

Assurance Reports on Bank Disclosure Statements

Summary of submissions and feedback statement

20 July 2022



Reserve Bank
of New Zealand
Te Pūtea Matua

Contents

1	Introduction	2
2	Background	2
3	Consultation Process	2
4	Summary of Submissions	3
4.2	Components of Assurance Reports	3
4.3	Reference to Conditions of Registration and s78 Guidelines	4
4.4	Appropriate Assurance Standard for Information on Capital Adequacy	5
4.5	Reasonable Assurance Option for Capital Adequacy Disclosure	6
4.6	Auditor’s Signature	6
4.7	Minor Wording Changes and Rationalisation	7
5	Next Steps	8

1 Introduction

1.1.1 We recently consulted on proposed changes to the assurance reports required on registered banks' public disclosure statements. This document provides a summary of the key points raised by submitters, along with our responses to those points. It also confirms the changes that we propose to have made to the Orders in Council that set the disclosure requirements and the associated assurance requirements, and the planned timetable for those changes.

2 Background

2.1.1 The Reserve Bank requires all registered banks to publish six-monthly disclosure statements. The requirements are imposed by two Orders in Council made under section 81 of the Banking (Prudential Supervision) Act 1989 ('the Act'): the 'local OIC', applying to banks incorporated in New Zealand, and the 'branch OIC', applying to overseas incorporated registered banks operating as a branch in New Zealand¹.

2.1.2 The OICs require every disclosure statement to be subject to a specified level, or to multiple levels, of assurance by an auditor. The main section of each OIC includes a clause specifying that the full-year disclosure statement must be accompanied by an 'auditor's report', and the half-year disclosure statement by an 'auditor's report or review statement'. The detailed content of these reports and review statements is specified in Schedule 1 of the respective OIC.

2.1.3 Although described as a single 'report' or 'statement', the current nature of the assurance opinions required for both full-year and half-year disclosure statements, and in both the local and branch OIC, means that in practice they are divided into three separate conclusions within one document, covering different parts of the required disclosure.

2.1.4 Combined with the requirement for auditors to report on 'Key Audit Matters' (KAMs) as part of their report on financial statements, which were introduced in 2015, this led to concerns being raised with us about the length, complexity and therefore readability of auditors' reports on bank disclosure statements.

2.1.5 The consultation paper proposed changes to the OIC assurance requirements to improve the readability of the auditor's report. At the same time, we took the opportunity to review the way the assurance requirements are expressed in the OICs, as some of the text seemed to be potentially redundant or out of date.

3 Consultation Process

3.1.1 We published the consultation paper 'Assurance Reports on Bank Disclosure Statements' on 18 January 2022, with the consultation period running to 15 March 2022. We also published drafts of the amending Orders that would make the proposed changes to the OICs. We received eight submissions responding to matters raised in the consultation paper, from:

- ANZ Bank New Zealand Limited;

¹ Consolidated "working copies" of the Orders, incorporating amendments, are available at <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/disclosure-requirements>

- Chartered Accountants Australia and New Zealand;
- External Reporting Board;
- KPMG New Zealand;
- MUFG Bank, Ltd;
- New Zealand Bankers' Association;
- Office of the Auditor-General; and
- PricewaterhouseCoopers New Zealand.

3.1.2 Non-confidential submissions are published on the Reserve Bank website alongside this document.

4 Summary of Submissions

4.1.1 All submitters were in favour of the proposed changes. There was general agreement that the changes would make assurance reports on disclosure statements easier to read, easier to understand, and hence more useful. There was also agreement that the changes would not substantially change the nature or scope of the underlying assurance work carried out. Submitters that responded to consultation questions about the cost and impact of the changes were of the view that there would be negligible effect on compliance costs either way.

4.1.2 Submitters made a number of helpful suggestions, many of which directly help to further simplify and rationalise the assurance requirements. The following sections summarise these comments and explain what we have done in response. At the same time as this feedback statement, we have published revised drafts of the two amending Orders needed to implement the changes, taking on board the responses set out below. References to OIC clause numbers in the following are based on those revised amending Orders.

4.2 Components of Assurance Reports

4.2.1 A key source of the current complexity of the assurance reports on bank disclosure statements is the need to combine three different forms of opinion into one report. One option to simplify matters would be to specify that these could be presented as three distinct reports. However, this did not appear to be feasible, as some banks in their disclosure statements intermingle the financial statements prepared under the Financial Markets and Conduct Act 2013 ('FMC Act') with additional information required by the OICs. This makes it unworkable to separate the distinct forms of assurance opinion.

4.2.2 What we did propose to reduce complexity was to bring out the distinction between reasonable assurance and limited assurance reports, and be clear which parts of the required reports fall into which category. We also attempted to disentangle the auditor's report on the financial statements required under the FMC Act from the other assurance reports required by the OICs.

4.2.3 Three responses supported the proposed separation into reasonable assurance and limited assurance reports, but suggested various ways of providing further separation of the components of the report. Two of these further suggested that we provide more flexibility, by allowing but not requiring separation of the components of the assurance report.

Response

4.2.4 We believe that providing optionality makes good sense. Some banks do present required disclosure information distinctly from the annual or interim financial statements prepared under GAAP, and their auditors would be able to provide three distinct assurance reports. For banks that do not do this, auditors would be able to simplify the assurance reports as far as possible, without requiring those banks to change the way they present the disclosure information.

4.2.5 To implement this change we have changed the OIC proposals as follows:

- in both OICs, in each of clauses 1, 2 and 3 in Schedule 1, we have specified the three assurance components distinctly in subclauses (a), (b) and (c). The text of subclause (a), which in each case specifies the assurance report required on financial statements or interim financial statements, is now drafted to make clear our intention to rely solely on the general assurance approach for those statements; and
- we have expanded clauses 25A and 25B in the local OIC, clauses 26A and 26B in the branch OIC, to provide full optionality over the different ways of combining (or not) the three types of assurance opinion.

4.3 Reference to Conditions of Registration and s78 Guidelines

4.3.1 The current Schedule 1 requires, for a full year disclosure statement, a statement “whether or not, in the auditor’s opinion (where applicable), the information has been prepared in accordance with guidelines issued under section 78(3) of the Act (if any) or any conditions of registration [CoRs]”. In the consultation, we proposed to keep this requirement, but narrow the scope, as the current wording could imply that this includes assuring that all of the information in a bank’s financial statements are prepared in accordance with CoRs and s78 guidelines. There did not seem to be a good reason for requiring this.

4.3.2 Two submitters welcomed this change. Two other submitters argued that this part of the full year assurance report serves no useful purpose, since all of the Schedules to the OICs that require various prudential information to be disclosed do so in such a way that pins the definitions of that information, where relevant, back to the relevant prudential requirements. This means that when a bank has complied with all of the disclosure requirements in the specified Schedules, its auditor cannot conclude that it has not complied with any CoR underlying the definitions for that information.

Response

4.3.3 We agree with this point in general. However, there is one exception. Under s74(4) of the Act, ‘The Bank may impose conditions that relate to any of the following matters: ... (c) the matters referred to in section 81, including any matters prescribed by an Order in Council made under that section’. This allows us to impose a CoR that relates to disclosure requirements imposed by OICs. We do not believe that it would be appropriate to use this

power to impose disclosure requirements generally on a class of banks (e.g. New Zealand-incorporated banks) by imposing new CoRs on them, since the Orders in Council provide the intended mechanism to do that. However, this does allow us to specify particular disclosure conditions on an individual bank, and we have in fact done so on occasion.

4.3.4 Where a bank is subject to such a CoR (specifying disclosure requirements additional to those listed in the Schedules to the OICs), we think it is important for the auditor to assure that the disclosure statement has been prepared in accordance with that condition, as well as with all the relevant clauses of the OIC.

4.3.5 In response, we have reorganised these proposed parts of the assurance report into a single statement on whether, in the auditor's opinion, the information that is required to be disclosed under the specified schedules:

- presents fairly the matters to which it relates;
- is disclosed in accordance with those schedules; and
- if applicable, has been prepared in accordance with any conditions of registration relating to disclosure requirements, imposed under section 74(4)(c) of the Act.

4.3.6 This text appears in Clauses 1(2) and 3(2) in Schedule 1 to both OICs. A negative assurance version is in Clause 2(2), for the corresponding opinion on the information in half-year disclosure statements. The wording of sub-clause (c) in each case (noted in the third bullet above) is designed to emphasise the very narrow scope of this part of the opinion.

4.4 Appropriate Assurance Standard for Information on Capital Adequacy

4.4.1 A form of limited assurance opinion is required on the disclosure of information on capital adequacy and liquidity ratios by New Zealand-incorporated banks, and the same form of opinion is required on the disclosure of information on credit and market risk disclosures and capital adequacy by overseas bank branches.

4.4.2 Two submitters raised the question whether this information meets the definition of 'historical financial information' as defined in auditing standards, or non-financial information. They told us that current practice is to treat it as historical financial information and prepare the opinion under NZ SRE 2410 (Revised)². If it is not deemed to be historical financial information, another standard providing limited assurance may be appropriate, such as ISAE (NZ) 3000 (Revised)³. If that was the case, it would not be feasible to include this opinion in a single assurance report combined with an opinion prepared under a different assurance standard.

Response

4.4.3 We do not see it as the Reserve Bank's role to give a view on the appropriate assurance standard to use. We have discussed this question with the External Reporting Board, and they have offered to facilitate discussions among interested stakeholders on the best

² New Zealand Standard on Review Engagements 2410 (Revised) *Review of Financial Statements Performed by the Independent Auditor of the Entity*

³ International Standard on Assurance Engagements (New Zealand) 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

approach to take. We stand ready to contribute in our area of expertise, namely the nature of the information that is required to be disclosed.

- 4.4.4 We believe that our more flexible approach to the combinations of different components of assurance reports (see above) will deal with the main potential problem arising from different required opinions having to be prepared under different assurance standards.

4.5 Reasonable Assurance Option for Capital Adequacy Disclosure

- 4.5.1 Two submitters suggested that there should be an option available to include a reasonable assurance opinion on the information that is currently only subject to a limited assurance opinion (capital adequacy and other information). They noted that some banks in other jurisdictions (including Australia) have been commissioning auditors to provide reasonable assurance opinions on such information. They argued that adding this option would future-proof the OICs, allowing a New Zealand bank that wanted to do this the ability to do so.

Response

- 4.5.2 We have not taken this suggestion on board. It lies outside the narrow objectives of this consultation, namely to make the assurance reports easier to understand and to rationalise the way the requirements for them are specified. We agree that, other things equal, readers of banks' disclosure statements will always prefer to have a greater degree of confidence in the accuracy of this particular information. However, we believe that the proposal raises some questions which would take time to work through, and risk further delaying the resolution of the main concerns addressed by the consultation.
- 4.5.3 We have some concerns about what messages financial commentators would take from a situation where some banks but not others took up the proposed option. On the other hand, the alternative of making a reasonable assurance opinion on this information mandatory at the full year would certainly add to banks' compliance costs, and so need further consultation.
- 4.5.4 While future-proofing would be desirable, we think it makes better sense to allow more time to consider this proposal more fully (subject to our other priorities). We would find it useful to talk to auditors about their understanding of what a reasonable assurance engagement on such information would involve, particularly in respect of risk-weighted assets determined using IRB (internal ratings-based) models. We would also like to consider this proposal in the broader context of what supervisory tools we can use to verify banks' compliance with key prudential ratios.

4.6 Auditor's Signature

- 4.6.1 We proposed to keep in the OICs the existing requirement for the auditor's assurance report or limited assurance report to be signed by the auditor 'either in the auditor's own name or the name of the auditor's firm'. (In the version we consulted on, see proposed new clauses 25A and 25B in the local OIC, clauses 26A and 26B in the branch OIC.)

4.6.2 One response suggested that this requirement could be cut, as it is required by applicable auditing and assurance standards. In fact for FMC reporting entities (including banks), the standards covering audit opinions (ISA(NZ) 700⁴) and review opinions NZ SRE 2410 require the name of the engagement partner to be given in all but exceptional circumstances. We believe this is sufficient, and have removed this text from the revised draft OICs.

4.7 Minor Wording Changes and Rationalisation

4.7.1 A key goal of the proposed changes that we consulted on was to better align the wording used in the OICs with that in the applicable auditing and assurance standards, and to remove duplication where possible. We received a number of helpful comments suggesting further rationalisation along these lines, and our responses are as follows:

- Two submitters suggested changing the numerous uses of “whether or not” in Schedule 1 of the OICs to simply “whether”. Referring to the “not” case is superfluous: if it arises, the auditor has to explain the basis for it. We have taken this on board in the revised draft OICs.
- Likewise, three submitters suggested that the phrase ‘and if it does not [fairly state etc], the respects in which it fails to fairly state those matters’ is unnecessary. If the auditor modifies the opinion, the assurance standards require that the “basis for the opinion” paragraph includes a description and quantification of any misstatement (unless impracticable). So the OIC requirement is at least implicitly covered by assurance standards. We have removed this text wherever it appeared.
- The draft OIC changes we consulted on included the phrase ‘prepared in accordance with applicable auditing and assurance standards’ as a qualifier to every required report. We felt this was important to emphasise the underpinnings of the assurance requirements for disclosure statements. The two submitters who commented on this were in favour. But one of these submitters suggested we should provide a definition for ‘applicable auditing and assurance standards’, and also suggested a way to avoid the repetitions. We have taken these points on board: see the defined term added in clause 4(1) of both OICs, and sub-clauses 7(3) and 7(4)(b) added in the local OIC, sub-clauses 8(3) and 8(4)(b) in the branch OIC.
- In the current OICs, the qualifier ‘in all material respects’ is applied to some required assurance opinions but not others. We did not address this in our consultation. Four submitters, within drafting suggestions provided, included this qualifier across all applicable opinions, and a fifth made the same point in a comment. We agree that this is desirable, both for internal consistency within our Schedule 1 requirements, and for consistency with auditing and assurance standards. We have added the qualifier in the additional places where needed.
- In line with drafting provided by two commenters, we have replaced all instances of the phrase ‘fairly states’ with ‘presents fairly’. This aligns with the wording required by applicable auditing and assurance standards.

⁴ International Standard on Auditing (New Zealand) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*

- In response to one comment we have replaced the phrase 'which would cause the auditor to believe' with 'that causes the auditor to believe', to align with the applicable auditing standard.

5 Next Steps

5.1.1 We have recommended to the Minister of Finance that he advises the Governor General to make the two amending Orders in Council in line with the drafts published along with this feedback statement. Subject to that process, we aim to get the changes made in time to apply to disclosure statements with balance dates starting from 30 September 2022.

5.1.2 Although this consultation is now closed, any further feedback is best directed to:

jeremy.richardson@rbnz.govt.nz