

LICENSING AND SUPERVISION OF BANKING BUSINESS

Manner of Conducting External Audit of a Bank Directive No.SBB /---/2022 **(Draft)**

Whereas, it is essential to ensure that a bank maintains accurate and reliable records and prepares financial statements in line with internationally accepted accounting standards and regulatory requirements;

Whereas, it is essential to ensure that a bank has adequate governance and oversight of its external audit function, and also ensures that external audit is performed by qualified and independent auditor;

Whereas, enhancing increased reliance on the works of external auditor's is believed to enhance quality and effectiveness of Risk Based Supervision (RBS);

Whereas, disclosure is necessary to enhance market discipline and public confidence thereby strengthening incentives for banks to behave in a prudent and efficient manner;

Now, therefore, in accordance with article 22(1) of NBE establishment (as Amended) Proclamation No.591/2008 and sub-article 25(1), 26(2), 31(4) and 66(2) of Banking Business Proclamation No.592/2008 as amended by Banking Business Proclamation No.1159/2019; the National Bank of Ethiopia has issued this Directive.

1) Short Title

This Directive may be cited as “**Manner of Conducting External Audit of a Bank Directive No. SBB/ ___ /2022**”.

2) Definition

For the purpose of this Directive, unless the context requires otherwise, the term:

- 2.1) “**Audit Engagement Letter/Audit Contract**” means a document containing the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and vice versa, agreed financial reporting framework for the preparation of the financial statements and the forms of reports to be produced, and a statement that a report may differ from its expected form and content;

- 2.2) **“Associates”** means a business entity in which an external auditor or his partner has a business interest;
- 2.3) **“Bank”** means a company licensed by the National Bank to undertake banking business or a bank owned by the Government;
- 2.4) **“Consolidated auditing”** means the auditing of all significant line of businesses, activities and process of a financial institution and any of its subsidiaries thereof.
- 2.5) **“Day-one gain/loss”** means the difference between the transaction price and the initial fair value of an asset or liability, if any.
- 2.6) **“Engagement Partner/Audit Manager”** means a partner or other person in the audit firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the audit firm;
- 2.7) **“Employee”** means a chief executive officer, a senior executive officer or any other employee who is appointed or hired by a bank to carry out its day-to-day activities;
- 2.8) **“External Auditor”** means a public auditor or an audit firm licensed by Accounting and Auditing Board of Ethiopia (AABE);
- 2.9) **“Independence”** shall mean freedom from conditions that threaten the ability of the external auditor to carry out its responsibilities in an unbiased manner;
- 2.10) **“National Bank”** means the National Bank of Ethiopia;
- 2.11) **“Partner”** means a certified and licensed individual auditor or an audit firm that is partnered to engage together in the planned audit engagement of a bank;
- 2.12) **“Sub-contracting”** means the further transfer of an audit activity or a part thereof, from one audit firm to another audit firm; and
- 2.13) **“Substantive procedures/test”** means those activities to be performed by the external auditor to detect material misstatement or fraud at the assertion level.

3) Scope of the Directive

This Directive shall be applicable on all banks operating in Ethiopia.

4) General Provisions on Appointment of an External Auditor

- 4.1) A bank shall select and appoint an external Auditor/s through a competitive bid and in compliance with its own procurement policies and procedures.
- 4.2) A bank may re-appoint an external auditor/s which was appointed as per sub-article 4.1 hereinabove, without competitive bid. However, an external auditor appointed on the basis of same shall not hold office for more than three consecutive years in a bank.
- 4.3) An external auditor/s elected by the subscribers meeting for audit of its first year operation may be re-appointed by the first Annual General Meeting. In such conditions, three years term stated under sub-article 4.2 hereinabove, shall include first year of operation.
- 4.4) Upon re-appointment of an external auditor, the terms of audit engagement letter/audit contract shall be revised if the level of change in the financial institution's business, or composition of external audit team warrants doing so and/or if there exists misunderstandings of the objective and scope of the audit.
- 4.5) An external auditor may be re-appointed after a lapse of three consecutive years as far as it is re-selected through a competitive bid.
- 4.6) If a bank's selected external auditor is subject to conflict of interest, no longer meets eligibility requirements and/or fails to adequately perform the required functions or duties; the National Bank may order a bank to replace the external auditor immediately.

5) Selection of an External Auditor

In conducting the selection and appointment of an external auditor, a bank shall:

- 5.1) ensure that an external auditor or any partner thereof is licensed by Accounting and Auditing Board of Ethiopia (AABE) and has subsequently renewed its license as appropriate;
- 5.2) ensure that members of audit team have comprehensive IFRS knowledge; and, at least, 60% of them have ACCA or other equivalent qualification as recognized and registered by AABE;
- 5.3) assess that the engagement partner/audit manager have a minimum of 5(five) years of experience in banking audit; and also ensure that at least 50% of the audit team have minimum of 3 (three) years experience in banking audit;

- 5.4) assess that the proposed audit team has adequate exposure, training or expertise of fair value estimation and is able to check the robustness of the processes for determining fair value of assets and liabilities; and also to evaluate key assumptions and inputs that a bank has used in its valuations;
- 5.5) ensure that an external auditor, its partner or its staff member **is not**:
- a) a shareholder, a director or an employee of a bank to be audited;
 - b) a spouse or relative by consanguinity or affinity to the first degree to a shareholder, a director or an employee of that bank;
 - c) a shareholder, a director or an employee of a firm which is directly or indirectly owned by:
 - i) a shareholder, director or employee of that bank; and
 - ii) a spouse or relation by consanguinity or affinity to the first degree to a shareholder, a director or an employee of that bank; and/or
 - d) an agent or representative or any service provider to that bank in any matter.
- 5.6) ensure that the audit firm and its partners, directors, management or members of the proposed audit team:
- a) have not been insolvent or declared bankrupt by a court;
 - b) have not been convicted by the court for any criminal offence, fraud/forgery, financial crime or other illegal activities;
 - c) are not defaulter of any bank or other financial institution, and
 - d) are not defaulter of any tax obligation.
- 5.7) ensure that the external auditor, its partners or its audit team members as well as their associates do not operate any deposit account and are not direct or indirect borrower and/or foreign currency user of your bank except at arm's length basis;
- 5.8) ensure that an external auditor will not be sub-contracting an activity or a part thereof; or, if the audit firm has a plan to sub-contract any activity that shall be disclosed in the audit contract and be subject to review as per the aforementioned due process and get approval by the National Bank;
- 5.9) clearly state in the audit contract that the contract with the audit firm may be cancelled if an audit firm fails to fulfill the criteria set out in this Directive due to change in its ownership, directors and managers and any disciplinary or legal actions taken against the firm or any of its audit team, or due to other similar matters, and

- 5.10) require an external auditor to complete a written “Independence Confirmation” and “Fit and Propriety Declaration” forms for each and every proposed audit team members, for every appointment or re-appointment, as per **Annex I** and **II** of this Directive, respectively.

6) Approval By the National Bank

- 6.1) Every year including its first year of operation, a bank shall submit written approval request for the appointment or re-appointment of an external auditor to the National Bank within **10 (ten)** working days from date of appointment or reappointment of an external auditor, along with Annual General Meeting minutes and other supporting documents as per **Annex III** of this Directive.
- 6.2) If the terms of audit engagement letter/audit contract is revised as per sub-article 4.4 of this Directive, a bank shall submit written approval request to the National Bank within **5 (five)** working days.
- 6.3) No bank shall remove or change its external auditor/s already appointed and approved by the National Bank, without the prior written approval of the National Bank.

7) Responsibilities of an External Auditor

Without prejudice to the duties imposed by other relevant laws, a bank’s external auditor shall be responsible for the following activities and proceedings.

- 7.1) ensure that the financial statements submitted to the National Bank have been prepared in accordance with relevant regulatory requirements.
- 7.2) focus on the recoverability and the carrying value of loan investments and other assets shown in the financial statements; and also identification and adequate disclosure of all material commitments and liabilities. More specifically, an external auditor shall at least cover the following areas:
- a) independently verify and validate the framework, structure, key assumptions and inputs and processes used for fair value estimation; and ensure that the valuation practices by a bank are consistent with internationally accepted accounting standards as adopted in Ethiopia;
 - b) assess the adequacy of provisions held for non-performing loans before annual accounts of a bank are finalized and dividends paid to shareholders;

- c) ensure that risks, fair value estimates and methodologies and uncertainties surrounding estimates have properly been disclosed;
 - d) ascertain that loan-loss provisions and day-one gain/loss recognition are reflected in fair value estimates have been carried out properly;
 - e) review computation of capital adequacy and liquidity ratios in accordance with the requirements of the National Bank;
 - f) review foreign exchange transactions (including recognition of valuation gains and losses), guarantees, and all contingent liabilities including letters of credit and other off-balance sheet items considering their amounts and nature; and
 - g) assess internal controls over fair value and other accounting estimates; and the overall adequacy of internal controls over financial reporting.
- 7.3) base its audit work on the assessment of the inherent risk of material misstatement and control risks, and substantive testing of the internal controls designed to prevent or detect and correct material misstatements. Among others, such substantive tests shall consider the findings of an internal auditor.
- 7.4) conduct its audit on consolidated basis; and if Board of Directors or Management imposes a limitation on the scope of the auditor's work, the auditor shall not accept such a limited engagement as an audit engagement, unless required by the National Bank as a special audit.
- 7.5) keep any information obtained during the course of the audit confidential or shall not disclose to any third party other than specifically allowed as per this Directive and other relevant laws, until the final report is issued.

8) Responsibilities of the Board of Directors of a Bank

The Board of Directors of a bank shall:

- 8.1) ensure that the external auditor who examines and reports on its financial statements has complete and unhindered access to and is provided with all necessary information;
- 8.2) monitor the independent conduct of the audit function and shall maintain effective communication with the external auditor to enhance the quality of the overall audit findings;

- 8.3) ensure that all significant line of businesses, activities and processes, and any subsidiaries thereof, have been audited and/or validated by its external auditor; and opinion has been reflected thereof.
- 8.4) review the terms of audit engagement letter prior to offering the audit work and ensure that it is prepared in line with the provisions of this Directive and other relevant laws; and the agreed terms shall be documented in a clearly written audit engagement letter;
- 8.5) ensure that the external auditor/s fulfill requirements set out in this Directive and recommend for the appointment and the approval to the shareholders meeting;
- 8.6) ensure fair and transparent reporting and prompt publication of the financial statements and the disclosures thereof;
- 8.7) conduct detailed deliberations on all matters and findings with the external auditor, in the presence of its internal auditors; and strengthen corporate governance of the financial institution accordingly; and
- 8.8) evaluate the effectiveness of the external audit process at the end of every audit cycle or every year and **periodically assess if required disclosures are made of.**

9) Special External Audit

- 9.1) The National Bank may require an external auditor of a bank to carryout special audit on its area of interest and submit a report accordingly.
- 9.2) Any remuneration for an audit conducted by an external auditor according to sub-article 9.1 of this article, shall be paid by the bank being audited.

10) Immediate Notification Requirements

- 10.1) An external auditor shall confidentially and immediately notify to the National Bank if a bank hinders access to necessary information that can materially affect expression of its opinion on the financial statements of a bank.
- 10.2) An external auditor shall inform a bank which it has engaged with, any changes in its ownership, directors and managers and any disciplinary or legal actions taken against the firm or any of its audit team members immediately.
- 10.3) If an external auditor of a bank terminates his service before his term of office for any reason by itself, a bank shall immediately notify such fact to the National Bank, with reasons and proposed subsequent actions to be approved by the National Bank.

11) Reporting Requirements

- 11.1) Audit report of a bank shall directly be presented by the external auditor to the shareholders of a bank and submitted to the National Bank including management letter, within **4 (four)** months from the end of Ethiopian financial year
- 11.2) Management Letter in **sub-article 11.1** hereinabove, shall include all early warning and/or any signaling issues irrespective of their materiality; and accordingly it shall include at least the followings:
- a) weaknesses in internal controls;
 - b) mis-valuation of assets or any misstatements and frauds committed;
 - c) breach of laws or regulations or the bank's memorandum of association or failure to meet National Bank requirements;
 - d) irregularities which may jeopardize the security of depositors or creditors;
 - e) issues that affect the bank's ability to continue as a going concern;
 - f) any adjustment made to the financial statements;
 - g) material adverse changes in any risks of the bank's business;
 - h) level of risks emanating from foreign exchange transactions, guarantees, all contingent liabilities including letters of credit and other off-balance sheet items considering their amounts and nature, and
 - i) any other governance related weaknesses.
- 11.3) Where it is deemed important, the National Bank may access external auditor's working papers, demand walk through presentation and conduct necessary investigations, and may require the auditor to extend the scope of the audit.
- 11.4) If not satisfied with the external audit report, the National Bank may order for a second audit or require the prompt appointment of a new auditor, but any related remuneration shall be paid by the respective bank.

12) Disclosure Requirements

- 12.1) A bank, in its official website, shall post audited financial statements and related disclosures including its core activities, capital and capital adequacy, risk profile, risk assessment processes, fair value estimates and methodologies and uncertainty surrounding estimates both in qualitative and quantitative terms; within 2 (two) weeks from the date of approval of the external audit report.

- 12.2) A bank's disclosure policy and procedure manual shall address matters related to disclosures of financial records and related information including internal controls and periodical assessment needed over the disclosure process.

13) Prohibition

The following information shall not be disclosed?

- 13.1) any information whose disclosure would possibly have adverse effect on customers and bank's safety and soundness;
- 13.2) actual level of nonperforming loans ratio in its website and/or in its audit report, apart from provision of general information on credit risk; and
- 13.3) inability of the bank to meet obligations to its depositors or other creditors; or possibility of inability to make payments to its depositors or other creditors in the foreseeable future.

14) Penalty and Administrative Sanctions

- 14.1) Any director or employee of bank who obstructs the proper performance of an external auditor in accordance with the provisions of this Directive shall be punished with the penalty from Birr 50,000 (Fifty Thousand Birr) to Birr 100,000 (Hundred Thousand Birr).
- 14.2) National Bank may suspend or remove directors, chief executive officer and senior executive officers of a bank who obstructs an external auditor in the performance of his or her duties, or fails, refuses or neglects to provide an external auditor with such books, accounts, computer systems, vouchers and other financial records as requested by the external auditor.

15) Repeal

Directive No.SBB/19/96 is hereby repealed and replaced by this Directive.

16) Effective Date

This Directive shall enter into force as of March 2022

Annex I: External Audit Team Member's Independence Confirmations Form¹

This confirmation of independence and compliance with ethical requirements is provided in respect of the audit of the financial statements of the (Name of the Bank) and its related entities including

_____, _____, _____,
_____ and _____ for the FY ended _____.

I confirm that I am in compliance with the applicable independence rules as specified below, with respect to (Name of the Bank); hereafter referred to us “**a client**”.

- 1) I or my immediate family members do not have a financial interest in a joint venture or business relationship (or commitment to do so) with the Client or any related entity or any officer, director or other individual who performs senior managerial functions for this client thereof.
- 2) I or my immediate family members are not the beneficiaries of any estate or trust which has a direct financial interest in this audit client or any related business entity.
- 3) No close family member is a director, officer or is in a position to exert direct and significant influence over the financial statements of this client or any related entity, or was employed in such a role.
- 4) I or my immediate family members including spouse and dependents do not have a direct or indirect financial interest in this audit client or any related entity.
- 5) I or my immediate family members have not served as a trustee or as an executor over any interest that has or is committed to acquire a direct or material indirect financial interest in this client or any related entity.
- 6) I or my immediate family members do not have any loans, other than those extended under arms length basis and within the ordinary course of business with this client or any related entity or any shareholder, officer or director thereof.
- 7) I do not have a close personal relationship with a director, officer or any employee of the client or related entity that is in a position to exert direct and significant influence over the financial statements.
- 8) I am not an employee of this client or any related party and I will not entertain an offer of employment with this client or a related entity during my office term.
- 9) I further confirm that if the above circumstances change during the engagement period, I will notify the engagement partner/manager or the client any such changes in a timely manner.

¹ This form should be completed at the engagement planning stage by each of the audit team members

10) I signed under the table below that I am in compliance with independence rules listed from No.1 to 8 hereinabove and I will comply with independence rule No. 9, hereinabove. Otherwise, I will be legally responsible.

No.	Name of Engagement Team Member	Designation/ Engagement Role	Signature
1			
2			
3			
4			
5			
6			
7			

Annex II: External Audit Team Member's Fit and Propriety Declaration Form

Name: _____

Engagement Role: _____

Specific Tests to Assess Fitness and Propriety

Please answer the entire "YES"/"NO" questions and sign accordingly.

1. Have you been insolvent or declared bankrupt by a court?	Yes	No
2. Have you been convicted by the court for any criminal offence, fraud/forgery, financial crime or other illegal activities?	Yes	No
3. Have you been a defaulter of any bank or other financial institution?	Yes	No
4. Have you been a defaulter of any tax?	Yes	No
5. Have you ever been subject to any proceeding of a disciplinary or criminal nature, or have been notified of any impending proceedings or of any investigation, which might lead to such proceedings?	Yes	No
6. Have you, or any business in which you have had controlling interest or have exercised significant influence, been investigated, suspended or criticized by a regulatory or professional body, a court, whether publicly or privately?	Yes	No
7. Have you ever been associated, in ownership or management capacity, with a company, partnership or other business association whose license revoked, withdrawn or terminated?	Yes	No
8. Have you ever contravened any of the requirements and standards of a regulatory body, professional body, government or its agencies?	Yes	No
9. Have you ever been a director, partner, or otherwise involved in the management, of a business that has gone into receivership, insolvency or liquidation while you have been connected with that business or within one year after that connection?	Yes	No
10. Have you ever been dismissed, asked to resign or resigned, from employment or from a position of trust, fiduciary appointment or similar for negligence, incompetence or mismanagement?	Yes	No
11. Have you ever been disqualified from acting as director or serving in a managerial capacity?	Yes	No
12. Have you ever been diagnosed as being mentally ill or unstable?	Yes	No
13. Do you have reasons to believe that any of your close relatives or business associates, if subject to the above tests, would have responded as "Yes" to any of the above questions?	Yes	No

I hereby **declare** that to the best of my knowledge and belief the statements made and the information supplied in this questionnaire hereinabove and the attachments are correct and that there are no other facts that are relevant for assessing my fitness and propriety;

I understand that the Client may seek additional information from any third parties it deems necessary in view of assessing my fitness and propriety; and I undertake to bring to the attention of the Engagement Partner/Manger and/or a Client any matter which may potentially affect my status as being a fit and proper person as and when they arise.

Name _____

Signature _____

Date: ____/____/____

Annex III: Information and Documents Required for Approval of a Newly Appointed and Re-appointed External Auditor

A) Profile/s of External Auditor/s

1. Name of the financial institution: _____
2. Date of Application: _____
3. Name of the External auditor/Engagement Partner/Manager. _____
4. Name of the External auditor's Partner (if any) _____
5. Type of appointment: New _____ Re-appointment for 2nd time _____ Re-appointment for 3rd time: _____
6. Address of the external auditor
 - City/Town: _____
 - Sub-city: _____
 - Woreda _____
 - Kebele: _____
 - Telephone: _____
 - P.O.Box: _____
 - E-mail: _____
 - House No: _____

B) Documents Required to be submitted

- 1) Application Letter
- 2) Copy of Board Directors meeting minutes and Annual General Meeting minutes of shareholders showing approval of the appointment of the external auditor;
- 3) Proposed contract or audit engagement letter to be signed;
- 4) "Independence Confirmations" and "Fit and Propriety Declarations";
- 5) Renewed Trade License and Renewed Professional License provided by AABE;
- 6) Curriculum vitae of the proposed audit team members including ACCA certificate if any;
- 7) The name, qualification and experience of the Engagement Partner/ in this specific audit;
- 8) Details of the audit firm's and audit team members experience in auditing a bank or other financial institutions;
- 9) Details of any existing business relationships between the external auditor or its partners or its staff with the financial institution;
- 10) Copy of the license to practice auditing, including for each partner;
- 11) Taxpayer registration number, and tax clearance certificate;
- 12) A copy of certificate from Accounting and Auditing Board of Ethiopia (AABE) that the audit firm does not have any record of disciplinary action taken against unethical and unprofessional conduct;
- 13) The National Bank may require verifying any information submitted by the financial institution for the purpose of approval of the external auditor.
- 14) Certificate of Good Conduct from police for the auditor and all audit team members;
- 15) Copy of ID card or Passport of all audit team members;
- 16) In case of re-appointment, a financial institution may not submit some of the above documents which have already been submitted previously; and
- 17) In addition, the National Bank may require other information considered necessary.