

To the Prudential Authority

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Drafted by the SAICA Basel Task Group and tabled at the SAICA BPG meeting for submission to the Prudential Authority

Considerations when deciding which version of the BA returns should be subject to the regulatory assurance engagement in terms of Regulation 46 to the Banks Act

Introduction

In light of fact that the Prudential Authority (PA) are considering all regulatory assurance engagements to be done on the 1st submission, this paper aims to set out the considerations when deciding which version of the year end BA returns to be subject to the regulatory assurance engagement performed in terms of Regulation 46 to the Banks Act. It is known that currently different approaches are followed across the industry. The PA has requested a paper that sets out the various implications or considerations when auditing the 1st submission versus a 2nd submission at year-end, given that different approaches are currently followed on the regulatory assurance engagements. This paper is intended to set out the factors to consider and does not advocate any particular view on the most appropriate version of the BA returns to form part of the regulatory assurance engagements, as the banks (as defined in the Banks Act, including local branches of foreign institutions) have different preferences and currently the PA has instructed external auditors to audit the first submission at certain banks and a second version at other banks, resulting in different approaches followed by the PA across the banks. The intention is to capture various discussion points in order for the PA to issue formal practical guidance.

Background

The PA has indicated that they will consider issuing formal guidance or clarification via third-tier legislation to specify which version of the BA returns to be the final subject matter of the regulatory assurance engagements or to indicate the relevant arrangements if the PA allows different versions to be the subject matter of the assurance engagements for different banks. This paper provides some matters for the PA to consider in this process.

In terms of Regulation 46, the auditors of a reporting bank shall report on the bank's financial position and results of its operations as reflected in the returns listed under Regulation 46(6) and reported on to the PA before/on 120 days after the bank's year-end. The BA returns are required to be submitted by the reporting bank within 15 to



30 business days following the month end to which they relate, depending on the type of the BA return.

The year-end BA returns are required to reflect the financial statements, as required under Regulation 2 & 3. The latter is usually finalised by the bank, **after** the required submission of the BA returns by the bank, commonly referred to as the “first submission”. Due to normal year-end closing adjustments to the financial statements (which could include audit adjustments and are adjusted post the first submission of BA returns) the first submission may not reflect the final / audited financial statements. In order to address this timing difference, banks have adopted the practice of updating the BA returns as soon as the financial statements are finalised to ensure that the BA returns reflect the financial statements, and re-submit the suite of BA returns to the PA. This re-submission is referred to as the “second submission” which is catered for in Regulation 7 and is allowed to take place up to 90 business days after the year end. In certain circumstances, a submission post the 90 business day has also been noted. This is referred to as a “third submission”.

Inconsistency has been noted in the industry regarding which version of the year end BA returns form the subject matter of the regulatory assurance engagements, in terms of Regulation 46, that is which version of the BA returns are finally signed off by the auditors. Regulation 46 is not prescriptive on this matter, leading to different banks and audit teams signing off different versions of the BA returns, as well as some frontline teams within the PA being prescriptive on which versions of the BA returns to be audited (e.g. in certain instances, the first submission has been prescribed as the subject of the audit). In general, the later versions of the BA returns (second and third submissions) provides a greater opportunity for regulatory reporting matters to be corrected on the resubmissions. The PA has raised concerns where the corrections relate to matters identified by the external auditors, especially those that don't relate to financial year-end adjustments. It is submitted that these BA returns might not be reflective of the quality of the BA returns submitted **during** the year.

There are two main concerns that the above inconsistent practice causes:

- (a) The corrected BA returns might not be representative of the quality of the BA returns submitted to the PA for other months during the year; and
- (b) This creates an "uneven playing field" in terms of different versions subject to the assurance engagement across the industry.

In discussions with the PA, it was noted that in addition to obtaining an audit report on the BA returns for the year-end reporting period, the PA also wants to assess the process and quality of reporting throughout the financial year, as well as alignment of the returns to the financial statements.

Given the different size, scope and complexity of banks across the industry and the different timeframes involved in the financial year-end closure / statutory audit



process, as well as the various dates by which year-end results are published, together with the fact that different banks prefer different approaches as to which version of BA returns to be the subject of the Regulation 46 assurance engagement, it is suggested the PA does not issue guidance that is too prescriptive, but rather considers different approaches after engagement with banks and external auditors. The proposed approach elected by the PA for a specific bank will take into account the various factors listed above and can be communicated by the relevant PA frontline teams to banks and external auditors on a case-by-case basis following the annual bi-lateral meeting that occurs between the PA and external auditor. This would result in the PA will having clarity on the expectations or outcomes of the Regulation 46 reports received.

The following two approaches are being followed currently by the PA:

Approach 1:

First submission

If the first submission is elected by the PA to form the subject of the regulatory audit, then the regulatory audit will identify and raise issues that are already known to management (such as year-end adjustments to the financial statements processed post first submission date), which may diminish the value of the regulatory audit to management. However, an audit of the first submission may shed some light on the quality of the regulatory reporting processes as it will test the robustness of the bank's regulatory reporting system. This reporting will also be entirely consistent with the rest of the year's BA return reporting. It would also be expected that more findings will be raised relating to the BA returns not agreeing to financial statements, due to the timing differences. It should however be noted that submission of regulatory returns by business day 15 is a very short time-frame and any adjustments post this submission date does not necessarily reflect on a poor reporting process through-out the year. An audit of the first submission will also not result in Regulation 2 & 3 being met whereby the BA returns audited aligns to the financial statements.

Approach 2:

Second submission

Reporting on the second submission eliminates the differences between financial statements and the BA returns. All issues reported by the auditors should purely reflect the quality of the management regulatory reporting. The timing of the second submission is a critical factor as well. Although Regulation 7 allows up to 90 days for resubmission, this second submission should be finalised much earlier than this to allow the audit process to be completed by 120 days from the year end, the reporting deadline. Finalisation of the second submission within 90 days will not allow enough time for the regulatory audit to be satisfactorily completed.



It is possible that the audit starts earlier than the 90 days, on the first submission for instance, and management keeping to the 90-day submission deadline. It is submitted that in this case the PA might request the auditors not to share the initial audit findings with management until after the second submission has finally gone to the PA. This is however not practical as auditors are inherently required to keep management updated on their progress and issues encountered.

Alternatively, it is suggested that a second submission be finalised within 50-60 days which would allow sufficient time for the audit to be completed and within the regulatory deadline. Consideration should also be given to when the financial results are finalised and the annual financial statements are published via SENS or similar announcements, for a second submission to be done to align BA returns to final financial results. For some large banks the annual financial results might not be completed within the 50 – 60 days' timeframe suggested.

Reporting of corrected matters

In the event where auditors have raised initial audit findings on the year-end first submission that relates to regulatory reporting issues and not so much to the normal year-end financial statement adjustments processed, and management corrects these regulatory errors before a second submission, the auditors should still report such corrected matters to the PA in a separate annexure. Therefore, it is recommended that the auditors would still provide the PA with a list of all regulatory errors / findings raised initially, which might have been corrected via the second submission.

All errors identified by the regulatory audit process are required to be reported to the PA. However, if corrected they should not impact our Regulation 46 reports (audit opinion) and are noted as an appendix to the auditors' opinion.

Process surrounding Locked>Returns:

It is our understanding that whatever the decision or requirement is pertaining to which BA return submission version should be audited, the process surrounding Locked Returns should be considered and confirmed by the PA.

Once a request by the external auditor is submitted to the PA for the BA Returns (the current version of returns received by the PA and uploaded into their supervisory system) to be Locked, the PA will lock such set of returns and provide copies thereof to the external auditor. At this stage the bank is no longer able to submit or request further submissions of BA returns. The version of the returns that are locked, should form the subject of the Regulation 46 audit and as such the audit opinions should be based on this set of returns.

Once the Regulation 46 assurance engagements have been completed and the external auditor has concluded and reported on the Regulation 46 audit, then only



could the bank request an audit lock to be lifted and for any re-submissions post the audit to be done, if needed. The PA will require a written letter by the external auditor that they have completed their Regulation 46 audit and that there is no further reason why the audit lock could not be removed, before an audit lock will be released by the PA. This assures the PA that the version of the BA returns that were locked are in fact the subject of the Regulation 46 assurance engagements.

Conclusion:

It is firstly recommended that the PA issue clear and explicit guidance on which version of the BA returns to form the subject of the regulatory assurance engagements to ensure clarity amongst the bank, its external auditor as well as the relevant PA frontline team.

It should be noted that if the PA does allow for a second submission to be done (meaning the second submission of BA returns becomes the subject of the regulatory audit) for certain banks, for the reasons listed above, and for the auditors to then report on all uncorrected audit findings that remain after the second submission and which accompanies their audit report, as well as an additional annexure that sets out the corrected audit findings initially raised by the auditors.

Suggestion would be for any such guidance to be issued ideally before mid-March 2020, considering the December 2019 year-end audits.

Overall it should be noted that any change in the regulatory audit process from one year to the next should be communicated well in advance by the PA, as it could have significant impacts on the regulatory audit process of banks. Some large complex banks have current well established processes at year-end and would ideally not want to deviate from current processes without formal engagements with the PA.



**Please refer to the summary of the considerations below:
Appendix: Summary**

