



BANK OF PAPUA NEW GUINEA

PRUDENTIAL STANDARD

7/2005

EXTERNAL AUDITS

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PART I: PRELIMINARY

- 1: **Short Title** – External audits.
- 2: **Authorization** – The Bank of Papua New Guinea (Central Bank) is authorized to issue prudential standards under Section 27 of the Banks and Financial Institutions Act 2000 (Act) in relation to prudential matters to be complied with by all Authorized Institutions.
- 3: **Application** – All banking institutions licensed by the Central Bank to conduct banking business in Papua New Guinea (PNG).
- 4: **Definitions** – Terms used within this standard are as defined in the Act, as defined below, or as reasonably implied by contextual usage:
 - 1) **“audit”** – for the purpose of this standard, means those audit services that are performed by an external auditor with the objective to examine, verify, confirm and evaluate the financial statements and other information prepared in accordance with appropriate criteria to enable the auditor to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework and that, in the auditor’s opinion, give a true and fair view, or present fairly, in all material respects the financial condition of a bank.
 - 2) **“audit firm”** – means either the firm or entity, including where appropriate its partners, providing audit services or a sole practitioner providing audit services.
 - 3) **“bank”** – means all banks and other licenced financial institutions authorized under the Act to carry on banking business.
 - 4) **“external auditor”** – means that person with final responsibility for the audit and/or the audit firm engaged by a bank to perform an audit or related services.
 - 5) **“management letter”** – means that written communication from the external auditor to bank management addressing any identified weaknesses in the internal control systems; accounting or record-keeping deficiencies; concerns as to the integrity of financial data or other material matters disclosed during the course of an audit.
 - 6) **“related services”** – comprises reviews, agreed-upon procedures and compilations of financial information as these terms are defined in international auditing standards.

PART II: STATEMENT OF POLICY

- 1: **Purpose** – This standard is intended to ensure that the engagement of external audits and appointment of auditors by banks provides assurances to the Central Bank as to 1) the completeness and accuracy of financial information being reported; 2) the adequacy of internal risk management systems; 3) compliance with provisions of the Act, prudential standards and other directives issued by the Central Bank and other authorities in PNG; 4) the timely reporting of material matters regarding a bank; and 5) the independence of the external auditor.
- 2: **Scope** – This standard applies to all banking institutions licensed and operating in PNG.

- 3: **Responsibility** – It is the responsibility of the board of directors of each bank to (a) appoint and engage a qualified, independent person or firm to prepare audited financial statements for the bank, (b) submit the audited financial statements and other required information to the Central Bank, (c) publish its financial statements, and (d) promptly inform the Central Bank of any information that is relevant to the supervisory oversight of the bank.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

- 1: **Minimum Requirements** – The following minimum requirements shall apply:
- (a) audits of banks shall be conducted not less than annually as of the date of each bank’s financial year end;
 - (b) the audit report and management letter with respect of an audited bank shall be submitted to the Central Bank within 90 days after its financial year-end;
 - (c) every auditor who is a registered accountant or audit firm whose partners are registered accountants by the Accountants Registration Board of Papua New Guinea and is entitled to practice in PNG shall be considered to be qualified and approved to audit banks unless the Central Bank issues a written objection for cause;
 - (d) in accordance with the requirements of Schedule 4 of the Act, a bank shall provide written notice to the Central Bank, within 14 days, if any person ceases to be the bank’s auditor;
 - (e) a tri-partite meeting of representatives of the bank, its external auditor and the Financial System Supervision Department of the Central Bank shall be held within 60 days after receipt of the annual audit report and management letter. The date shall be scheduled and agenda for this meeting shall be prepared by the Financial System Supervision Department and provided to the bank and its auditor;
 - (f) the auditor and the bank’s board of directors, executive management and/or an accountant appointed by the Central Bank or other person appointed by the Central Bank as an administrator or statutory manager shall report promptly to the Central Bank at any time that they have reasonable cause to believe the bank to be capital insolvent, or imminently insolvent; is illiquid; whether certain matters exist that may materially prejudice the interests of its depositors; if the bank is in material breach of the Act or prudential standards; or of any other matter of material concern; and
 - (g) a bank’s auditor shall provide the Financial System Supervision Department, when requested in writing, full access to and/or copies of its working papers, as defined in international auditing standards, with respect to a particular bank audit within 10 days of such request.
- 2: **Prohibited Actions** – No bank may:
- (a) appoint and engage an auditor/audit firm if any written objection for cause has been issued by the Central Bank;
 - (b) appoint and engage the same audit partner, i.e. the lead and/or coordinating partner, for more than five (5) consecutive years¹;
 - (c) appoint and engage an auditor/audit firm to provide advisory or consulting services to a bank while that same auditor/audit firm is engaged for services to conduct the bank’s annual audit and related services, except that services related to the preparation of a bank’s corporate tax return are not prohibited; or
 - (d) lend any money or other property to its external auditor or audit firm, irrespective of

¹ If, on the effective date of this standard, the audit partner currently engaged by a bank has already been engaged for a period of five years or longer, the bank may extend the term of his/her current engagement effective of this standard.

terms and amount; or provide deposit accounts or other banking services on preferential terms to its external auditor or audit firm; or enter into any other business arrangement on preferential terms regarding an auditor or audit firm while such auditor/audit firm is engaged to conduct a bank's audit or related services.

3: Reporting Requirements. Each bank and its external auditor shall submit to the Central Bank such reports as the Central Bank may require and in the form and frequency as may be prescribed. At a minimum, the following written reports and publications are required:

- a. **The bank** – within 90 days of the end of its financial year end:
- (1) a statement, signed by the chief executive and the chairman of the board, as to whether the bank or, where applicable, the group comprising the bank and its subsidiaries, has complied with the Act, or other relevant acts, prudential standards and other directives issued by the Central Bank and other authorities in PNG;
 - (2) a declaration by the managing director, and endorsed by the board of directors, as to whether bank management has –
 - i) identified the key financial and operating risks of the bank;
 - ii) established systems to control and monitor those risks including, where appropriate, adherence to prudent policies and procedures, to reasonable operating limits and to adequate and timely reporting processes; and
 - iii) satisfied itself that those risk management systems are operating effectively and are adequate in regard to the risks they are designed to control; and
 - (3) declaration as to whether actual or potential conflicts of interest exist with respect to the bank's engagement of an external auditor which may compromise the independence of the auditor's performance; and
 - (4) publication in a newspaper of general circulation in Papua New Guinea, in a form and content as specified by the Central Bank, of the audited statement of condition (balance sheet and a statement of income and expenditures) as of its financial year end.
- b. **The auditor** – within 90 days of the end of the bank's financial year end, a report to the audited bank and to the Central Bank as to 1) the adequacy of and adherence to financial reporting requirements and internal risk management systems; 2) whether the bank is in compliance, technically and in substance, with provisions of the Act, or other relevant acts and with prudential standards issued by the Central Bank and other authorities in PNG and whether any exceptions or breaches exist; and 3) the adequacy of provisions made by a bank for identified and potential losses, irrespective of whether or not such provisions are consistent with or technically satisfy the minimum requirements of Prudential Standard 2/2003 – Asset Classification, Provisioning and Suspension of interest.

PART IV: CORRECTIVE MEASURES

1: Remedial measures and sanctions – If a bank breaches any provision of this prudential standard in a flagrant manner which results, or threatens to result, in an unsafe or unsound condition, or fails to comply with the instructions and reporting requirements, or if there is risk that the existing capital base will be impaired and result in a condition that threatens the interests of depositors or the general public, the Bank may pursue appropriate corrective actions and sanctions by imposing or varying conditions on the bank's licence as provided in Section 14 of the Act.

Such conditions imposed on a bank's licence under Section 14 may include, but are not limited to, the following –

- (a) Require the bank to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way, including a prohibition from engaging in any further foreign exchange activities for a specified period of time;
- (b) Impose limitations on the acceptance of deposits, the borrowing of money, the granting of credit or the making of investments;
- (c) Prohibit the bank from soliciting deposits, either generally or from persons who are not already depositors;
- (d) Prohibit the bank from entering into any other transaction or class of transactions;
- (e) Suspend access to the credit facilities of the Central Bank; or
- (f) Suspend or require the removal of any directors, managers or chief executives.

- 2: **Additional measures and sanctions** – In addition to the measures in paragraph 1 above which may be taken against a bank, its directors, managers or chief executives, the Central Bank may deny approval for an accountant and the firm which employs the accountant from conducting audits of banks for purposes of the Act and this standard.

PART V: EFFECTIVE DATE

- 1: **Effective date** – The effective date of this prudential standard shall be 23rd September 2005.
- 2: **Supercedence** – This standard supercedes and replaces Prudential Standard 1/2001 “Risk Management Reporting” dated February 2001 and Guidance Note 2001-2 dated February 2001.

Questions relating to this prudential standard should be addressed to The Manager, Financial System Supervision Department, Bank of PNG, Tel: 322-7200.

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Policy and Regulations