the effectiveness of the Company’s internal control over financial reporting as of *(fiscal year-end date – December 31, 20XX)*. The purpose of our examination is to express an opinion as to whether management’s assertion is fairly stated, in all material respects, based upon reasonable criteria.
Objective of the external audit (3)

• As required by professional standards, we will meet with the Audit Committee to discuss (1) any relationships that may reasonably be thought to bear on our independence and (2) the quality of the Bank's financial reporting. The discussion of financial reporting will cover, but will not be limited to: significant accounting policies; accounting estimates, judgments and uncertainties; accounting adjustments; and unusual transactions.
What level of assurance does the auditor need?

- Generally accepted auditing standards require that we obtain reasonable, rather than absolute, assurance that the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. Also, an audit is not designed to detect error or fraud that is immaterial to the financial statements. However, we will bring to your attention immaterial misstatements and any fraudulent or illegal acts of which we become aware during our audit.
Will the external auditor catch all misstatements?

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How about immaterial amounts?

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EA – Reporting Lines

- Board of Directors
- Audit Committee
- Management
- Internal auditor
- Regulators
Who does the auditor work for?

• “This will confirm the arrangements between XYZ Bank (The Bank) and The External Auditor for the audit of the Bank's consolidated balance sheet as of December 31, 2000, and the related consolidated statements of income and cash flows for the year then ending.”
EA – Interaction With Others

- Board of Directors/Audit Committee
  - Report on management
  - Report on financial statements
  - Report on independence
  - Report on controls
What does the auditor do? (1)

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What does the auditor do? (3)

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EA – Interaction With Others

- Management
  - Suggestions for improvement
  - Report on financial statements
What has to be communicated to the Bank? (1)

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What has to be communicated to the Bank? (2)

• Any “reportable conditions” (defined by the American Institute of Certified Public Accountants as “significant deficiencies in the design or the operation of internal control that, in the auditor’s judgment, could adversely affect the organization’s ability to record, summarize and report financial data consistent with the assertions of management in the financial statements”) identified during our audit of the financial statements or our examination of internal control over financial reporting (see below) will be communicated to you, along with our recommendations for improvement.
What is a “reportable condition”?

- A significant deficiency in the design or the operation of internal control that, in the auditor’s judgment, could adversely affect the organization’s ability to record, summarize and report financial data consistent with the assertions of management in the financial statements.
What has to be communicated to the Bank? (3)

- As required by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), we will also discuss management’s assertion regarding the effectiveness of internal control over financial reporting before those reports are filed by management with the appropriate regulatory agencies.
EA – Interaction With Others

- Federal Banking Regulators
  - Report on financial statements
  - Report on reportable conditions
  - Informal conversations
  - Regulatory compliance – LIMITED
Who owns the auditor’s working papers?

• The working papers prepared in conjunction with our work are the property of The External Auditor, constitute confidential and proprietary information and will be retained by us in accordance with our policies and procedures.
Can the Regulators view or have copies of the working papers?

- However, if we are requested to make certain working papers and other material pertaining to the institution prepared in the course of performing the completed external auditing program available to the FDIC and the Federal Reserve Board (the “banking regulators”) pursuant to authority given to them by law or regulation, we will provide such access under our supervision.
EA - Profession

- AICPA Code of Ethics
- SEC/Banking Regulators sanctions
- Civil lawsuits
- Firm reputation
What standards must the external auditor follow?

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