

Auditing Association of German Banks

## Audit Guidelines

October 9, 2013

*Please note:*

*The present English text is furnished for information purposes only.*

*The original German text is binding in all respects.*

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## **1. Purpose of Audits**

- 1.1 Pursuant to § 3 paragraph 1 of the Articles of the Auditing Association of German Banks (*Prüfungsverband deutscher Banken e.V.*), audits shall be performed in the interests of the German Banks' Deposit Protection Fund (*Einlagensicherungsfonds deutscher Banken*) existing within the Association of German Banks (*Bundesverband deutscher Banken e.V.*).
- 1.2 Audits shall be designed to ascertain whether there is any threat to the security of deposits at the audited bank or whether there are any doubts about the adequacy of the deposit protection ceiling.
- 1.3 The term "threat" shall include auditing covering the bank's future prospects and the aspects which are of importance for the bank's participation in the Deposit Protection Fund pursuant to § 3 paragraph 1 of the By-laws (*Statut*) of the Deposit Protection Fund: inter alia, adequate equity as defined in the German Banking Act (*Kreditwesengesetz (KWG)*), trustworthiness and professional qualifications of the management and trustworthiness of the owners of qualified participating interests in the bank. "Doubts about the adequacy of the deposit protection ceiling" may arise if a bank displays a special risk profile – particularly if an increased latent risk as defined in § 11 paragraph 1 sentence 1 no. 2, in conjunction with sentence 2, of the Articles is detected – and may result in the respective deposit protection ceiling being lowered.

The said auditing shall include detecting any existing losses of the size specified in § 35 paragraph 2 no. 4 a) and b) German Banking Act (KWG) and identifying facts pursuant to § 29 paragraph 3 sentence 1 German Banking Act (KWG).

- 1.4 In close conjunction with the audit, advice may be provided to the bank pursuant to § 3 paragraph 3 of the Auditing Association Articles with a view to preventing any future endangerment of deposits.

## **2. Types of Audits**

- 2.1 There shall be the following different types of Auditing Association audits:

- a) Deposit protection audits at member institutions pursuant to § 4 paragraph 1 sentence 1 no. 1 and § 5 paragraph 1 of the Articles
- b) Deposit protection audits at former member banks under the conditions specified in § 4 paragraph 2 of the Articles
- c) Follow-up audits to preceding deposit protection audits
- d) Admission audits pursuant to § 4 paragraph 1 sentence 1 no. 1 and § 8 paragraph 1 of the Articles.

Audits may, pursuant to § 4 paragraph 1 sentence 2 of the Articles, also include affiliated enterprises or may, under § 5 paragraph 3 of the Articles, cover the head office of member banks and their other branches.

- 2.2 Audits under paragraph 2.1 a) and c) above may be either announced or unannounced. Audits under paragraph 2.1 b) and d) above shall be announced only.
- 2.3 The present Audit Guidelines shall also apply accordingly to ownership control audits under § 4 paragraph 1 sentence 1 no. 2 and § 6 of the Articles. These shall take place in announced form only and may be combined with audits under paragraph 2.1 a), c) and d) above.

### **3. Scope of Audits**

- 3.1 Audits under paragraph 2.1 a) to c) above may
  - a) cover the entire business operations (full audits)
  - b) be limited to certain areas pursuant to § 4 paragraph 3 second half of sentence 1 of the Articles (partial audits).
- 3.2 Follow-up audits (paragraph 2.1 c) above) shall be limited to those areas of the bank's business which are specified in the report on the preceding deposit protection audit.
- 3.3 The admission audit (paragraph 2.1 d) above) and the initial audit upon completion of the admission procedure shall in principle be full audits. Repeat audits shall generally be limited to certain areas unless there are specific reasons which make it apparent that a new full audit is advisable.

- 3.4 In the course of audits, the legal situation, the economic and organisational basis as well as selected aspects of the internal control system of the bank, including the net asset position, liquidity position and earnings position, shall be examined in each case.
- 3.5 In the case of audits limited to certain areas pursuant to paragraph 3.1 b) above, their focus shall be communicated to the bank in the audit notice. If it should prove necessary on the basis of findings made during the audit, the Auditing Association shall reserve the right to extend the audit to other areas.

#### **4. Performance of Audits**

- 4.1 Audits shall be performed on the basis of the Articles and the principles laid down for credit institutions – in particular the provisions of the German Banking Act (KWG) and the announcements of the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*) and the other competent authorities – in compliance with auditors' professional standards and applying *mutatis mutandis* the General Terms of Engagement for German Public Auditors and Public Audit Firms in their currently valid version. In applying their standards, auditors shall take into account the circumstances of a properly managed bank and the experience of the Auditing Association.
- 4.2 Auditors shall identify themselves when commencing their auditing work. Under § 5 paragraph 1 sentence 2 of the Auditing Association Articles, they shall be entitled to request all documents, evidence and information which appear important to them and to put together working papers and permanent files within the usual professional limits. In the process, documents may be copied or duplicated in extract form. Data and information required for performance of the audit shall also be made available on request by providing electronic access or by transferring data to Auditing Association personal computers for subsequent evaluation using auditing programmes. The working papers as well as the transferred data and subsequent evaluations shall be for the purpose of preserving evidence and monitoring auditing. They shall be held in secure safekeeping at the Auditing Association premises. § 24 of the Articles on the duty of secrecy and confidentiality and the relevant provisions concerning auditors shall be observed in this regard. To support auditing activity, a comprehensive information and communication system shall be used; to access

the Auditing Association's intranet, it may therefore be necessary for the bank to provide appropriate technical facilities.

- 4.3 The assessment made in the course of an audit shall in principle be based in each case on the circumstances on a specified audit date. The audit date shall be communicated to the bank with the audit notice. This shall usually be the last day of the month prior to the commencement of the audit. To obtain a better insight, the auditor may examine transactions conducted before or after the audit date either on a random sampling basis or in their entirety. If the workflow system is examined in the course of an audit, as for example happens in the case of the internal control system, the assessment shall cover timespans specified by the auditor. In these cases, no specific audit date shall be selected.
- 4.4 The Auditing Association may in special cases also audit areas outsourced to other enterprises at these enterprises and examine borrower or third-party security, provided the bank would also be entitled to do so.

The bank shall be obligated, on request, to enable the Auditing Association to perform such audits if this is necessary for proper assessment of the bank's circumstances.

- 4.5 Auditors shall obtain letters of representation signed by the managers for the audit files.

## **5. Duration of Audits**

The Auditing Association shall endeavour to ensure that audits are as brief as possible. The duration of an audit shall also generally depend, however, on how willing bank managers and staff are to be audited and to provide information or make available documents and data.

## **6. Frequency of Audits**

- 6.1 The interval since the preceding deposit protection audit at a member bank pursuant to paragraph 2.1 a) above shall be not less than two years and not more than five years. The interval between two audits shall be calculated on the basis of the audit date, which shall vary from audit to audit.

Deposit protection audits may take place at intervals of less than two years if they extend to areas other than those covered in the preceding audit.

The first audit after completion of the admission procedure shall take place no later than the third full fiscal year of the relevant member bank.

- 6.2 Irrespective of the provision contained under paragraph 6.1 above, audits may be performed at shorter intervals if there are signs – which shall be notified to the bank concerned – that a threat to the security of deposits exists. Reference is made to § 5 paragraph 1 of the Auditing Association Articles.
- 6.3 Should an audit conclude with "special audit findings" pursuant to paragraph 7.4 below or "conditions" imposed under § 11 paragraph 1 of the Articles, a follow-up audit (paragraph 2.1 c) above) may take place if necessary shortly thereafter. This follow-up audit shall focus on re-examination of shortcomings ascertained and elimination thereof or compliance with "conditions" imposed.
- 6.4 There is agreement with the Federal Financial Supervisory Authority (BaFin) that no overlaps should occur between Auditing Association audits and audits pursuant to § 44 paragraph 1 German Banking Act (KWG). If the Auditing Association is aware of any audits by the competent supervisory authorities and the results are known to it, the Auditing Association shall, as a rule, conduct an audit concerning the same subject area at the earliest one year after the date of the audit by the competent supervisory authority; the reasons for a shorter interval shall be communicated to the bank concerned.
- 6.5 Admission audits pursuant to § 4 paragraph 1 sentence 1 no. 1 and § 8 paragraph 1 of the Auditing Association Articles shall not in principle be waived.

## **7. Reporting Audit Results**

- 7.1 During the audit, auditors shall prepare a draft report on their findings. In the interests of uniformity, such reports shall be based on model audit reports.
- 7.2 Auditors shall brief the bank on an ongoing basis, and especially at the end of the audit, on the provisional audit results. Briefing shall take place subject to the audit review following completion of the audit. The written reports after completion of the audit review shall apply exclusively; any statements and information given verbally outwith an audit shall be non-binding in each case.
- 7.3 Each report shall contain a summarised result presenting the most important audit findings and the overall assessment of the risk exposure.
- 7.4 If an audit produces "special audit findings", these shall be indicated subsequent to the summarised result. If these findings are such that they are accompanied by an objection within the meaning of § 11 paragraph 1 no. 1 of the Auditing Association Articles or that an otherwise imminent threat to the security of deposits cannot be ruled out, "conditions" may be imposed pursuant to § 11 paragraph 1 of the Articles. Conditions shall be imposed and lifted in compliance with § 11 of the Articles.

Where "conditions" are imposed, the bank shall be required pursuant to § 11 paragraph 5 sentence 1 of the Articles to state in writing at the request of the Auditing Association that it complies with these conditions. In the course of each subsequent audit, the Auditing Association shall make sure that these conditions are complied with.

- 7.5 "Special audit findings" may be made in the report also in regard to individual business transactions or basic objections with the aim of affording the bank the opportunity to improve the situation or to eliminate the shortcoming concerned within a set period of time.

In this case, the bank shall be requested to respond to the audit findings within a reasonable period of time following receipt of the final copy of the report. In doing so, it shall indicate whether and to what extent it has complied with the "special audit findings". Where required, a follow-up audit shall take place (cf. paragraph 6.3 above).



- 7.6 If in the course of an audit an asset or debit item cannot be conclusively assessed (e.g. due to the absence of any proof of the value of the asset item or an inability to assess the value of a security) or if an unsecured loan – measured against the circumstances of the bank or the borrower – appears too high, the Auditing Association shall refer to an "increased latent risk", signifying a corresponding "tying up" of equity and/or hidden reserves. Should the tying up of equity give rise to a "special risk profile" for the bank pursuant to § 6 paragraph 1c of the By-laws of the Deposit Protection Fund, this shall result in the deposit protection ceiling being lowered accordingly.
- 7.7 The audit report shall contain an audit opinion indicating in summarised form whether any threat to the security of deposits exists, possibly highlighting significant audit results. The audit opinion shall also include an assessment of the adequacy of the relevant deposit protection ceiling.
- 7.8 On completion of the audit review, the bank shall receive the draft audit report and be invited to comment. For this, a period shall be set – as a general rule two weeks – which shall, on the one hand, take account of the needs of the bank and shall, on the other hand, ensure that the audit report is up-to-date.
- If the bank fails to comment on the draft audit report at its disposal following expiry of the period set, the Auditing Association shall proceed to prepare and deliver the final report without considering any subsequent comments received from the bank.
- 7.9 Copies of the audit report shall be sent to the bank and, pursuant to § 5 paragraph 2 sentence 2 of the Auditing Association Articles, simultaneously to the Federal Financial Supervisory Authority (BaFin), the responsible regional office of the *Deutsche Bundesbank* and to the bank's own annual financial statements auditor. In addition, the Auditing Association shall be entitled to make available the audit report in full or in part to the other competent supervisory authorities as well.
- 7.10 Pursuant to § 5 paragraph 2 sentence 1 of the Articles, the Auditing Association shall inform the Board of Directors of the Association of German Banks, the Deposit Protection Committee and the Member of the Management Board of the Association of German Banks responsible for the Deposit Protection Fund if an audit has led to findings which make it appear that deposits may possibly be endangered. It shall do so immediately, i.e. if necessary, even prior to completion

of the audit. The Auditing Association shall inform the competent supervisory authorities simultaneously in corresponding application of § 29 paragraph 3 German Banking Act (KWG). It shall do so verbally or in writing, whereby the draft report may be sent either wholly or in extract form prior to obtaining the bank's response pursuant to paragraph 7.8 above. The bank management shall be informed simultaneously at the latest. In addition, the Auditing Association shall be entitled to communicate and explain to the competent supervisory body of the member bank audit results or other significant facts that may seriously impair the further development of the member bank (§ 5 paragraph 2 sentence 3 of the Articles).

- 7.11 Pursuant to § 4 paragraph 1 sentence 1 no. 8 of the Articles, the Auditing Association shall inform the Deposit Protection Fund of the Association of German Banks of the volume of protected deposits as well as the level of, and any change in, the protection ceiling of the bank if the audit has led to the detection of increased latent risks within the meaning of paragraph 7.6 above.
- 7.12 In the case of admission audits, the Auditing Association's Advisory Board and, where necessary, the Members Meeting (pursuant to § 24 paragraph 3 sentence 2 of the Articles) as well as the Association of German Banks (pursuant to § 24 paragraph 2 sentence 1 of the Articles) shall be informed of the audit results that are of importance for the admission decision.
- 7.13 The report on auditing in the context of Owner Control Procedures shall be sent to the holder of the qualified participating interest or their legal representative or personally liable partner of the enterprise holding the participating interest. If the prerequisites for participation in the Deposit Protection Fund are not met or are no longer met according to the audit result, the audit report shall also be made available to the Association of German Banks and the competent supervisory authorities, unless the said report has to be submitted in any event in corresponding application of § 26 paragraph 2 or § 29 paragraph 3 German Banking Act (KWG).

## **8. Audit Costs**

- 8.1 Approximately 50 % of Auditing Association costs shall be met from members' contributions and approximately 50 % by charging audit fees.

- 8.2 The bills of fees for deposit protection audits and follow-up audits shall be issued on this basis. Further details are contained in the current version of the scale of fees and charges adopted by the Advisory Board pursuant to § 15 paragraph 5 of the Articles.
- 8.3 In the case of admission audits under paragraph 2.1 d) above, ownership control audits under paragraph 2.3 above and audits under paragraph 2.1 sentences 2 and 3 above at affiliated companies, and in the case of additional audit activities to assess the areas outsourced to other enterprises under paragraph 4.4 above and increased latent risks within the meaning of paragraph 7.6 above, particularly at the head office of a member bank or other branches abroad, the rebate resulting from members' contributions under paragraph 8.1 above shall not apply even if such audits are carried out in the course of or in connection with deposit protection audits. Audit fees shall be borne by the member bank concerned unless the audited company or audited holder of the qualified participating interest or the audited head office agrees to assume these. Further details are contained in the scale of fees and charges adopted by the Advisory Board pursuant to § 15 paragraph 5 of the Articles.
- 8.4 Bills of fees shall indicate the number of audit days taken and the daily rates per category of staff.
- 8.5 If the audit date is less than one year after the date of the preceding audit covering the same area for which fees were charged, the audit shall be performed free of charge. This shall not apply to follow-up audits pursuant to paragraph 2.1 c) above or audits in connection with paragraph 6.2 sentence 1 above.
- 8.6 If audits are delegated by the Auditing Association pursuant to § 4 paragraph 3 sentence 2 of the Articles either wholly or in part to other persons or enterprises, the latter's costs and fees shall be settled directly between the latter and the audited party or, in special cases, costs charged by the latter to the Auditing Association shall be refunded provided the said costs and fees are reasonable in relation to the relevant Auditing Association scale of fees and charges.

## **9. Responsibility**

- 9.1 Decisions regarding the performance of audits and their focus shall be incumbent upon the Executive Board. Details of responsibility for auditing arrangements are contained in the Executive Board's schedule of responsibilities.
- 9.2 The Auditing Association's Advisory Board shall perform the duties provided for in the Articles. It shall not in principle be informed of the results of auditing carried out at individual banks, but may be briefed on general results, individual results without naming names, and member banks audited in the course of the fiscal year. This shall not apply in the case of admission audits; in their case, the Advisory Board shall be informed of all audit results that are of importance for the admission decision.
- 9.3 The duties and responsibilities of the Members Meeting are governed by the Articles of the Auditing Association. The Members Meeting shall be informed pursuant to § 24 paragraph 3 sentence 2 no. 2 of the Articles of the content, results and findings of audits solely in the cases referred to therein.