

**OFFICIAL INFORMATION
OF THE CZECH NATIONAL BANK
of 19 March 2003**

**regarding Article 22 (3) of Act No. 21/1992 Coll. on Banks,
as amended by Act No. 126/2002 Coll.**

The Czech National Bank hereby provides the following information on Article 22 (3) of Act No. 21/1992, on Banks, as amended by Act No. 126/2002 Coll. (hereinafter referred to as the “Act on Banks”):

1. After receiving the bank’s notification of the selection of the auditing company, the Czech National Bank will consider whether there exist any grounds for rejecting it.
2. a) Auditing company means a legal entity or natural person carrying on auditing activities pursuant to Act No. 254/2000 Coll., on Auditors, as amended.
b) Responsible auditor, responsible partner, responsible manager and responsible employee of the auditing company means the auditor, partner, manager or employee of the auditing company who participated/participates/will participate in providing auditing services pursuant to Article 22 (1) of the Act on Banks in the bank that has provided notification of the selection of the auditing company.
3. The grounds for rejecting the auditing company include in particular:
 - a) ascertainment that the auditing company has a special relation to the bank pursuant to Article 19 of the Act on Banks. The same applies to natural persons performing auditing activities on behalf of the auditing company,
 - b) the existence of material¹ differences between the opinions of the Czech National Bank and the auditing company on the amount of provisions and reserves created by the bank in at least one of the previous two accounting periods,

¹ The term “materiality” is used in compliance with Auditing Standard No. 6 – Audit Materiality – issued by the Chamber of Auditors of the Czech Republic.

- c) the existence of serious differences² between the opinions of the Czech National Bank and the auditing company in the evaluation of the appropriateness, efficiency and effectiveness of the management and control system of the bank, including its risk management system, at least in one of the previous three accounting periods,
 - d) the existence of material differences between the opinions of the Czech National Bank and the auditing company in the evaluation of the reporting system for the Czech National Bank pursuant to Article 74 (3) of Decree of the Czech National Bank No. 333 Coll. of 3 July 2002, stipulating the prudential rules of parent undertakings on a consolidated basis, together with Article 1 (2) of Provision of the Czech National Bank No. 2 of 3 July 2002 on capital adequacy of banks and other prudential rules on a solo basis, in at least one of the previous two accounting periods,
 - e) a conflict of interests of the auditing company (item 8) that might limit its independence of judgement,
 - f) failure to prove adequate prerequisites (item 7) to carry on activities within the scope stipulated in Article 22 (1) of the Act on Banks,
 - g) any other finding of the Czech National Bank indicating a limitation on the competence of the auditing company to carry on activities within the scope stipulated in Article 22 (1) of the Act on Banks or suggesting a loss of trustworthiness of the auditing company.
4. The existence of material and serious differences between the opinions of the Czech National Bank and the auditing company regarding a bank other than the one that provided notification of the selection of this particular auditing company may also be grounds for rejecting the auditing company.
5. Should the Czech National Bank ascertain any serious shortcomings in the bank's risk management systems or its compliance with the regulatory requirements arising from the provisions issued by the Czech National Bank and from the legal regulations, an assessment will be made of whether the auditing company indicated these shortcomings in its reports pursuant to Article 22 (1) (c) of the Act on Banks in an appropriate and timely manner.

² "Serious difference" means a difference where (a) in most cases the evaluation of the individual areas by the auditing company is one classification degree better than the evaluation by the Czech National Bank, or (b) even if there is a smaller number of differences, where the evaluation by the auditing company is two classification degrees better than the evaluation by the Czech National Bank. The classification of shortcomings is given in the Official Information on Certain Provisions of Provision No. 11 of the Czech National Bank of 10 December 2002, stipulating requirements for the testing of a bank's management and control system, including the risk management system.

6. When evaluating the auditing company the Czech National Bank will use the following documents and instruments:
 - a) comparisons of the results of the Czech National Bank's inspections in banks with the reports of the auditing company, taking into account differences in the time and circumstances of their preparation,
 - b) written documents submitted by the auditing company,
 - c) presentations by and discussions with the auditing company,
 - d) other documents that the Czech National Bank has at its disposal,
 - e) other findings of the Czech National Bank.

7. When assessing the prerequisites created by the auditing company to carry on activities within the scope stipulated in Article 22 (1) of the Act on Banks, the Czech National Banks will focus in particular on:
 - a) the methodological approach and methods of the auditing company. The assessment will focus primarily on the completeness of the auditing company's methodology, with a special emphasis on methods covering the areas of activity typical of banks and/or financial institutions, the degree of detail of the methodology, and the quality and details of the relevant recognised principles and procedures applied by the auditing company to evaluate the bank's condition. It will also be assessed whether the auditing company's methodology is set up so as to ensure the traceability and stability of the auditing company's procedures,
 - b) the qualifications, experience and knowledge of the responsible auditors, responsible partners, responsible managers and responsible employees of the auditing company, primarily in the area of banking and financial risks,
 - c) the experience of the responsible auditors, responsible partners, responsible managers and responsible employees of the auditing company with auditing banks and/or financial institutions,
 - d) the technical background of the auditing company and, where relevant, the group of which the auditing company is a member. Here the assessment concentrates mainly on the technical support provided by the parent, partner or otherwise ownership-linked auditing company for auditing banks and/or financial institutions.

8. The Czech National Bank considers the following in particular to be a conflict of interests limiting the independence of judgement of the auditing company in providing services pursuant to Article 22 (1) of the Act on Banks:
- a) providing services involving the performance of any internal audit activities in the bank by the auditing company or by any other auditing company connected therewith personally or by ownership in the previous two years,
 - b) providing other services which were or are linked to activities within the scope stipulated in Article 22 (1) of the Act on Banks (e.g. implementation of, or co-operation on, the system of preparation and compilation of statements for the Czech National Bank) by the auditing company or by any other auditing company connected therewith personally or by ownership in the previous two years; this provision does not apply to accounting or tax consultancy services,
 - c) involvement of the responsible partners and responsible managers of the auditing company in providing services pursuant to subparagraphs a) and b) in the previous two years where these partners and managers provided these services within some other auditing company,
 - d) other business relations between the bank and the auditing company not related to providing auditing services in the current or previous accounting period which might compromise the independence of the auditing company. These include specifically business relations where the bank is a creditor vis-à-vis the auditing company (loans or guarantees provided by the bank and suchlike),
 - e) the fact that a senior officer of the bank has become a responsible auditor, responsible partner or responsible manager of an auditing company that is subject to evaluation by the Czech National Bank, or vice versa, for two years after this fact arose,
 - f) the fact that persons other than those specified in item 3a) have a special relation to the bank and at the same time are involved in activities pursuant to Article 22 (1) of the Act on Banks.
9. Where the Czech National Bank concludes during the evaluation of the auditing company that there are grounds for rejecting the company, it will discuss this fact with the bank and the auditing company prior to sending the final notification to the bank so that the auditing company has the opportunity of giving its opinion.

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