# UK Code of Practice for the relationship between supervisors and auditors

*Pat Sucher, 24 June 2011*

# Agenda

- Introduction to the Code of Practice
- Objectives of the Code of Practice
- Legal basis
- Principles
- Practical implementation

# Introduction

- As explained in our Discussion Paper and subsequent Feedback Statement – *Enhancing the auditor's contribution to prudential regulation*, we recognise the need for better, more frequent dialogue between auditors and supervisors.

- The need to "reinforce the dialogue between regulators and auditors" also featured in the EC's Green Paper, which described a 2-way process of discussing areas of concern.

- To guide this relationship we worked with the audit profession to develop a set of principles which comprise the 'Code of Practice', which has now been issued as formal FSA guidance, after a short consultation period which indicated broad support from auditors and firms. (http://www.fsa.gov.uk/pubs/guidance/fg11_09.pdf)

# Objectives

- Foster a productive working relationship between auditors and supervisors of regulated firms, in order to:
  - Enhance the effectiveness of audits, resulting in better quality financial reporting, and
  - Improve supervisory and policy decision making

- Audit effectiveness enhanced by:
  - Better, more comprehensive issue identification through ongoing dialogue with supervisors
  - Influence of auditor on management's financial statement disclosures

- Supervisory efforts enhanced by:
  - Auditor insights on issues impacting prudential regulation

# Legal basis

- The legal framework in the UK facilitates the level of information sharing envisaged by the Code.
- Specifically:
  - The FSA may pass on information (including confidential information) to the auditor to enable it to perform its functions or for the auditor to discharge his statutory duties
  - An auditor has a statutory *duty* to report certain matters to the FSA, but also a legal *right* to report matters to the FSA
  <u>- The enhanced engagement envisaged by the Code is aimed at delivering the full benefits of this right of the auditor</u>
  - This information exchange is recognised in EU law such that it does not breach confidentiality rules / professional secrecy requirements

# Principles

**Context:**

- Deals with *firm specific* communication (although we also engage with auditors on a broader level)
- The relationship does not detract from the distinct roles and responsibilities of management, the board and audit committee, and the auditors
- A 2-way / mutually beneficial relationship
- Principles based; not a statutory requirement or ‘enforced’ (not considered necessary)

# Principles

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| **Principle 1**: Supervisors and auditors shall seek an open, cooperative and constructive relationship |
| **Principle 2**: Supervisors and auditors should engage in regular dialogue |
| **Principle 3**: Supervisors and auditors shall share all information relevant to carrying out their respective statutory duties in a timely fashion |
| **Principle 4**: Supervisors and auditors shall respect their duty to treat information shared between the two parties or received from firms confidentially |

# Implementation

- Form and frequency
  - Depends on level of risk posed by the firm (i.e. the Code is proportional)
  - Alignment of timing to audit cycle and/or supervisory processes

- Areas of mutual interest
  - The Code suggests topics to cover which are aligned to the audit process (e.g. risk assessment, key accounting judgments, governance, reporting)

- Assessment and feedback
  - Quality of dialogue to be actively monitored and fed back to audit firms and supervisors in order to ensure we realise benefits

# Practical challenges

- Practical challenges
  - Behaviours:  achieving real ‘two-way’, open information sharing
  - Building a trusting *relationship* (not just a series of meetings)
  - Involving the right people given the circumstances
  - Perceptions of undue influence by the regulator into the audit process
  - Developing appropriate communication protocols; especially for dealing with sensitive subjects