Doing Banking in Italy: Governance, Risk, Accounting and Auditing issues

Banks have a critical position in the development of economies due to their major role in running the financial system. The financial crisis was considered to a large extent attributable to excessive risk-taking by banks. Of particular concern was the perceived failure by boards to exercise sufficient risk oversight and establish appropriately compliance and control functions. This led to a stronger European frame of regulation & supervision as well as to a focus on internal governance and risk management. In addition to this, improving culture, and risk culture in particular, in the banking and financial services industry is nowadays an imperative, in order to lessen frequent misconducts of banks and protect them from reputational risk, so creating significant value for their stakeholders and for the whole economy. In a related manner, it was recently emphasized by the Basel Committee on Banking Supervision that the recent financial crisis not only revealed weaknesses in risk management, control and governance processes at banks, but also highlighted the need to improve the quality of external audits. Importantly, the external auditors of banks can play an important role in contributing to the financial stability of the whole banking system. Accordingly, in the near future, more than before, there will be the need to stimulate the effectiveness of external auditing of banks, and the relevant better qualification and training of external auditors, as well as a widespread knowledge of banking accounting system, financial statements, and international accounting standards.

This volume is built upon several years of research, teaching and professional experiences of the editors and co-authors in the Banking sector. The book provides added value to the actual ongoing debate on Governance, Risk, Accounting and Auditing pivotal issues, which are nowadays affecting the Italian and European banking and financial scenario.

EDITORS

Alessandro Carretta is professor of Financial Markets and Institutions at the University of Rome ‘Tor Vergata’, Italy. His main research interest relates to banking management, regulation, governance and corporate culture. Prof. Carretta has extensively published books and articles, and he is member of committees and boards of several journals, research bodies and financial institutions.

Massimo Sargiacomo is professor of Accounting at the University ‘G.d’Annunzio’ of Chieti-Pescara, Italy. His main research interest relates to accounting, management accounting, auditing and accounting history of any institution. Prof. Sargiacomo has extensively published books and articles, and he is member of editorial boards of “A” class ASN-VQR journals.
Doing Banking in Italy: Governance, Risk, Accounting and Auditing issues
Section I – The Framework

1. Regulation and Supervision in the financial system: is the Banking Union in action? (Luigi Donato) ................................................................. 1
1.1 The genesis of the Banking Union .............................. 2
1.2 The building of the Single Supervisory Mechanism ............ 5
  1.2.1 Theory and project .................................. 5
  1.2.2 Rationale and targets .............................. 6
  1.2.3 The Basic rules of the SSM .......................... 7
1.3 The balance between the principles of separation and integration in the SSM regulation .......................... 13
  1.3.1 An overview .................................. 13
  1.3.2 The decision-making procedure ..................... 14
  1.3.3 The achievement of integration in the basic targets, in the legal regime of the SSM and in the organization .................. 16
  1.3.4 The separation between regulation and supervision .................................................. 18
  1.3.5 The due process to adopt decisions and the Administrative Board of Review ................. 19
  1.3.6 The accountability ................................ 21
1.4 Another open front: supervision versus banking resolution. Complementarity or conflict? .................... 22
1.5 Some conclusions and next steps .............................. 23
# Contents

## 2. Corporate governance: why are banks so special?
(Paola Schwizer) ................................................................. 29

2.1 Banks are special ................................................................. 30
   2.1.1 Banks as financial intermediaries ............................ 30
   2.1.2 The different types of banks .................................. 31

2.2 Corporate Governance and Corporate Governance of Banks ................................................................. 35
   2.2.1 Corporate governance: key elements and structures ................................................................. 35
   2.2.2 Corporate governance and sound and prudent bank management ........................................ 38

2.3 Regulation on Corporate governance .................................................. 41
   2.3.1 Lines of development of regulation on bank corporate governance ........................................ 41
   2.3.2 Regulatory issues on bank corporate governance: a European perspective .................. 43
      2.3.2.1 CRD IV and CRR provisions on corporate governance ........................................ 45
      2.3.2.2 CRD IV and CRR provisions on remuneration ........................................ 47

2.4 Conclusions ................................................................. 48

## 3. Legal framework of banking governance and board’s responsibilities
(Alessandra Stabilini) ................................................................. 53

3.1 The legal framework of the corporate governance of banks ........................................................................ 54

3.2 Banking governance and the financial crisis: what was wrong? ................................................................. 57

3.3 The response of banking regulators and the new legal framework ................................................................. 60

3.4 Core concepts of banking governance and corporate bodies’ duties ................................................................. 62
   3.4.1 The governance structure: functions and bodies ................................................................. 62
   3.4.2 The duties of the different corporate functions ................................................................. 63
   3.4.3 Internal control system and Risk Appetite Framework ................................................................. 64
3.4.4 The Board of Directors ........................................... 65
3.4.5 Remuneration policies ........................................... 66
3.5 The not-so-silent player: the Banking Authority ................. 66
3.6 Civil liability of Board’s members .................................. 68
3.7 Recovery and resolution mechanisms and the bail-in principle. .............................................................. 69
3.8 Conclusion: a few thoughts on the consequences of regulation ................................................................. 71

4. Internal controls: tools and processes (Paola Schwizer) ................................................................. 79

4.1 Internal controls as value drivers ...................................... 80
4.1.1 The relationship between business goals, risk and internal controls .............................................. 80
4.1.2 The basic concept of internal control system .................. 82
4.1.3 COSO and ERM framework for the ICS ....................... 84

4.2 Internal controls’ failures and regulatory response for the banking industry .................................................. 87
4.2.1 Weaknesses in the internal control system as cause for bank distress ............................................. 87
4.2.2 The internal control system in banking firms: a definition ................................................................. 89
4.2.3 The regulatory response to the crisis: an organic revision of internal governance system ................ 91

4.3 The internal control system in banking firms: structure and processes ...................................................... 94
4.3.1 The first layer of the internal control system: line controls ................................................................. 95
4.3.2 The second layer of the ICS: the risk specialists ............... 96
4.3.3 The third layer of the ICS: the internal auditing function ................................................................. 100
4.3.4 The big picture: how to let internal controls work as an effective and dynamic system ............... 103

4.4 Conclusions .................................................................. 106
5. **Reputational Risk**  
(Gaia Soana) ........................................................... 111

5.1 Reputational risk: the main features ........................................ 111
5.2 Reputational risk in banking: the regulatory approach ....... 115
5.3 Reputational risk management ............................................. 117
  5.3.1 Risk identification ............................................. 119
  5.3.2 Risk assessment ............................................. 123
  5.3.3 Risk Treatment .............................................. 126

6. **Compliance Risk**  
(Ferdinando Parente) ................................................. 131

6.1 The evolution of compliance: overview ......................... 131
  6.1.1 The international guidelines .................................. 132
  6.1.2 The Italian legislative framework ........................... 135
  6.1.3 The legislative scope of compliance risk .................. 139

6.2 The definition of Compliance Risk .................................. 144
6.3 Compliance Risk Management ....................................... 145
  6.3.1 Compliance risk management framework: key components .............................................. 148
  6.3.2 Identification of the regulatory requirements, risks and measures: the Compliance Risk Matrix 149
  6.3.3 Compliance risk assessment .................................. 151
  6.3.4 Assessment of the compliance risk and parametric scales .............................................. 152
  6.3.5 Estimating the Gross Risk or Inherent Risk ............... 154
  6.3.6 The estimated suitability of the measures and determination of level 1 residual risk 155
  6.3.7 Assessment of the effectiveness of the measures and determination of level 2 residual risk 156
  6.3.8 Assessment of the adequacy of specialized measures .............................................. 158
  6.3.9 Use of compliance risk indicators ........................... 161

6.4 The Compliance Plan .................................................. 162
7. Risk culture in financial institutions regulators and supervisors  
(Alessandro Carretta and Nicola Bianchi) ................................. 167

7.1 Introduction ........................................................................ 168
    7.1.1 Corporate culture: the missing link to understand and manage organizations .......... 169
    7.1.2 Corporate culture in banking ........................................ 170

7.2 Risk Culture ...................................................................... 172
    7.2.1 Definition .................................................................. 172
    7.2.2 Measurement ................................................................ 174
    7.2.3 Evaluation .................................................................. 176
    7.2.4 Risk Culture in the frame of governance & risk management of financial institutions .......... 184
    7.2.5 People’s view on risk culture: a behavioural approach ............................................... 185
    7.2.6 Risk culture and banks’ account .................................... 186

7.3 Risk culture in regulation’s world ...................................... 187
    7.3.1 Corporate and risk culture in the Banking Union: main issues and evidence from recent experiences ......................................................................................... 188
    7.3.2 Risk culture in banking: a regulation’s perspective ....................................................... 188
    7.3.3 A culture ratio is more important than a capital one ..................................................... 190

Section II - Accounting and Auditing issues

8. The Financial Statements in the Italian Banking System 
(Guido Paolucci) ........................................................................ 197

8.1 Introduction ........................................................................ 198


8.3 The banks’ Financial Statements ....................................... 202

8.4 The impact of IAS/IFRS on banks’ Financial Statements ...... 203
### 8. The Balance Sheet
- **8.5 The Balance Sheet** .......................................................... 204
- **8.6 The structure of the Balance Sheet** ..................................... 205
- **8.7 The Income Statement** ............................................................ 208
- **8.8 The impact of IAS/IFRSs on the Income Statement** ............... 208
- **8.9 The structure of the Income Statement** .................................. 209
- **8.10 The Statement of Comprehensive Income** ............................. 212
- **8.11 The Statement of Changes in Shareholders’ Equity** ................ 214
- **8.12 Structure and contents of the Statement of Changes in Shareholders’ Equity** ................................................................. 215
- **8.13 The Cash Flow Statement** .................................................... 218
- **8.14 The structure of the Cash Flow Statement** .............................. 218
- **8.15 The Notes to the Financial Statements** .................................... 223
- **8.16 The Notes to the Financial Statements: purposes and contents** 224

### 9. External Auditing, Governance & Control in Italian Saving Banks (Massimo Sargiacomo and Adalberto Rangone)
- **9.1 Introduction** ........................................................................ 229
- **9.2 Preliminary analysis for the comprehension of Italian savings banks jsc** ............................................................ 230
  - **9.2.1 The origin and the important role of the foundations of banking origin** ............................................................... 232
  - **9.2.2 Composition and classification of the foundations of banking origin** ............................................................... 233
  - **9.2.3 Savings banks jsc and foundations of banking origin: from majority shareholders to connected parties** ............... 236
- **9.3 The current organizational structure of savings banks jsc** .......... 244
- **9.4 The internal audit function in savings banks jsc** ..................... 246
- **9.5 New regulations concerning the risk management** .................... 249
- **9.6 The compliance system and the internal control function** .......... 251
- **9.7 The board of statutory auditors’ general duties** ....................... 254
9.8 Examples of the board of statutory auditors yearly controls .............................................................. 258
  9.8.1 External auditing controls on reputational and legal risks: examples of controls to the compliance office .............................................................. 259
  9.8.2 External auditors and the credit risk: some examples of controls to the credit office ............. 261
  9.8.3 External auditors and informative systems issues: examples of controls on “sealed accounts” to the organization office ............................................... 262

9.9 The board of statutory auditors’ report on the financial statement: principles and essential contents ........................................................................................................... 265

10. External Auditing in Italian Cooperative Banks
    (Valerio Antonelli and Raffaele D’Alessio) ............ 281
    10.1 Introduction .......................................................... 282
    10.2 Nature and economic relevance of CBs .................. 283
    10.3 Audit committee and external auditing .................. 284
    10.4 Audit committee and offsite supervision ............... 287
    10.5 Audit committee and Internal Capital Adequacy Assessment Process (ICAAP) ......................... 288
    10.6 Audit Committee and Supervisory Review and Evaluation Process (SREP) ....................... 289
    10.7 Audit Committee’s Reporting ............................... 291
    10.8 AC’s supervision of CB’s accounts ....................... 293

11. External auditing in Italian banks listed on the stock market
    (Claudia Rossi and Stefania Servalli) ................. 299
    11.1 Scenario of Italian listed banks and their auditors ........ 300
    11.2 Italian auditing regulation of Italian listed banks .......... 304
    11.3 Auditing in listed banks ........................................ 307
    11.4 Final observations ........................................... 311
Foreword

Banks have a critical position in the development of economies due to their major role in running the financial system. The financial crisis was considered to a large extent attributable to excessive risk-taking by banks. Of particular concern was the perceived failure by boards to exercise sufficient risk oversight and establish appropriately compliance and control functions. This led to a stronger European frame of regulation & supervision as well as to a focus on internal governance and risk management. In addition to this, improving culture, and risk culture in particular, in the banking and financial services industry is nowadays an imperative, in order to lessen frequent misconducts of banks and protect them from reputational risk, so creating significant value for their stakeholders and for the whole economy. In a related manner, it was recently emphasized by the Basel Committee on Banking Supervision that the recent financial crisis not only revealed weaknesses in risk management, control and governance processes at banks, but also highlighted the need to improve the quality of external audits. Importantly, the external auditors of banks can play an important role in contributing to the financial stability of the whole banking system. Accordingly, in the near future, more than before, there will be the need to stimulate the effectiveness of external auditing of banks, and the relevant better qualification and training of external auditors, as well as a widespread knowledge of banking accounting system, financial statements, and international accounting standards.

The experience of banking legislation shows that after each crisis, regulatory reforms were implemented to address the gaps found in the regulations or practices of supervision. After the recent crisis, too, a season of reform started in Europe on the basis of the analysis carried out on the factors that didn’t prevent the contagion of instability to financial markets. The developments of such a deep crisis and weaknesses shown by the financial system are essential to understand the reform of European banking supervision, which is certainly the greatest ever made. Chapter 1 is therefore aimed at describing and commenting on the status of the process of establishing the Banking Union, with a focus on the complex gears of the Single Supervisory Mechanism (SSM) and on the central role of the European Central Bank (ECB). In this context, the ECB is not only the responsible authority but also the engine of the supervisory mechanism and the
bridge between micro-supervision and financial stability. The ECB activity can also influence the same rules regarding European supervision. In any case, in a very short time the SSM was consolidated and worked incisively. The future performance of the Banking Union (and thus the smooth functioning of the European banking system) depends on the balance that the supervisory mechanism and the resolution mechanism will gradually find, in the dilemma between complementary and potential conflict. New rules and new practices of supervision will increasingly represent the frame of reference for European banks, and this scheme will not only cover the governance of banks but also the key elements of the corporate strategy and the daily activities. Ultimately, understanding the new supervision will also be for the Italian banks - both large and small - a necessary basis for doing business.

The effectiveness of corporate governance plays a central role for the investors’ protection, the reliability of financial reporting, the quality of strategic planning and monitoring. It affects business growth and economic performance, lowering the cost of capital and encouraging firms to use resources more efficiently. For the banking system, corporate governance issues (Chapter 2) are therefore considered a decisive element of sound and prudent banking management, as important as capital adequacy. Corporate governance is also affected by the type of bank, and banks of different size, legal status, ownership, function have different business models, capital allocation and risk taking policies, thereby requiring different corporate governance mechanisms. Bank governance structures and processes evolved over time often reaching even higher standards than those generally applied to listed companies. The European Union directly intervened with CRD IV and CRR in the composition and functioning of banks’ boards, in order to ensure that they become effective monitors of management and, more generally, effectively perform their steering role. New rules imposed higher responsibilities, increased and diversified duties and strong commitment to bank directors, as well as more transparent and rational nomination processes. Enforcement and sanctions are becoming more incisive and aimed at influencing individuals and institutions’ risk-taking behaviour as well as their reputation. Because of these interventions, bank boards can be considered a benchmark, at least on paper. Substance over form will be achieved however only if all the stakeholders, and mainly institutional investors and the market itself, reach a full maturity in their monitoring function over the governance quality.

As far as the legal framework of the corporate governance of banks is concerned, the starting point is the question on the need for a special body of law regulating the governance of banks instead of simply applying general corporate law. The main issue concerns the role, if any, bad corporate governance of banks had in the crisis of 2008 and how regulators responded. Chapter 3 illustrates the banks’ corporate governance as it is today and the role and responsibilities of corporate bodies in the new legal framework.

Bank failures and widespread losses over the past decades clearly show the difficulties of assessing all the risks that arise from corporate strategies and providing effective control processes and tools to prevent and manage the risk-return trade-off. As shown in
Chapter 4, risk management and internal control are not objectives in themselves, they are not unrelated to achieving business goals, nor represent an obstacle. They should always be considered when setting and achieving organizational objectives and creating, enhancing, and protecting stakeholder value. Risk management focuses on identifying threats and opportunities, while internal control helps counter threats and take advantage of opportunities. This system of internal governance is a fundamental tool for the board of directors as well as for both top and middle management, since it helps the bank to “keep on course” and achieve strategic and operational goals. Due to the shortcomings in risk identification and in information flows identified in the crisis period, the head of the risk management function (Chief Risk Officer, CRO) is now required to play a more strategic role, and is to be actively involved at an early stage in elaborating an institution’s risk strategy and in all material risk management decisions. The real risk manager or risk owner is in fact the person who takes the decision and thus the risk, in other words the line manager. The control function is carried out by the risk specialist who describes and quantifies the risk, helping management to take good decisions. The risk management process must be integrated with all levels of the bank by way of common language and culture. Risk report forms have to be comprehensible and lead different levels and departments of the bank to assess risk correctly. Besides, an efficient and continuous coordination between different departments and control and supervision offices must be in place.

Reputational risk (Chapter 5) is very important in banks, as their activity is based on credibility and trust by their stakeholders. It is a multidimensional, speculative, secondary risk, and is often described by financial risk managers as the most difficult risk to manage. Financial regulators recognize that reputational risk is not easily measurable, but they expect industry to further develop techniques to manage all aspects of it by means of appropriate policies and processes. The reputational risk management covers the set of processes adopted by financial companies to identify, assess and treat reputational risk, and is essentially concerned with protecting a bank from potential threats to its reputation and minimizing the effects of primary risks. It consists of the identification, assessment, and prioritization of the risk, followed by the application of resources to minimize, monitor, and control the probability and/or the impact of primary events or to maximize the realization of opportunities.

Chapter 6 covers the compliance world. It starts from the evolution of the compliance function, which highlighted the growing importance of the concepts of culture and behaviour within the bank’s organization - both in view of the guidelines and approaches issued internationally and within Italy and the legislative scope of compliance, as redesigned by Italian legislation on the internal control system. The definition of compliance risk follows, marking out the relevant boundaries with the other risks of the bank, and the use of risk assessment techniques and the risk-based approach presented, confirming the central role played by compliance in the risk management system of banks and financial companies. Finally, the chapter goes through the compliance plan definition process and discusses the importance of preparing it according to a risk-based
approach that enables a focus of the compliance activities on the areas most exposed to the compliance risk.

The interest for culture in banking grew after the financial crisis and the more recent misconduct scandals. There is obviously a cultural problem under the decisions and behaviours in banking world that led to the crisis. Corporate culture is the missing link to understand how organizations act. Culture “holds together” the company: it is the result of shared values, basic underlying assumptions and business experiences, driving behaviours and strategy itself. Risk culture - which is investigated in Chapter 7 - could be seen as a sub-culture with a central role in financial institutions. The risk culture “depends” primarily on the national culture. In addition, the regulation has an impact on culture and the supervisors’ different approaches influence in different ways the risk taking of banks. The interaction between governance, culture and performance is increasingly a main issue in the banking arena. Board must understand the risk culture of their organization in conjunction with their business model and not take it for granted. Accounting values affect accounting systems and therefore cultural factors directly influence the development of accounting and financial reporting systems at a country and industry level. The aims of the regulation are to create a stable banking union and take care of the weakness in corporate governance. This brings to a further specification of cultural requirements for banking.

Chapter 8 investigates the content and the structure of the Italian banks’ “Financial Statements”, according to the International Accounting Standards (IAS/IFRS) and the Regulatory and legal acts issued by the Bank of Italy, which adopted the IAS/IFRSs rules by issuing the Circular n. 262/05 (amended on 22nd December 2014). The section unveils how the structure and the content of banks’ Financial Statements mirror the requirements of IAS 1 ‘Presentation of Financial Statements’. Complying also with the requirements stipulated by the above mentioned circular, the banks’ Financial Statements must be composed by six mandatory documents: Balance Sheet, Income Statement, Statement of Comprehensive Income, Cash Flow Statement, Statement of Changes in Shareholders’ Equity and Notes to Financial Statements. Therein, it is unveiled how, having such a structure, the Financial Statements strengthen their role as essential information tools both for stakeholders and for the supervisory activity deployed by the Bank of Italy. Importantly, the chapter also outlines the main topics of the IAS/IFRSs that are used by banks in preparing Financial Statements - i.e. IAS 32, IAS 39, IFRS 7, IFRS 9 and IFRS 13 - at the same time emphasizing that the mentioned Standards are the most controversial ones, more than being difficult to interpret and to apply in the banking context.

Chapter 9 explores the complex activities of external auditing in a specific area of the Italian banking world, that is, the Italian Saving Banks (SBs). A preliminary portrayal of the main features of the SBs is provided, illustrating both the governance relations with the Foundations of Banking Origin, and a basic organizational structure, as well as the main tasks and activities of Internal Audit, Risk Management and Compliance Commit-
...tee/Office. The analysis on the Board of Statutory Audit’s general duties revealed that the Bank of Italy wants External Auditors to ascertain the effectiveness of all the structures and functions involved in the control systems, at the same time addressing controls transversally throughout the entire business organizations. This working scenario is described to be very complicated and risky, considering both the extant paucity of laws and bylaws - as well as banking/finance peculiar legislation - addressed to specifically list the duties and tasks of the Board of Statutory Auditors in Italian Banks, and the possibility that External Auditors might be retrospectively considered guilty of lacks of controls, omissions, or inaction by the Bank of Italy. Examples of yearly controls deployed by the Boards of Statutory Auditors are thus depicted, and drawing on the evidence gathered from 88% of the total SBs affiliated to ACRI (Italian Association between Savings Banks and FBOs), the frame, principles and essential content of the auditors’ reports on the annual financial statements are outlined.

In Chapter 10 external auditing is focused on another main area of Italian Banking systems, that is, the Italian cooperative banks (CBs). Acting in a system where internal auditing is partly replaced by the Local Federation, the Auditing Committee is said to play a primary role in the supervision of the company’s compliance with the laws and the by-laws, principles of good management, adequate organisational, managerial and accounting systems. In a related manner, the Audit Committee monitors the completeness, adequacy and operations of the internal auditing system (if any), and supervises and prevents the bank’s crises by monitoring the quality of loans granted to the bank’s customers, controlling over suspected money laundering transactions, and preventing conflicts of interest. After having described the nature and economic relevance of CBs, this section provides a comprehensive analysis of the external auditing role played by the Audit Committee, at the same time explaining its offsite supervisory role and its specific relations with ICAAP (Internal Capital Adequacy Assessment Process) and SREP (Supervisory Review and Evaluation Process). The final act in the Audit Committee’s supervisory process – reporting – is then outlined, paying particular attention to the frame and content of the final report addressed to the shareholders on the yearly financial statements.

The last section (Chapter 11) illuminates the audit activity in listed banks in the Italian scenario, starting from an overview of their auditors. Considering the civil law context characterizing the Italian environment, the regulations regarding auditing of listed banks is then investigated. In this regard, the Legislative Decree n. 39/2010 implementing the Directive 2006/43/EC on statutory audits, and the recent adoption of ISA with some interpretation/application notes localizing the standards in respect of Italian laws and regulations (the so-called ISA Italy) is thoroughly considered. The auditing activity of banks is also analysed in its different moments considering the peculiarity of banks.

Milan, 10th September 2015

Alessandro Carretta          Massimo Sargiacomo
Valerio Antonelli, is Full Professor of Auditing, Department of Management & Innovation Systems at the University of Salerno. He is member of the Italian Commission of Auditing Standard Setting - National Council of Accountants and Chartered Accountants (Italy).

Nicola Bianchi is PhD Candidate in Management at the University of Rome “Tor Vergata”

Alessandro Carretta is Professor of Banking at University of Rome “Tor Vergata”, where he is also Chair of the PhD program in Management. He is also SDA Bocconi Professor of Banking and Insurance, and he is member of committees and boards of several journals, research bodies and financial institutions.

Raffaele D’Alessio, is Associate Professor of Auditing, Department of Management & Innovation Systems, University of Salerno. President of the Italian Commission of Auditing Standards Setting - National Council of Accountants and Chartered Accountants (Italy).

Luigi Donato is Director General for Property and Tenders of Bank of Italy (until 2014 in the Directorate for Banking and Financial Supervision). He has filled teaching positions on Regulation and Supervision at Bocconi University in Milan and others Universities.

Guido Paolucci, is Professor of Business Administration, Department of Management & Industrial Organization, at the Polytechnic University of Marche.He has a wide experience as Independent Director or Statutory Auditor of Financial Institutions.

Ferdinando Parente (until 2010 at the Bank of Italy- Milan branch) is accountant and auditor. He is founder of the “Parente & Partners” and from 2001 teaches at the University Carlo Cattaneo – LIUC, actually Law of Banks and Financial Markets. From 2013 he is an independent director of a major national bank.

Adalberto Rangone has got a joint-PhD in Economics from the University of Oradea, and in Management and Business Administration from the University G.d’Annunzio of Chieti-Pescara. He is now Research Fellow at the University of Pavia. “

Claudia Rossi is Professor of Business Administration, Department of Management, Economics and Quantitative Methods at University of Bergamo. She has a long experience as member of the Board of Statutory Auditors of Italian listed banks.
Massimo Sargiacomo is Professor of Accounting, Department of Management and Business Administration, at the University G.d’Annunzio of Chieti-Pescara, where he is also Chair of the PhD program in Accounting, Management and Business Economics. He is member of editorial boards of several journals.

Paola Schwizer is Professor of Financial Markets and Institution at the University of Parma and SDA Bocconi Professor of Banking and Insurance. She is President of Ned-community, the Italian Association of non-executive and independent directors and member of the board of directors of ecoDa, the European Confederation of Directors’s Association.

Stefania Servalli is Associate Professor of Business Administration, Department of Management, Economics and Quantitative Methods at University of Bergamo. She has been in the Board of Directors of an Italian listed bank and now in a Local Committee of an Italian listed bank.

Maria Gaia Soana (Ph.D University of Rome “Tor Vergata”) is Assistant Professor of Financial Markets and Institutions at the University of Parma and SDA Bocconi Professor of Banking and Insurance

Alessandra Stabilini (LL.M. Chicago Law School and PH.D Bocconi University) is Researcher in Commercial Law and Adjunct Professor of International Corporate Governance at the University of Milan. She practices law as an Equity Partner of Nctm law firm, Milan.
Regulation and Supervision in the financial system: is the Banking Union in action?

Luigi Donato

The experience of banking legislation shows that after any crisis, whether systemic or sectorial, regulatory reforms have been implemented to address the gaps found in the regulations or practices of supervision. After the recent crisis, too, a season of reform started in Europe on the basis of the analysis carried out on the factors that didn’t prevent the contagion of instability to financial markets. The developments of such a deep crisis and the weaknesses shown by the financial system are essential to understand the reform of European banking supervision, which is certainly the greatest ever made. Therefore, this study is aimed at describing and commenting on the status of the process of establishing the Banking Union (BU) with a focus on the complex gears of the Single Supervisory Mechanism (SSM) and on the central role of the European Central Bank (ECB). From this perspective we’ll try to answer the question if the BU is in action and how. The underlying objective of the work is still to define the lines of operation of European supervision, as the new rules and the new practices of supervision will increasingly represent the reference frame for European banks, and this scheme will not only cover the governance of banks but also the key elements of the corporate strategy and the daily activities. Ultimately, understanding the new supervision will be a necessary basis for doing business for the Italian banks, large or small…

Learning Objectives

- The structural and contingent causes that led to the financial crisis, thus giving impetus to the construction of the Banking Union.
- Two specific regulatory failures of the past: the separation of micro-prudential supervision from macro-prudential supervision and the belief that corporate law was sufficient to ensure sound and prudent management.
- The start-up of the Single Supervisory Mechanism.
Chapter 1

The factors that influenced the construction of the SSM are: the need of more severe tools, the urgency to entrust the ECB with the responsibility of the European supervision, the need for integration while respecting the Grundnorm of separation between central banking and supervision. These factors resulted in a complex system with regard to the governance of the SSM, to the decision-making procedure, and to accountability. A further element of complexity is the separation of supervision and resolution, along with the establishment of a different framework of authorities and tools. In this context, the ECB is not only the responsible authority but also the engine of the supervisory mechanism and the bridge between micro-supervision and financial stability. The ECB activity is also able to influence the same rules regarding European supervision. In any case, in a very short time the SSM has been consolidated and has worked incisively.

The future performance of the BU (and thus the smooth functioning of the European banking system) depends on the balance that the supervisory mechanism and the resolution mechanism will gradually find, in the dilemma between complementary and potential conflict.

References

ANGELONI I. (2015), Rethinking banking supervision from a SSM perspective, remarks at the conference “The new financial architecture in the Euro zone”, 23rd April 2015 (on ECB website);


D’AMBROSIO R. (2013), Giusto procedimento e garanzie dei soggetti coinvolti nei procedimenti di vigilanza e sanzionatori in seno al Meccanismo di Vigilanza Unico (Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings), in Quaderni di ricerca giuridica della Banca d’Italia, n. 74;


DRAGHI M. (2015), *Keynote Address: Money and Monetary Institutions after the Crisis*, in “Money and Monetary Institutions after the Crisis. Proceedings of the Conference in Memory of Curzio Giannini”, Bank of Italy, Rome;


PANETTA F. (2015), *The European Banking and Capital Market Union: Challenges and Risks*, remarks at the conference organized by the Fondazione Italiani europei, 6th February 2015 (on Bank of Italy’s website);

RECINE F., FERRARINI G. (2015), *The Single Rulebook and the SSM: should the ECB have more say in prudential rule-making?* in European Banking Union, Ferrarini G. and Busch D. (eds.), Oxford University Press.
Banks have a critical position in the development of economies due to their major role in running the financial system. A shock to one bank can be quickly propagated to others through direct connections, thus generating systemic risk. A bank’s failure to follow good practices in corporate governance and the lack of effective governance are among the most important internal factors which may endanger the solvency of a bank. Corporate governance is also affected by the type of bank, and banks of different size, legal status, ownership, function have different business models, capital allocation and risk taking policies, thereby requiring different corporate governance mechanisms.

The financial crisis has been considered to a large extent attributable to excessive risk-taking by banks. Of particular concern was the perceived failure by boards to exercise sufficient risk oversight and establish appropriately strong risk management functions. For this reason, prudential regulation on corporate governance seeks to influence risk-taking in regulated entities. The European Union has directly intervened with CRD IV and CRR in the composition and functioning of banks’ boards, in order to ensure that banks’ boards become effective monitors of management and, more generally, effectively perform their steering role.

Learning Objectives

In this chapter we will discuss:

- why banks are a special kind of financial intermediary;
- what corporate governance is and why it is relevant for banks;
- what regulatory provisions affect bank corporate governance.
References


BASEL COMMITTEE ON BANKING SUPERVISION (2010), Principles for enhancing corporate governance, March.

BASEL COMMITTEE ON BANKING SUPERVISION (2015), Guidelines. Corporate governance principles for banks, July.


Ghezzi F., Malberti C. (2008), The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law, ECFR, 1–47.


This chapter deals with the legal framework of the corporate governance of banks and the related responsibilities of the board of directors. We will start by asking ourselves what creates the need for a special body of law regulating the governance of banks and prevents us from simply applying general corporate law. Then, we will try to understand what role, if any, bad corporate governance of banks had in the global financial crisis of 2008, and we will describe how regulators responded. This will lead us to the illustration of banks’ corporate governance as it is today, and of the role and responsibilities of corporate bodies in the new legal framework. At the end of the chapter we will cast a few doubts on the effectiveness of the answers provided so far.

Learning objectives

In this Chapter we will discuss of:

- The legal framework of the corporate governance of banks
- Banking governance and the financial crisis: what was wrong?
- The response of banking regulators and the new legal framework
- Core concepts of banking governance and corporate bodies’ duties in Italy
- The other not-so-silent player: the Banking Authority. Powers and sanctions
- Directors’ liability
- Recovery and resolution mechanisms and the bail-in principle
- Conclusion: a few thoughts on the consequences of regulation
to the growth of economy (see the public consultation on the possible impact of the CRR and CRD IV on bank financing of the economy in July 2015). However, shadow banking shows two features that, taken together, deserve the attention of regulators: first, shadow banking is much less regulated than banking; second, the banking and the non-banking financial systems are interconnected. How much interconnected, it is hard to say.

According to the FSB, the level of interconnectedness declined in 2013, but the FSB itself recognizes that “the relevance of the findings in this area is hampered by the absence of reporting of these data by a number of large institutions” (FSB 2014, 4). In any event, a certain degree of interconnection clearly exists and this means that the non-banking system’s crises can create systemic consequences on the banking universe. This poses problems that are hard to estimate at the time being, but that might prove to be very serious over time, and cast doubts on the real efficacy of banking regulation that might deserve further thoughts.

Summary

In this chapter we examined the legal framework of the corporate governance of banks and the related responsibilities of the board of directors. First, we tried to understand what creates the need for a special body of law regulating the governance of banks and that prevents regulators from simply applying general corporate law. Then, we outlined the role of bad corporate governance of banks in the global financial crisis of 2008, a much debated issue, and briefly described how regulators responded and how the corporate governance legal framework looks like today. As a conclusion, we presented a few thoughts on the effectiveness of the answers provided so far.

References


Chapter 3


HOPT K. J. (2011), Corporate Governance of Banks after the Financial Crisis, E. Wymeersch, K. J. Hopt, G. Ferrarini (eds.), Financial Regulation and Supervision, A
Bank failures and widespread losses over the past decades show clearly the difficulties of assessing all the risks that arise from corporate strategies and providing effective control processes and tools to prevent and manage the risk-return trade-off. Financial regulators contribute to the effective planning and operating of internal control and risk management systems by introducing principles and mandatory rules which have been completely revised since the crisis and following the European Banking Union as a fundamental driver of sound and prudent management.

According to COSO and ERM’s worldwide standards, regulators established a “three-lines-of-defence” framework, based on specialized control functions and activities – line controls, risk management and compliance, internal auditing – and on several organizational principles and mechanisms aimed at risk prevention, assuring monitoring and management, given the firm strategic goals and risk appetite. Due to the shortcomings in risk identification and in information flows identified in the crisis period, the head of the risk management function (Chief Risk Officer, CRO) is now required to play a more strategic role, and is to be actively involved at an early stage in elaborating an institution’s risk strategy and in all material risk management decisions.

**Learning Objectives**

In this chapter we will discuss:

- what an internal control system is and why it is an important tool to manage business risks
- why internal control systems in banking firms failed during crisis times and the regulatory response
- the main features of an internal control system in banking firms
Chapter 4

Most reports and studies on the financial crisis identify weak internal governance issues as a crucial underlying factor. Weaknesses were often the result of an insufficient implementation of existing guidelines. For this reason, financial regulators opted for a new internal governance structure based on three “lines of defense”, in which the risk management function plays a strategic role and is actively involved at an early stage in drawing up an institution’s risk strategy and in all material risk management decisions.

References


BCBS, BASEL COMMITTEE ON BANKING SUPERVISION (1998), Framework for internal control systems in banking organisations, September.

BCBS, BASEL COMMITTEE ON BANKING SUPERVISION (2012), The internal audit function in banks, June.


CEBS (2006), Guidelines on the implementation, validation and assessment of Advanced Measurement(AMA) and Internal Ratings Based (IRB) Approaches, 4th April.


FSB, FINANCIAL STABILITY BOARD (2013), Principles for An Effective Risk Appetite Framework, 18th November.


Reputational risk is very important in banks, as their activity is based on credibility and trust by their stakeholders. It is a multidimensional, speculative, secondary risk, and is often described by financial risk managers as the most difficult risk to manage. Financial regulators recognize that reputational risk is not easily measurable, but they expect industry to further develop techniques to manage all aspects of it by means of appropriate policies and processes. The reputational risk management covers the set of processes adopted by financial companies to identify, assess and treat reputational risk, and is essentially concerned with protecting a bank from potential threats to its reputation and minimising the effects of primary risks. It consists of the identification, assessment, and prioritization of the risk, followed by the application of resources to minimize, monitor, and control the probability and/or the impact of primary events or to maximize the realization of opportunities.

Learning Objectives
In this chapter we will discuss:

- Definition and features of reputational risk;
- The regulatory approach to reputational risk;

5.1 Reputational risk: the main features

Reputational risk is very important in banks, as their activity is based on trust and credibility. A good reputation contributes strongly to the survival of banks over time by improving their competitiveness and maintaining a stable and sustainable development.

The definition of reputational risk is the first step in evaluating its management in the banking sector. To date, literature produced several definitions.
Reputational Risk

...with operational risk as the main primary risk. Regulators identify compliance, credit, liquidity and market risks as other primary sources of reputational risk. Although financial regulators recognize that reputational risk is not easily measurable, they expect banks to further develop techniques to manage all aspects of it by means of appropriate policies and processes. Banks should therefore implement an effective reputational risk management process. This requires the identification of all potential sources of reputational risk to which they are exposed. Once a list of primary risks is developed, reputational risk needs to be assessed. For this purpose, banks should estimate the probability that a primary event will occur, the reputational exposure indicator and the loss given reputational event. Finally, reputational risk must be treated by banks through risk transfer, elimination or retention.

References

ACE (2013), Reputation at risk, Ace European risk briefing 2013.
BASEL COMMITTEE ON BANKING SUPERVISION (1997), Core principles for effective banking supervision, September.
BASEL COMMITTEE ON BANKING SUPERVISION (2001), Customer due diligence for banks, October.
BASEL COMMITTEE ON BANKING SUPERVISION (2004), International convergence of capital measurement and capital standards. A revised framework, June.
BASEL COMMITTEE ON BANKING SUPERVISION (2006), Core principles for effective banking supervision, October.
BASEL COMMITTEE ON BANKING SUPERVISION (2009), Enhancements to the Basel II framework, July.
CRUZ M.G. (2002), Modelling, measuring and hedging operational risk, Chichester, Wiley & Sons.
ECONOMIST INTELLIGENT UNIT (2005), Reputation: risk of risks, Economist Intelligence Unit white paper.
EUROPEAN BANKING AUTHORITY (2014), Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP), December, EBA/GL/2014/13.


HONG KONG MONETARY AUTHORITY (2008), Supervisory Policy Manual.


PRICEWATERHOUSECOOPERS (2004), Uncertainty tamed? The evolution of risk management in the financial services industry.

PRICEWATERHOUSECOOPERS (2007), Creating value: effective risk management in financial services.


VEYSEY S. (2001), To manage brand risk, be aware, plan, communicate, in Business Insurance, 14th May.

After having examined the evolution of the compliance function - starting from the approaches and guidelines given by international standard setters and through the legislative changes made on the Italian scene - this chapter focuses specifically on the definition of the compliance risk and its management. The application of risk assessment techniques, the method to assess compliance risk and the contents of the compliance plan will be presented in particular.

Learning objectives

In this chapter we will discuss:
- evolution of the compliance function
- definition of compliance risk
- compliance risk assessment
- methods used to assess compliance risk
- compliance risk indicators
- compliance plan

6.1 The evolution of compliance: overview

“Weaknesses in risk culture are often considered a root cause of the global financial crisis, headline risk and compliance events”\(^1\).

\(^1\) FSB, Guidance on Supervisory Interaction with Financial Institutions on Risk Culture. A framework for Assessing Risk Culture, 7\(^{th}\) April 2014. In particular, “A financial institution’s risk culture plays an important role in influencing the actions and decisions taken by individuals within the institution and in shaping the institution’s attitude toward its stakeholders, including its supervisors. A sound risk culture consistently supports appropriate risk awareness, behaviours and judgements about risk-taking within a strong risk
in view of the guidelines and approaches issued internationally and within Italy — the chapter examined the legislative scope of compliance, as redesigned by Italian legislation on the internal control system.

The definition of compliance risk was analysed, marking out the relevant boundaries with the other risks of the bank, and the use of risk assessment techniques and the risk-based approach presented, confirming the central role played by compliance in the risk management system of banks and financial companies.

Finally, the chapter examined the compliance plan definition process and the importance of preparing it according to a risk-based approach that enables a focus of compliance activities on the areas most exposed to the compliance risk.

References

ABI (2008), Libro bianco sulla funzione compliance, Bancaria Editrice, Rome.
Chakrabarty K. C. (2013), Compliance function in banks – back to the basics, at the launch of certificate programmes on compliance function and training, Mumbai, 12th July.


MUSILE TANZI P. – GABBI G. – PREVIATI D. – SCHWIZER P. (2012), Managing Compliance Risk after MiFID, Research carried out by SDA Bocconi Research Division in collaboration with AICOM and SIA SSB GROUP.


PASQUINI C. (2009), Il Compliance Test nelle banche italiane, in “Bancaria” no.11, Bancaria Editrice, Rome.


Risk culture in financial institutions, regulators and supervisors
Alessandro Carretta and Nicola Bianchi

Corporate culture is the missing link to understand how organizations act. Culture "holds together" the company: it is the result of shared values, basic underlying assumptions and business experiences, driving behaviours and strategy itself. Risk culture could be seen as a sub-culture with a central role in financial institutions. The risk culture "depends" primarily on the national culture. In addition, the regulation has an impact on culture and different supervisor’s approaches influence in different ways the risk taking of banks. The organization’s behaviour is part and expression of the risk culture. The interaction between governance, culture and performance is increasingly a main issue in the banking arena. Boards must understand the risk culture of their organization in conjunction with their business model and not take it for granted. Accounting values affect accounting systems and therefore cultural factors directly influence the development of accounting and financial reporting systems at a country and industry level. The aims of the regulation are to create a stable banking union and take care of the weakness in corporate governance. This brings to a further specification of cultural requirement for banking. Disclosing such information regulators will offer banks an incentive to address the problem of a poor risk culture and provide valuable information to stakeholders.

Learning Objectives
In this chapter we will discuss:
• Definition and features of risk culture in banking
• Relations between governance, risk management and risk culture
• The regulatory approach to risk culture
Summary

The interest for culture in banking grew after the financial crisis and the recent Libor scandal. There is a cultural problem under the decisions and behaviors that brought to the crisis. Improving culture in the banking and financial services industry is an imperative.

Risk culture is an element of the corporate culture. It regulates how business models answer to changes in the environment: it can resist to new contexts or adapt to it if the existing assumptions are no longer able to solve organization’s challenges. Risk culture affects the role of risk management in the organization. Cultures that encourage higher risk taking went through more bank failures and troubles during the recent financial crisis.

The regulators’ approach on risk culture is the last step of a more general and systematic process. Regulators should disclose their own assessment of a bank’s risk culture.

References


BARCLAYS PLC (2014), Building the 'Go-to-Bank'. Annual Report, London: Barclays PLC.


BASEL COMMITTEE (2005), Compliance and the compliance function in banks, April. http://www.bis.org/publ/bcbs113.pdf 13/07/2015


BASEL COMMITTEE (2015), Standards: Revised Pillar 3 disclosure requirements, January. http://www.bis.org/bcbs/publ/d309.htm 13/07/2015

BASEL COMMITTEE (2015a), Corporate governance principles for banks. Guidelines, BSCBS Publications.


CARRETTA A. (2015), Serve a poco iniettare capitale nella banca se questa non ha un’adeguata cultura del rischio, MF, 6 February


COMMITTEE OF EUROPEAN BANKING SUPERVISORS (2010), High level principles for risk management. 16 February.


ERNST AND YOUNG (2014), *Risk Culture: Meeting regulatory expectations and assessing culture.* Global Regulatory Network Executive Briefing, June


FINANCIAL STABILITY BOARD (2009), *Principles for sound compensation practice.*


INSTITUTE OF INTERNATIONAL FINANCE (2009), Reform in the financial services industry: Strengthening practices for a more stable system. Report of the IIF Steering Committee on Implementation (SCI).

INSTITUTE OF RISK MANAGEMENT (2012), Risk Culture under the microscope guidance for board.

KANAGARETNAM K. - LIM C.Y. - LOBO, G. J. (2013), Influence of national culture on accounting conservatism and risk taking in the banking industry, working paper, July


MECHELLI A. (2013), La value relevance del bilancio di esercizio, Giappichelli, Torino.


PRICE WATERHOUSE COMPANY (2012), The Risk Culture Survey.


PRICE WATERHOUSE COMPANY (2014), Cure for the common culture: How to build a healthy risk culture, PwC FS Viewpoint. OCTOBER.
PROTIVITI. (2014), Establishing and Nurturing an Effective Risk Culture.
The Financial Statements in the Italian Banking System

Guido Paolucci

This chapter analyses the content and the structure of the Italian banks’ Financial Statements. In the Italian Banking Sector, a bank compiles its Financial Statements according to the International Accounting Standards (IAS/IFRSs) and the Regulatory and legal acts issued by the Bank of Italy. In particular, Italian banks’ Financial Statements are prepared in compliance with Legislative Decree n. 38 of 28th February 2005, which provided the compulsory adoption of the IAS/IFRSs. The Bank of Italy adopted the rules of IAS/IFRSs by issuing the Circular n. 262/05 (amended on 22nd December 2014), according to which the structure and the content of banks’ Financial Statements reflect the requirements of IAS 1 Presentation of Financial Statements. In the mentioned "Circular" it is stated that the banks’ Financial Statements must be composed of six mandatory documents: Balance Sheet, Income Statement, Statement of Comprehensive Income, Cash Flow Statement, Statement of Changes in Shareholders’ Equity and Notes to the Financial Statements. In this way, the Financial Statements strengthen their role as essential information tools for stakeholders and for the supervisory activity made by the Bank of Italy.

This chapter also outlines the main topics of the IAS/IFRSs that are used by banks in preparing Financial Statements, i.e. IAS 32, IAS 39, IFRS 7, IFRS 9 and IFRS 13. These Standards are, of course, the most controversial and difficult to interpret and apply. In the banking context, the Accounting Standards concerning financial instruments are absolutely relevant and involve several considerations. Regarding the financial instruments, the most significant issues are those introduced by IFRS 9 that brings many relevant challenges to banks, whose activity is characterized by complicated transactions in financial instruments, is related to various types of compound financial instruments and generates loans to various portfolios of clients with different credit risk.

Learning objectives

In this chapter we will consider:

- The Legislative Framework for Financial Reporting in Italian Banking Sector;
- The impact of IAS/IFRS on the Italian banks’ Financial Statements;
cally on the components of its Regulatory Capital, so stakeholders can be acquainted with the risk and the capitalization levels of the bank, to evaluate its soundness. The Basel 3 Agreement prescribes transparency rules on information related to Regulatory Capital, its adequacy, the exposure to risks and their management, to facilitate market actors in the evaluation of the overall situation of the bank (Linsley & Shrives, 2005).

It should be noted that the effects of the implementation of IAS/IFRSs are reflected in the inclusion of disclosures required by specific IAS/IFRS as well as in renewing the structure and the content of the Notes. For example, Part L provides information on economic and financial data of the bank divided by sectors and geographical areas in line with IAS 14 Segment Reporting, while Part H incorporates the disclosure required by IAS 24 Related Party Disclosures. This Standard disciplines the disclosure on the impact of transactions with related parties in the representation of the economic and the financial position of the bank.

Nevertheless, the most significant innovation of the structure of the Notes to the Financial Statements relates to the information contained in Part E. This section characterizes the Notes because it regards the disclosure of risks related to financial instruments which, as noted, represent the core business of banking activity. In this Part of the Notes, the Bank of Italy requires the presentation of specific qualitative and quantitative information on the risks associated with financial instruments operations, thus replicating the requirements of IFRS 7.

References


BRÎNZĂ D.E. (2011), Historical cost and fair value within the context of financial crisis, Challenges of the Knowledge Society. Economy, No. 1, April, pages 1497-1502.


Saving banks played a pivotal role to support Italian economy and populations. The Basel Committee on Banking Supervision recently underlined that "the recent financial crisis" ... "highlighted the need to improve the quality of external audits of banks".

External auditing in Italian savings banks is very complex and sophisticated, and it is impossible to operate it without having a clear knowledge of the main interconnections with the governance, organization and internal control features and issues, as the existing doctrines related to banking supervision provide that the board of statutory auditors has "the responsibility to monitor the functionality of the overall system of internal controls".

The Bank of Italy also provided that external auditors must "ascertain the effectiveness of all the structures and functions involved in the control systems" at the same time addressing controls "transversally throughout the entire business organizations". Such a complicated scenario becomes even more risky if we consider, from the one hand, the general paucity of laws and bylaws - as well as banking/finance peculiar legislation - addressed to highlight the specific duties and tasks of the board of statutory auditors in Italian Banks, and from the other hand the possibilities that Auditors across the years will be considered guilty of lacks of controls, omissions, or inaction, thus being charged of severe monetary sanctions by the Bank of Italy.

By conducting an empirical analysis on the broad majority of the SBs affiliated to ACRI, we provide a general map of duties and tasks of the board of external auditors, at the same time illustrating some examples of controls to be deployed, as well as the main structure and content of the yearly report to financial statements.

---

1 This chapter is the result of a joint effort by the authors who share the formulation. However, the writing of the specific sections must be divided as follows: Massimo Sargiacomo (corresponding author): paragraphs 9.1, 9.7, 9.8, 9.9; Adalberto Rangone: paragraphs 9.2, 9.3, 9.4, 9.5, 9.6.
Taking awareness of the accounts homogeneity and quality, the board of statutory auditors has full right to certify the accounting situation, by expressing an opinion favorable to the financial statement approval. As prescribed by law, this certification process must be expressed both in case of separate financial statement and in case of consolidated financial statement.

Summary

In this section we investigated the External Auditing of Italian Saving Banks, as well as the main Governance and Control features that are deemed pivotal in order to understand the analysis. Admittedly, the recent financial crisis didn’t simply unveil weaknesses in risk management, control and governance processes at banks, but also highlighted the need to improve the effectiveness of external auditors and audits of banks. External auditors of banks can play an important role in contributing to financial stability, and solving governance and internal control issues. This book-chapter first of all revealed the historical relations between foundations of banking origin (FBOs) and Italian Saving banks (SBs), as well as their connections with Corporate Governance. Then, after having illustrated the basic organizational structure of a SB, the manuscript briefly recapitulated the main features of the Internal Auditing, Risk Management and Compliance Offices, in order to better highlight the connections with the External Auditors. The general duties and functions of the External Auditors are thus portrayed, at the same time highlighting both their main activities and some related examples and the pivotal content of the yearly Report on Financial Statement.

References

AMATUCCI C. (2010), *Il Comitato per il controllo interno fra finzione ed effettività*, in Modelli di Corporate Governance e responsabilità di amministratori e manager, a cura di Manlio Lubrano di Scorpaniello, Università degli Studi del Sannio, Franco Angeli, Milano.


CASSA DI RISPARMIO DEL FRIULI VENEZIA GIULIA SPA (2015), Relazione di accompagnamento al bilancio, at http://www.carifvg.it/dati-societari/bilanci.jsp
CASSA DI RISPARMIO DI CENTO SPA (2015), Relazione di accompagnamento al bilancio, at: https://www.crcento.it/dati/pagine/Relazioni%20e%20Bilancio%202014.pdf
CASSA DI RISPARMIO DI CIVITAVECCHIA SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.cariciv.it/dati-societari/bilanci.jsp
CASSA DI RISPARMIO DI FERMO SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carifermo.it/it/bilancio/

CASSA DI RISPARMIO DI FORLÌ E DELLA ROMAGNA SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carifermo.it/it/bilancio/

CASSA DI RISPARMIO DI FOSSANO SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carifermo.it/it/bilancio/

CASSA DI RISPARMIO DI GENOVA E IMPERIA SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carigere.reportingcenter.it/it/documenti


CASSA DI RISPARMIO DI ORVIETO SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.popolarebari.it/content/bpb/it/il-gruppo/investor-relations/bilanci.html#CassadiRisparmiodiOrvieto.html


CASSA DI RISPARMIO DI RAVENNA SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carip.it/dati-societari/bilanci.jsp


CASSA DI RISPARMIO DI SAN MINIATO SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carisbo.it/dati-societari/bilanci.jsp


CASSA DI RISPARMIO DI VOLterra SPA (2015), Relazione di accompagnamento al bilancio, at: http://www.carisbo.it/dati-societari/bilanci.jsp

DE CECCHI M. (2011). The Italian Economy Seen from Abroad over 150 Years, Bank of Italy, Economic History Working Papers, no. 21, October.


GANDINI G., GENNARI F. (2008), Funzione di compliance e responsabilità di governance, Paper n.86, Dipartimento di Economia Aziendale, Università degli Studi di Brescia.


LEARDINI C., ROSSI G., TODESCO C. (2009), Governance e accountability nelle Fondazioni Bancarie, Economia Aziendale Online n. 4, Pavia.
PESENAHLO A. (2012), Manuale del revisore legale. La revisione contabile per imprese industriali, commerciali e PMI. Milano: IPSOA.
SARENS, G., ALLEGRINI, M., D’ONZA, G. AND MELVILLE, R. (2011), Are internal auditing practices related to the age of the internal audit function? Exploratory
evidence and directions for future research, Managerial auditing journal, 26 (1): 51-64.


SPINETTI, F. (2012), La revisione legale del collegio sindacale nelle BCC. Le verifiche periodiche sulla regolare tenuta della contabilità sociale, Roma: ECRA


Cooperative banks are an important area of the Italian banking world. CBs’ auditing is very complex, and includes internal auditing (partly replaced by the Local Federation), auditing firms, auditing committees, as well as banking supervision by the Bank of Italy (onsite supervision). Within such supervisory system, the Audit Committee has a primary role in the supervision of the bank’s compliance with laws and bylaws, principles of good management, as well as adequate organisational, managerial and accounting system. In addition, the Audit Committee monitors the completeness, adequacy and operation of the internal auditing system. Moreover, the Audit Committee supervises and prevents the bank’s crises, by monitoring the quality of loans granted to the bank’s customers, considers mechanisms to prevent conflicts of interest, and monitors control over suspected money-laundering transactions. With its powers and the information, the Audit Committee receives, it does not manage risks but coordinates the functions in charge of supervising risk ratings. Finally, the Audit Committee of a CB is involved in supervision of ICAAP and SREP.

Learning objectives

In this section, we will learn how to:

- Distinguish cooperative banks from other types of Italian banks.
- Understand how cooperative banks’ auditing systems are organised.
- List the cooperative banks’ external auditing functions.
- Find connections between banking supervision and cooperative banks’ external auditing.

---

1 This chapter is the result of a joint effort by the authors who share the formulation. However, the writing of the specific sections must be divided as follows: Valerio Antonelli (corresponding author): paragraphs 10.1, 10.2, 10.3; Raffaele D'Alessio: paragraphs 10.4, 10.5, 10.6, 10.7.
Chapter 10

which goes with the financial statement and which is addressed, therefore, to the share-
holders.

References

ARENA M., AZZONE G. (2009), Internal Audit effectiveness: relevant drivers of audi-

ARENA, M., ARNABOLDI M., AZZONE G. (2006), Internal audit in Italian organiza-


BCBS (2013), Recommended Enhancements to Selected IAASB Standards, at www.bis.org.


Ferri G., Masciandaro D., Messori M. (2001), Corporate Governance, Board Turnover and Performance: The Case of the Local Banks in Italy, Università Bocconi, Milano.


Ojo M. (2007), Comparative Analysis between the External Auditor’s Role in Bank Regulation and Supervision. A Comparative Analysis between the UK, Germany, Italy and the US, MPRA Paper 6289, at: http://mpra.ub.uni-muenchen.de/6829/


This chapter explores the auditing activity in listed banks in the Italian scenario. A short introduction referred to the Italian listed banks and an overview of their auditors open the chapter. Considering the civil law context characterizing the Italian environment, the regulations regarding the auditing of listed banks are explored. In this regard, the Legislative Decree 39/2010 implementing the Directive 2006/43/EC on statutory audits and the recent adoption of ISA with some interpretation/application notes localizing the standards in respect of Italian law and regulation (the so-called ISA Italy) are considered. The auditing activity of banks is also analysed in its different moments considering the peculiarity of banks.

Keywords
In this Chapter, we will deal with:
- Italian listed banks;
- International Standard on Auditing (ISA);
- Internal Control System;
- Auditing procedures.
Chapter 11

2015, through the adoption of ISA Italy ISQC 1, with the aim of defining a system of quality control to provide a reasonable assurance that the audit firm and its personnel comply with standards, legal and regulatory requirements, and reports issued are appropriate.

The purpose of this chapter was to offer a general overview of the audit of Italian listed banks, identifying the scenario auditors operate in, the system of law and regulations related to their activity and underlining some specificities of auditing in the banking sector. Further developments on this topic could be referred to an in-depth analysis of key areas of bank’s financial statements with significant risk of material misstatement (e.g. loan loss provisioning, financial instruments, deferred tax, going concern assessment etc.); the exploration of the interplay of auditors with other internal/external actors of banks (Internal Auditing, Audit Committee, Board of Statutory Auditors); and the relation with banking sector supervisors and market authorities.

Summary

This chapter offered an overview of auditing referred to Italian listed banks, exposing the legal and regulatory requirements and the recent introduction of ISA Italy, i.e. International Standard on Auditing with some interpretation/application notes localizing the standards.

The auditing activity of banks was analysed in its different moments considering the peculiarity of banks. The auditors’ independence, the rotation mechanisms and the quality control activity emerged as fundamental.

References


External auditing in Italian banks listed on the stock market 313


