

**Basel Committee on Banking Supervision**

# Core Principles Methodology

October 2006



BANK FOR INTERNATIONAL SETTLEMENTS

## Accounting and Auditing Sub Component *A Team that Works*



### Objective:

- ✓ Enhance understanding of key supervisory issues
- ✓ Improve the quality of banking supervision worldwide

### Members

Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States

### Four main sub-committees

Accord Implementation Group

Policy Development Group

Accounting Task Force

International Liaison Group

Located :

Bank for  
International  
Settlements  
Basel,  
Switzerland,

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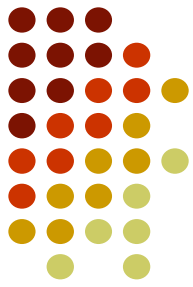
### Accounting Task Force

The **Conceptual Framework Issues Subgroup** monitors and responds to the conceptual accounting framework project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB)

The **Financial Instruments Practices Subgroup** examines implementation of international accounting standards related to financial instruments, and the links between accounting practices in this area and prudential supervision.

**Audit Subgroup** focuses on responding to international audit standards-setting proposals, other issuances of the International Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants,

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### Core Principles for Effective Banking Supervision

de facto the standard for sound prudential regulation and supervision of banks

- Principle 1:** Objectives, independence, powers, transparency and cooperation
- Principle 2:** Permissible activities
- Principle 3:** Licensing criteria
- Principle 4:** Transfer of significant ownership
- Principle 5:** Major acquisitions

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**Principle 6:** Capital adequacy

**Principle 7:** Risk management process

**Principle 8:** Credit risk

**Principle 9:** Problem assets,  
provisions and reserves

**Principle 10:** Large exposure limits

**Principle 11:** Exposures to related  
parties

**Principle 12:** Country and transfer risks

**Principle 13:** Market risk

**Principle 14:** Liquidity risk

**Principle 15:** Operational risk

**Principle 16:** Interest rate risk in the  
banking book

**Principle 17:** Internal control and audit

**Principle 18:** Abuse of financial  
services

**Principle 19:** Supervisory approach

**Principle 20:** Supervisory techniques

**Principle 21:** Supervisory reporting

**Principle 23:** Corrective and remedial  
powers of supervisors

**Principle 24:** Consolidated supervision

**Principle 25:** Home-host relationships

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### Principle 22: Accounting and disclosure

#### Adequate records

in accordance with accounting policies and practices  
widely accepted internationally,

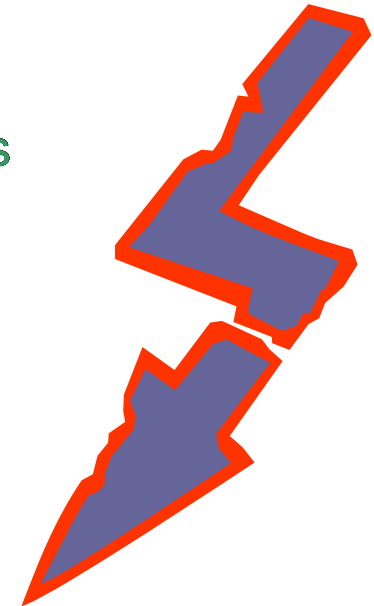
and publishes,

on a regular basis, information

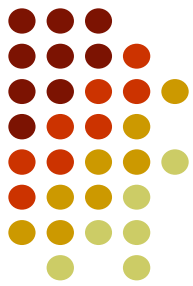
that fairly reflects its

financial condition

and profitability



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### Assessment missions in the context of:

#### Financial Sector Assessment Program (FSAP)

A joint IMF and World Bank effort introduced in May 1999 to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. Reports on Observance of Standards and Codes (ROSCs) as a by-product, are a key component of the FSAP.

#### Offshore Financial Center Program (OFC)

Launched in July 2000 is addresses potential vulnerabilities in financial systems by identifying gaps in supervision and improving coverage the activities of Offshore Financial Centers Focused on jurisdictions with significant financial activity and few previous assessments of standards,

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**Essential  
criteria**

Record-keeping systems produce **reliable data**

**Hold bank management** and the bank's Board **responsible** for ensuring annual public financial statements proper external verification and an external auditor's opinion.

Use valuation rules that are **consistent, realistic and prudent** to show profits net of appropriate provisions



**Establish**, the scope of external audits and the **standards to be followed**



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**Essential  
criteria**



**Determine what areas the audits must covers** such as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, and the adequacy of internal controls over financial reporting.

the **power to reject and rescind** the appointment of an external auditor that is deemed to have inadequate expertise or independence

**Require banks to produce annual audited financial statements based on accounting principles and rules** that are widely accepted internationally and have been audited in accordance with internationally accepted **auditing** practices and standards.

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**Essential  
criteria**



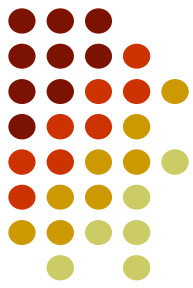
Require periodic public disclosures of information that adequately reflect the true financial condition. Promote the comparability, relevance, reliability and timeliness

Required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and basic business, management and governance.

Provide effective review and enforcement mechanisms designed to confirm compliance with disclosure standards

# ENFORCE

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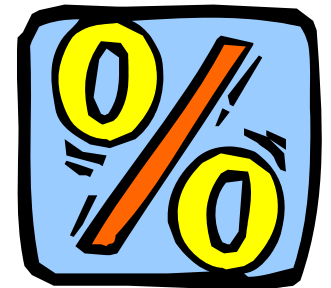
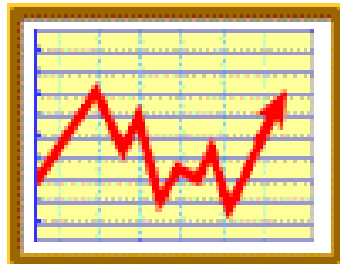
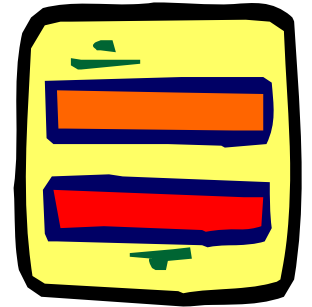


**Essential  
criteria**



**Publish aggregate information on the banking system to facilitate public understanding of the banking system and the exercise of market discipline.**

**Such as balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).**



**Additional  
criteria**

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- 1 Meet periodically with external audit firms to discuss issues
- 2 External auditors have the duty to report to the supervisor matters of material significance
- 3 Require banks to rotate their external auditors from time to time.
- 4 Requires banks to have a formal disclosure policy
- 5 Power to access external auditors' working papers

