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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/1

To: All banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Proposed Directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Version of BA returns that form the basis for reporting by auditors in terms of regulation 46 of the Regulations relating to Banks

Executive summary

In terms of regulation 46(1) of the Regulations relating to Banks (the Regulations) the auditor of a bank shall annually, within 120 days of the financial year-end of the reporting bank, report on the bank's financial position and the results of its operations as reflected in the returns in subregulation (6) that were submitted to the Prudential Authority (PA) as at the financial year-end of the reporting bank.

The PA has noted several varied practices across the industry regarding the version of the year-end BA returns that form the basis of the regulatory audit opinion or review conclusion. In some instances, the audit opinion or review conclusion is based on the first submission of BA returns to the PA, while in other cases, it is expressed on the BA returns that have been resubmitted to take account of any year-end and other adjustments, that is, the second submission.

Concerns were raised by the industry, that the use of different versions of the BA returns as the basis for the audit opinions or review conclusions may create an unlevel playing field across the banks, as it would affect the number and nature of audit findings reported, including the audit opinion or review conclusion. This proposed Directive directs banks on the version of the BA returns that must be used to form the basis of the regulatory audit opinion or review conclusion.

1. Introduction

1.1 In terms of regulation 3 of the Regulations, all prescribed returns must be prepared in accordance with Financial Reporting Standards¹ unless expressly otherwise provided in the Banks Act 94 of 1990 (Banks Act) or the Regulations. Furthermore regulation 2(1) requires that the BA returns must reconcile to the management accounts and/or board reports. In practice, this means that the final BA returns for the financial year must, where applicable, reconcile to the banks' audited annual financial statements (AFS) for the financial year under review.

¹ These are the International Financial Reporting Standards issued by the International Accounting Standards Board.

- 1.2 The audit of the BA returns (regulatory audit) is typically only concluded after the audit of the AFS for the year is finalised. Due to year-end audit adjustments to the AFS, the first submission of the BA returns, in most cases, does not align to the audited AFS. Therefore, banks update the BA returns and resubmit them to the PA as soon as the AFS are finalised, to ensure that the information in the BA returns aligns to that in the AFS, as required by regulation 2(1) read with regulation 3 of the Regulations. In terms of regulation 7 of the Regulations, the bank must make this submission by no later than 90 calendar days after year end.
- 1.3 Core Principle 9 read with Core Principle 10 of the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision set out various requirements related to, among others, the techniques and tools used by supervisors to implement the supervisory approach and the independent verification of information through either on-site examinations or use of external experts.²
- 1.4 Through the regulatory audit the PA needs to obtain comfort over the quality of regulatory reporting by banks throughout the year. In some cases, the PA has specifically requested auditors to use the first submission of BA returns, as it is most representative of the bank's reporting throughout the year. This approach typically results in a larger volume of findings in comparison to the audit of the second submission of BA returns at year-end, as the first submission of returns would not ordinarily reconcile to the AFS due to, among others, the timing of the submissions.
- 1.5 When the second submission forms the subject of the regulatory audit, the findings related to year-end adjustments to the AFS and any other adjustments effected by management since the first submission would be eliminated and the auditor's reports would only reflect any other unadjusted deficiencies identified by the auditor, resulting in fewer findings. The PA would not, therefore, have sight of these corrected errors or adjustments as part of the auditor's reports which is inconsistent with the supervisory approach adopted by the PA to obtain the necessary independent verification of required information obtained through the use of the external audit process.
- 1.6 The PA understands that this inconsistency has resulted in an unlevel playing field for banks, as the version of the BA returns that forms the basis of the audit opinion or review conclusion affects the number and nature of findings reported to the PA as well as the opinions or conclusions drawn by the auditors.
- 1.7 The PA considered the practicalities of the various approaches used and has decided that the approach specified in paragraph 2 must be adopted for the audit and review of the BA returns in terms of regulation 46 of the Regulations.

2. Proposed Directive

- 2.1 Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act, banks, branches of foreign institutions, controlling companies and auditors of banks or controlling companies are hereby directed as follows:

² Available online: <https://www.bis.org/publ/bcbs230.htm>

- 2.1.1 The first submission of the BA returns must be used as the basis for the initial audit work. Certain adjustments may subsequently be required to align the BA returns at year end to the AFS once finalised or to correct any reporting errors identified either by the auditors or management. In such instances, a resubmission of the BA returns by the bank would be required in line with the requirements of regulation 7 of the Regulations, i.e., the second submission. This resubmission request must be accompanied by a reconciliation by management, clearly reflecting the changes made in the resubmission in comparison to the previous submission, duly signed and acknowledged by the auditor, in the form of an audit letter.
- 2.1.2 The audit opinion or review conclusion submitted to the PA in terms of regulation 46 of the Regulations must be based on the resubmitted return. The auditor must provide a detailed report to the PA, consisting of all adjustments made to the BA returns between the first and second submissions, distinguishing clearly between those adjustments that were made as a result of aligning the BA returns to the audited AFS and other audit findings or corrections of errors. The report must also clearly distinguish those findings identified by management from those identified by the auditor. Annexure 1 of this proposed Directive provides a template that may be used for this purpose.
- 2.1.3 The requirements set out in this proposed directive apply to audits or reviews conducted in terms of regulation 46 for financial years ending on or after 31 December 2023.
- 2.2 Furthermore, although the PA does not prescribe the materiality threshold that should be used by the auditor when deciding to report a finding to the PA, the PA would like to emphasise that those unadjusted findings that are quantitatively above the auditor's de minimis (clearly trivial) threshold should always be reported and highlighted as such. Any significant qualitative items³, must also be reported to the PA.
- 2.3 The content of the auditors' reports submitted to the PA must be consistent with the content of reports submitted to those charged with governance, such as the Audit Committee of the bank.

3. Invitation for comment

- 3.1 Auditors, banks and other interested persons are hereby invited to submit their comments in respect of this proposed Directive to: Irene.Peter@resbank.co.za by no later than 18 August 2023.
- 3.2 All comments may be published on the website of the PA, unless a respondent specifically requests confidential treatment.

³ Whether an item is considered significant will depend on the auditor's professional judgment.

Fundi Tshazibana
Chief Executive Officer

Date: 20 July 2023

Encl:1