



**CENTRAL BANK OF CYPRUS**

EUROSYSTEM

**BANKING SUPERVISION AND REGULATION DIVISION**

**“COMMUNICATION BETWEEN THE CENTRAL BANK OF CYPRUS  
AND THE APPROVED AUDITORS OF BANKS”**

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THE APPROVED AUDITORS<sup>1</sup> OF BANKS**

**A. INTRODUCTION**

1. The objective of the Central Bank of Cyprus (hereinafter to be referred to as “CBC”) is to create a constructive communication relationship with the approved auditors of banks so as to promote the provision of information to the CBC in a manner facilitating its supervisory function, as the latter arises from the provisions of the Banking Laws of 1997 to 2011 (hereinafter to be referred to as “the Law”).
  
2. In accordance with Section 28(1) of the Law, the CBC may arrange trilateral meetings with each bank and its approved auditor to discuss matters relevant to the CBC’s supervisory responsibilities. Also, in accordance with Section 28(2) of the Law, the CBC may, if it considers it desirable or necessary in the interests of depositors, arrange bilateral meetings with approved auditors of banks. Moreover, in accordance with Section 28(3A) of the Law, the approved auditor of a bank is required to report promptly to the CBC any fact or decision concerning the bank which came to his/her knowledge in the course of audit work which may:
  - (a) constitute a material breach of the laws, regulations or administrative provisions which lay down the conditions governing authorisation or which specifically govern the pursuit of the activities of banks;
  - (b) affect the continuous functioning of the bank; or
  - (c) lead to refusal to certify the accounts or to the expression of reservations.
  
3. The purposes of this document is to:
  - a) set out a framework on the arrangements for the trilateral meetings between the CBC, the banks and their approved auditors;
  - b) generally describe the situations and the conditions under which the CBC may invite the approved auditors of banks to bilateral meetings; and

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<sup>1</sup> Under Section 2(1) of the Law, an “approved auditor” means a person qualified under Section 155 of the Companies Law to be an auditor of a company other than an exempt private company and who is expressly authorised for this purpose by the CBC.

- c) describe the situations where reporting to the CBC needs to be made by an approved auditor in accordance with Section 28(3A) of the Law.

**B. TRILATERAL MEETINGS**

- 4. According to Section 28(1) of the Law, the CBC may convene trilateral meetings with each bank and its approved auditors to discuss issues relating to its supervisory responsibilities arising from the statutory audit of the approved auditors at each bank concerned in accordance with Section 24 of the Law. The said meetings will be arranged by the Bank Supervision and Regulation Department of the CBC.
- 5. The meetings provide the CBC with the opportunity to discuss major issues arising from the statutory audit of the approved auditors at each bank which relate to the supervisory function of the CBC. These include issues relating to the operations of the bank, its accounting system, its internal control system and annual balance sheet and profit and loss account.
- 6. The Bank Supervision and Regulation Department shall prepare the agenda for each trilateral meeting which should circulate in advance to all interested parties. Matters to be discussed during the trilateral meetings are expected to cover, among others, the following:
  - a) the annual balance sheet and profit and loss account, copies of which each bank is required, under Section 24(1) of the Law, to submit to the CBC within four months from the end of each financial year;
  - b) the approved auditor's report submitted with the above financial statements as well as any other special reports submitted in a form prescribed by the CBC;
  - c) matters, without any restriction, arising from the audit work of the approved auditor in relation to (a) and (b) above and their subsequent management letter, if any, which has been submitted by the approved auditor to the Senior Management of the bank;
  - d) the control environment and risk profile of the bank;
  - e) procedures in place to identify, assess, manage and mitigate risks;

- f) matters that, either the bank or its approved auditors, have brought to the knowledge of the CBC in the period preceding the meeting, the way in which these matters have or have not been resolved to the satisfaction of the auditors and/or the CBC and/or the way in which these matters are being presented in the audited financial statements;
  - g) matters emanating from the supervisory responsibilities of the CBC; and
  - h) any other matter that the bank concerned or its approved auditor wish to include in the agenda of the meeting.
7. The approved auditor is expected to participate actively and contribute constructively to trilateral meetings and discuss with the CBC information in his/her possession on the financial condition of the bank, including, if necessary, information concerning the customers of the bank collected in the course of audit work.
8. Following the completion of a trilateral meeting, the Bank Supervision and Regulation Department will prepare the minutes of the meeting, which will be agreed both with the bank concerned and its approved auditors. The final text of the minutes is circulated to all parties concerned.

**C. BILATERAL MEETINGS AND REPORTING TO THE CBC BY APPROVED AUDITORS**

9. According to Section 28(2) of the Law, bilateral meetings are arranged when the CBC considers it desirable or necessary in the interests of depositors and their framework is similar to that of trilateral meetings as described above. More specifically, they are intended to facilitate reporting to the CBC by the approved auditors of issues arising from the obligations imposed on them under Section 28(3A) of the Law.
10. In accordance with Section 28(3A)(a) of the Law, the approved auditor is obliged to report promptly to the CBC any fact or decision concerning the bank, of which he has become aware while carrying out his/her audit which may:
- i) constitute a material breach of the laws, regulations or administrative provisions which lay down the conditions governing authorisation or which specifically govern the pursuit of the activities of banks;

- ii) affect the continuous functioning of the bank; or
  - iii) lead to refusal to certify the accounts or to the expression of reservations.
11. The above obligation also applies, under Section 28(3A)(b) of the Law, with regard to facts or decisions which the approved auditor becomes aware in the course of carrying out the audit of an undertaking having close links<sup>2</sup> resulting from its control relationship with the bank.
12. In the event that the auditor, in the normal course of his/her duties, has reasonable grounds to believe that there are events or decisions which constitute or may constitute a major breach of the laws or regulations or affect the operations of the bank or may lead to disclaimer of opinion or the expression of reservations in the report accompanying the bank's annual financial statements, he/she is required to inform the CBC accordingly prior to the issue of the audit report to the annual financial statements.
13. The approved auditor, having regard to the Law and its relevant articles mentioned above, exercises his/her professional judgement to decide whether an issue arising from his/her audit work falls under paragraphs (i), (ii) and (iii) of Section 28(3A)(a) of the Law. These issues may include, inter-alia, cases where there are reasonable grounds to believe that:
- a) the bank does not maintain, or may not be able to maintain in the near future, the capital adequacy ratio prescribed in accordance with Section 21 of the Law and/or the Directives of the CBC, or
  - b) the bank does not maintain the liquidity ratios prescribed by the CBC in accordance with Section 23 of the Law and/or the relevant Directives of the CBC, or
  - c) the bank has not made adequate assessment and provisions for the impairment of receivables/debtors and other assets, probable losses arising from contingent liabilities and other obligations as well as for tax obligations, as required by the International Financial Reporting Standards, or

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<sup>2</sup> Under Section 2(1) of the Banking Laws of 1997-2011, "close links" means a situation in which two or more natural or legal persons are linked in any of the following ways: (a) participation in the form of ownership, direct or by means of control, of 20% or more of the voting rights or capital of an undertaking; (b) means of control; or (c) the fact that both or all natural or legal persons are permanently linked to one and the same third person by a means of control relationship.

- d) the accounting and internal control systems of the bank are inadequate having regard to the size, nature and complexity of its operations, and/or its organisation and management structure fall short of the provisions of the Directive of the CBC on “A Framework of Principles of Operation and Criteria of Assessment of Banks’ Organisational Structure, Internal Governance and Internal Control Systems”, or
- e) the business of the bank, or a significant part thereof, is directed, or may be directed for a period of time, or the bank is managed by one individual alone, in violation of Section 19 of the Law, or
- f) the bank does not maintain, or may not maintain in the near future the minimum own funds required under Section 20 of the Law and/or the relevant Directives of the CBC, or
- g) there has been a change in the name, or amendment in the Memorandum and Articles of Association of the bank, or any other document relating to its formation, for which the CBC was not informed, or
- h) there is evidence that raises doubt as to the correctness of actions or decisions taken by the Board of Directors and/or the Senior Management of the bank, which could have significant consequences on the soundness of the bank and/or raise supervisory concerns, or
- i) the bank has exceeded the limits on credit exposures set out in Section 11 of the Law, or
- j) the going concern status of the bank has been jeopardised, or
- k) there are instances of non-compliance with the conditions of the licence granted to the bank, the provisions of the Law, regulations and directives issued by the CBC or any other instance which may lead to disclaimer of opinion or expression of reservations in the audit report on the bank’s financial statements.

The cases referred to above are indicative and do not constitute an exhaustive list of all cases which may fall under Section 28(3A) of the Law.

The approved auditor reports to the CBC all facts and decisions concerning

the bank and which, by exercising his/her professional judgement, he/she has reasonable grounds to believe that these come under the provisions of paragraphs (i) or (ii) or (iii) of Section 28(3A)(a) of the Law.

Reporting of facts or decisions covered by Section 28(3A) of the Law must be made in writing within one working day from the date that the matter came to the knowledge of the approved auditor.

The CBC, after receiving in writing the above reports, may convene bilateral meetings with the approved auditor concerned to discuss further the events and circumstances forming the grounds of his/her report to the CBC under Section 28(3A) of the Law.

Minutes of bilateral meetings will not be circulated to approved auditors unless the CBC decides otherwise.

14. Furthermore, if the CBC considers it beneficial for maintaining the soundness of a bank and/or protecting the latter's depositors, it may convene a trilateral meeting with a bank and its approved auditors to discuss the report made by the latter to the CBC under Section 28(3A) of the Law.

**D. GENERAL**

15. Any of the parties involved may, at any time, request the arrangement of a trilateral or bilateral meeting in situations other than those described above where specific concerns or issues arise during the year.
16. The meetings should be attended by members of the Senior Management of the bank who have full knowledge of the matters to be discussed and have appropriate power to take decisions and, where deemed necessary, issue instructions for further action. With regard to approved auditors, it is expected that the meetings will be attended by the partner in charge of the audit and other management staff involved in the field audit who are capable of presenting audit findings and recommendations.
17. In accordance with Section 28(3) of the Law, any fact or information divulged to the CBC by an approved auditor in good faith which is relevant to the functions and responsibilities of the CBC under the Law, does not constitute a breach of the duty of confidentiality owed by the approved auditor to his/her clients.

18. It is noted that according to Section 43(1) of the Law, the infringement of any provisions of the Law constitutes an offence which is punishable with imprisonment not exceeding two years or a fine not exceeding 85.430 Euro or both of these penalties, and in the case of a continuing offence, is further punished with a fine not exceeding 1.708,60 Euro for each day during which the offence continues. Furthermore, according to Section 43(3) of the Law, any director, managing director, chief executive, manager, partner or employee of an organisation, incorporated or unincorporated, who authorises or knowingly permits the infringement of the Law is guilty of an offence and, in case of conviction, is liable to the penalties stipulated in Section 43(1).