

Audit Obligations

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AUDIT OBLIGATIONS UNDER PART V OF THE RESERVE BANK OF NEW ZEALAND ACT 1989

Introduction

1. Under the Reserve Bank of New Zealand Act 1989 (the “Act”), the Reserve Bank of New Zealand (the “Bank”) is empowered to register and supervise banks for the purposes of:
 - (a) promoting the maintenance of a sound and efficient financial system;
 - (b) avoiding significant damage to the financial system that could result from the failure of registered bank.
2. To assist in achieving these objectives, the Act permits the Bank to recommend the establishment, by way of Order in Council, of disclosure arrangements for registered banks.
3. This document identifies the obligations of auditors under the Bank’s disclosure regime, as well as the other statutory obligations of auditors under Part V of the Act, and directs auditors to appropriate sources of guidance on fulfilling these obligations.

Audit Requirements of the Disclosure Regime for Registered Banks

4. The requirements implementing the disclosure regime are contained in two Orders in Council (or “Orders”). These Orders, along with some accompanying explanatory information, are included in the Banking Supervision Handbook issued by the Bank. The Orders require certain information to be disclosed in documents called disclosure statements, and to be reported on by an external auditor. The next sections briefly describe those disclosure documents and their associated audit requirements.

Disclosure Documents

5. Registered banks are required to publish disclosure statements at quarterly intervals - a full disclosure statement for the financial year and shorter disclosure statement for the half year and the first and third quarters (or “off quarters”) of the financial year. The two Orders implementing the disclosure regime set out the disclosure requirements for locally incorporated banks and overseas incorporated banks respectively.
6. Branches of overseas incorporated banks are also required to publish an additional form of disclosure statement, consisting solely of the financial statements of the bank as a whole and its group. A branch fulfils this obligation by making the published financial statements of the overseas bank and of the overseas banking group available on their New Zealand website by the end of the next working day after they are published in the bank’s country of domicile. Since the Orders do not impose any audit requirements on

this particular form of disclosure statement, the rest of this document only discusses the quarterly disclosure statements referred to in paragraph 5.

7. The kinds of information contained in the full year disclosure statement are described below:
 - (a) **General Disclosures:** includes details of matters such as guarantee arrangements, directorate and auditors, conditions of registration, pending proceedings and arbitration, credit ratings, historical summary of financial statements, members of the banking group, auditor's report, the directors' statement and, in the case of an overseas incorporated bank, the New Zealand chief executive officer's statement.
 - (b) **Financial Statements:** of the registered bank and the banking group prepared in accordance with the requirements of the Financial Reporting Act 1993, as though the references in the Financial Reporting Act 1993 to a "group" were to the banking group. These statements should be prepared as though the registered bank does not qualify for any exemptions pursuant to any differential reporting framework that would otherwise be applicable.
 - (c) **Additional Information:** includes additional financial disclosures, information relating to asset quality, capital adequacy of the registered bank and the banking group, concentration of credit exposures, credit exposures to connected persons (where applicable), securitisation, funds management and other fiduciary activities, and risk management policies.
8. Disclosure statements for the half year and off quarters contain interim financial statements, as well as abbreviated versions of the general disclosures and additional disclosures, and focus mainly on banking group information, rather than both group and legal entity information as is required for full year disclosure statements.

Conditions of Registration

9. The Orders require registered banks to disclose financial information on compliance with their conditions of registration – including in respect of capital adequacy requirements, and in respect of compliance with limits on exposures to connected persons (these conditions apply to locally incorporated banks only). The Banking Supervision Handbook contains three documents making up the capital adequacy framework (“Capital adequacy framework (Basel I approach)” (BS2), “Capital adequacy framework (standardised approach)” (BS2A), and “Capital adequacy framework (internal models based approach)” (BS2B)) which provide detailed information on capital adequacy requirements applied to locally incorporated banks as a condition of registration. Although the capital adequacy framework documents do not act as a basis for applying conditions of registration to overseas incorporated banks, the Orders do require banks incorporated overseas to disclose information on market risk exposures arising from their New Zealand business, and that information must be derived in accordance with BS2A. Overseas banks are also required to disclose risk weighted credit

exposures arising from their New Zealand business in accordance with BS2, but this requirement ceases for reporting dates on or after 31 December 2011.

Description of Audit Requirements

10. Registered banks are required to obtain a full external audit of the financial statements and additional financial information published in the full year disclosure statement (with one exception), and a limited scope external review of the same kinds of information published in the half yearly disclosure statement. The one exception to the full external audit requirement at the full year arises with the information on capital adequacy published by locally-incorporated banks, which is subject to a limited scope external review, as for the half year disclosure statement. No specific audit requirements apply at the off quarters.
11. The disclosure statement relating to full year periods must be published no later than three months following the balance date. The publication deadline for the half year and off quarter disclosure statements is normally two months, in part because a full external audit is not required. However, if the Reserve Bank is satisfied that a bank has reasonable grounds for not being able to comply with the two month deadline for its half year disclosure statement, the deadline is extended to three months. This might for instance be the case if a registered bank elects to obtain a full audit rather than a limited scope review of the financial information contained in the half year disclosure statement. The deadline for an off quarter disclosure statement is always two months regardless of whether a bank opts for an external audit or review of the financial information it contains.
12. An aspect of electing to obtain an audit or review during the off quarters relates to compliance with the Bank's capital adequacy requirements – unaudited retained earnings form part of Upper Tier Two Capital, whereas retained earnings which have been subject to audit or review are contained within Tier One Capital.
13. The audit requirements of the disclosure regime are described in more detail below. This description is intended only as a guide, and auditors should refer to the Orders for the exact requirements, and in particular: in the Order for New Zealand-incorporated banks, to clause 20 of Part 2, all of Schedule 1, clause 18 of Schedule 2, and clause 13 of Schedule 3; and in the Order for overseas-incorporated banks, to clause 21 of Part 2, all of Schedule 1, clause 21 of Schedule 2, and clause 16 of Schedule 3.
14. It should be noted that the disclosure regime does not exempt auditors from any other requirements that might be imposed on them under the Companies Act 1993 or the Financial Reporting Act 1993.

Audit of the Full Year Disclosure Statements

15. The auditor's report on the information (other than the general disclosures) contained in a full year disclosure statement is required to contain statements on the following matters:

- (a) **General Requirements:** For all financial statement-related and additional financial information prepared in accordance with the Orders, the general reporting requirements are similar to those which apply under section 16 of the Financial Reporting Act 1993. These requirements are set out in Schedule 1 of both Orders, and relate to the work done by the auditor, the scope and limitations of the audit, the nature of the auditor's relationship with the registered bank and the members of the banking group, whether proper accounting records have been kept, and whether the auditor has obtained all information and explanations required.
- (b) **Financial statements:** The auditor must give an opinion as to whether the annual financial statements of the registered bank and the banking group included in the registered bank's disclosure statement:
- (i) comply with generally accepted accounting practice and, if they do not, the respects in which they fail to comply; and
 - (ii) having regard to any information or explanations that may have been added, give a true and fair view of the matters to which they relate and, if they do not, the respects in which they fail to give such a view.
- (c) **Additional information:** The auditor is required to give an opinion as to whether the additional information on the registered bank and the banking group included in the registered bank's disclosure statement:
- (i) has been prepared in accordance with guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act (if any) or any conditions of registration imposed under section 74 of the Act; and
 - (ii) is in accordance with the books and records of the registered bank and banking group.

The auditor is also required to give an opinion as to whether:

- (iii) the additional information other than that relating to capital adequacy fairly states the matters to which it relates in accordance with the relevant requirements in the Orders, and, if it does not, the respects in which it fails to do so;

Additionally, for New Zealand incorporated banks the auditor's report is required to state:

- (iv) that the information relating to capital adequacy has been examined by the auditor; and
- (v) whether anything has come to the auditor's attention which would cause the auditor to believe that the information on capital adequacy is not in all material respects derived in accordance with the bank's conditions of registration, and in accordance with the bank's internal models for credit

risk and/or operational risk if applicable, and disclosed in accordance with Schedule 9 or 11 as applicable, in the Order applying to New Zealand-incorporated banks.

And for overseas incorporated banks, the auditor is required to give an opinion as to whether:

- (vi) the information relating to credit and market risk exposures and capital adequacy is in all material respects derived in accordance with Banking Supervision Handbook documents BS2 and BS2A, and is disclosed in accordance with Schedule 9 of the Order applying to overseas-incorporated banks.
16. The appropriate standards and guidance for auditors engaged to express an audit opinion in accordance with the audit requirements of the Orders are contained in the auditing standards and guidelines issued by the Institute of Chartered Accountants of New Zealand. Additionally, auditors are referred to the Market Risk Guidance Notes (BS6) contained in the Banking Supervision Handbook for guidance on the market risk disclosure requirements (contained in Schedule 9 or 11, as applicable, in the Order applying to New Zealand-incorporated banks, and in Schedule 9 in the Order applying to overseas-incorporated banks).

Review of Half Year Disclosure Statements

17. Registered banks are required to obtain a review by an external auditor of the financial statements and the additional information contained in the half year disclosure statements, unless they have obtained an audit opinion on this information. The requirements with respect to the half year review are:
- (a) **Financial statements:** The auditor is required to undertake a review of the half year financial statements included in the registered bank's disclosure statement and prepare a report stating:
 - (i) that the financial statements have been examined by the auditor; and
 - (ii) whether or not anything has come to the auditor's attention which would cause the auditor to believe that the financial statements have not been prepared, in all material respects, in accordance with NZ IAS 34.
 - (b) **Additional information not relating to capital adequacy:** The auditor's report is required to state:
 - (i) that the information has been examined by the auditor; and
 - (ii) whether anything has come to the auditor's attention which would cause the auditor to believe that the information does not fairly state the matters to which it relates in accordance with the relevant requirements in the Orders.

- (c) **Additional information relating to capital adequacy:** For New Zealand incorporated banks, the auditor's report is required to state:
- (i) that the information relating to capital adequacy has been examined by the auditor; and
 - (ii) whether anything has come to the auditor's attention which would cause the auditor to believe that the information is not in all material respects derived in accordance with the bank's conditions of registration, and in accordance with the bank's internal models for credit risk and/or operational risk if applicable, and disclosed in accordance with Schedule 9 or 11 as applicable, in the Order applying to New Zealand-incorporated banks.

For overseas incorporated banks, the auditor's report is required to state:

- (iii) that the information relating to credit and market risk exposures and capital adequacy has been examined by the auditor; and
 - (iv) whether anything has come to the auditor's attention which would cause the auditor to believe that the information is not in all material respects derived in accordance with Banking Supervision Handbook documents BS2 and BS2A, and disclosed in accordance with Schedule 9 of the Order applying to overseas-incorporated banks.
18. The audit opinion on the half year information is of a negative assurance form. The appropriate standards and guidance for auditors engaged to give a negative assurance opinion in order to fulfil the review requirements of the Orders are contained in the review engagement standards and guidelines issued by the Institute of Chartered Accountants of New Zealand. Additionally, auditors are referred to the Market Risk Guidance Notes (BS6) contained in the Banking Supervision Handbook for guidance on the market risk disclosure requirements (contained in Schedule 9 or 11 as applicable, in the Order applying to New Zealand-incorporated banks, and in Schedule 9 in the Order applying to overseas-incorporated banks).

Other Options for Audit Reports

19. A registered bank may choose to obtain a full scope audit rather than a limited scope review of the interim financial statements and additional financial information contained in its half year disclosure statement. In this case, the auditor's report must contain most of the same information as required for the auditor's report on the full year disclosure statement. The one exception is that instead of stating whether or not the financial statements give a true and fair view of the matters to which they relate, the report must state whether or not the interim financial statements of the banking group are prepared in all material respects in accordance with NZ IAS 34.
20. A registered bank may choose to have its off quarter disclosure statement audited or reviewed. The Orders do not prescribe the content of the auditor's report in this case, but

the bank must include in its disclosure statement a statement of the nature and scope of the audit or review, and a copy of the auditor's report or review statement.

Other obligations under Part V of the Act

21. Under section 96 of the Act, the auditor of a registered bank is required to disclose to the Bank, after informing the registered bank of an intention to do so (in accordance with section 97 of the Act), information relating to the affairs of that registered bank obtained in the course of holding office as an auditor if, in the auditor's opinion, the information indicates that the bank is in serious financial difficulties, or if the information is likely to assist the Bank in the exercise of its supervision responsibilities. Sections 96 to 98 of the Act are set out in Appendix One.
22. Auditors are protected, under section 98 of the Act, from civil, criminal or disciplinary proceedings brought against an auditor arising from the disclosure, in good faith, of any such information to the Bank.
23. Sections 93 and 94 of the Act also contain provisions which together enable the Bank to obtain audited information or data from registered banks for supervisory purposes.

APPENDIX ONE

AUDITOR OBLIGATIONS UNDER SECTIONS 96 TO 98 OF THE RESERVE BANK OF NEW ZEALAND ACT 1989

- 96. Disclosure of information to Bank by Auditors-** Every person who holds, or at any time has held, office as required by any enactment, as an auditor of a registered bank, shall disclose to the Bank information relating to the affairs of that registered bank obtained in the course of holding that office if, in the opinion of that person,-
- (a) The registered bank is insolvent or is likely to become insolvent or is in serious financial difficulties; and
 - (b) The disclosure of that information is likely to assist, or be relevant to, the exercise by the Bank of its powers under this Part of this Act.
- 97. Auditor to inform registered bank of intention to disclose -** Every auditor shall, before disclosing any information to the Bank under section 96 of this Act, take reasonable steps to inform the registered bank of the intention to disclose the information and the nature of the information.
- 98. Protection of auditors-**
- (1) No civil, criminal, or disciplinary proceedings shall lie against any auditor arising from the disclosure in good faith of information to the Bank pursuant to section 96 of this Act.
 - (2) No tribunal, body, or authority, having jurisdiction in respect of the professional conduct of any auditor shall make any order against, or do any act in relation to, that person in respect of such disclosure.
 - (3) No information received by the Bank pursuant to section 96 of this Act shall be admissible in evidence in any proceedings against the auditor concerned.
 - (4) Nothing in subsection (3) of this section shall limit the admissibility of any information obtained in any other way.