



RESERVE BANK OF MALAWI

## **DIRECTIVE**

NO.DO5-06/IA

### **AUDIT COMMITTEE, ANNUAL INDEPENDENT AUDIT, AND PUBLICATION OF FINANCIAL STATEMENTS FOR LICENSED INSTITUTIONS**

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## PART I: SHORT TITLE, AUTHORIZATION, APPLICATION, AND INTERPRETATION

- Sec. 1:**        **Short Title** – Independent Audit for Licensed Institutions
- Sec. 2:**        **Authorization** - Section 26 and 27 of the Banking Act of 1989
- Sec. 3:**        **Application** – This directive applies to all banks and other financial institutions licensed under the Banking Act (“licensed institutions”), on both a solo and consolidated basis.
- Sec. 4:**        **Interpretation** - In this directive, unless the context otherwise requires-
- 1)        **Audit** – means an objective evaluation of information about a licensed institution’s economic actions and events, financial statements, financial systems, records, transactions, and operations, conducted according to pre-established generally accepted standards by professional accountants for the purpose of providing assurance of accountability, giving credibility to the financial statements and other management reports, identifying weaknesses in internal controls and financial systems, and making appropriate recommendations for improvement.
  - 2)        **Audit Opinion** – means a formal report on an audit which gives the auditor’s conclusion and clearly sets forth a judgment of the reasonability with which the financial statements present the licensed institution’s financial position and results of operation and are presented in accordance with international and national accounting standards. The audit opinion expressed may be (1) unqualified, (2) qualified, or (3) adverse, or a disclaimer of opinion may be issued.
  - 3)        **Audit Report** – means the expression of opinion rendered in writing by the auditor on the financial information of the licensed institution. The audit report must contain the following information:
    - a) Title;
    - b) Addressee;
    - c) Identification of the financial information audited;
    - d) References to the auditing standards followed;
    - e) Expression or disclaimer of opinion on the financial information;
    - f) Signature;
    - g) Auditor’s address; and
    - h) Date of report.
  - 4)        **Banking Act** - means the Banking Act, 1989 of the Laws of Malaŵi.
  - 5)        **Board of Directors** – means the highest body of authority in a licensed institution responsible for strategically guiding the licensed institution,

effectively monitoring management, and properly accounting to shareholders.

- 6) **Executive Officer** – means an officer at the most senior level of the management of a licensed institution (whether or not he/she is a director) who effectively manages that licensed institution.
- 7) **Home Country Supervisor** – means the competent authority that supervises the financial activities in the country where the head office of a licensed institution’s foreign parent bank is located.
- 8) **Insider** – includes all of the following:
  - a) Principal shareholders;
  - b) Members of the board of directors and/or audit committee;
  - c) Executive officer; and
  - d) Senior management officials.
- 9) **International Accounting Standards** – means formal guidelines developed by the International Accounting Standards Committee that specify how certain types of transactions or events are to be recorded and what disclosures should be made in the notes to the financial statements.
- 10) **International Standards on Auditing** – means formal guidelines on auditing which are issued by the International Federation of Accountants.
- 11) **Letter of Engagement** – means a document addressed by the auditor to the client licensed institution confirming acceptance of the appointment, and stating the objective and scope of the audit, the extent of responsibilities to the client licensed institution, and the forms of any reports.
- 12) **Licensed Institution** – means a bank or other financial institution holding a valid license, issued by the Reserve Bank, authorizing it to engage in deposit-taking business in Malaŵi.
- 13) **Management Letter** – Separate from the audit opinion contained in the audit report, the management letter is addressed to the board of directors of the licensed institution and discloses weaknesses and other limitations found in the internal control structure and operating procedures of the licensed institution. The management letter:
  - a) Provides comments and observations on the accounting records, operating systems, and internal controls that were examined during the course of the audit;
  - b) Identifies specific deficiencies and areas of weakness in operating systems and internal controls, and makes recommendations for their improvement;
  - c) Communicates matters that have come to the auditor’s attention during the audit that might have a significant impact on the operations of the

licensed institution, including: (1) any fraudulent act by any director, senior management official, employee, or agent of the licensed institution; or (2) any irregularity or deficiency in the administration or operations of the licensed institution that should be expected to result in a material loss; and

- d) Brings to the attention of the board of directors any other matters that the auditor deems pertinent.

**14) Principal Shareholder** – means a person who holds (directly or indirectly): (1) Ten percent (10%) or more of either the equity or the voting rights of the licensed institution; or (2) Such other interest in the licensed institution that enables the person to exercise significant influence over its management or activity.

**15) Related Person** – includes all of the following:

- a) Any person who is related to an insider (principal shareholder, member of the board of directors or audit committee, executive officer or senior management official) of a licensed institution by marriage or consanguinity to the second degree;
- b) Any juridical person in which an insider has a business interest, including as a partner, director, manager or guarantor;
- c) An individual person for whom an insider is a guarantor;
- d) Subsidiary of the licensed institution or of an insider;
- e) Company or undertaking in which at least a 10% interest is held by the licensed institution or by an insider;
- f) Parent company of the licensed institution or of an insider;
- g) Company that is under common control with the licensed institution or of an insider;
- h) Company that holds at least a 10% interest of another company in which the licensed institution or an insider holds at least a 10% interest;
- i) Company that has common management and/or common directors with the licensed institution, an insider, or another related person of the licensed institution; and
- j) Political campaign committee that is controlled by an insider or related person or that the funds or services of which will benefit an insider or related person.

**16) Reserve Bank** – means the Reserve Bank of Malaŵi established under the Reserve Bank of Malaŵi Act, 1989.

**17) Senior Management Official** – means any person who is an officer of a licensed institution, including the (chief) executive officer, vice-president(s), chief accountant, chief lending officer, chief treasury officer (or their equivalents), and any other person who, alone or together with one or more others, has the authority to enter into commitments for the account of the licensed institution.

## **PART II: STATEMENT OF POLICY**

### **Sec. 1: Objectives**

- 1) To facilitate implementation of sections 19 and 20 of the Banking Act 1989.
- 2) To promote self-discipline in the management of banks by enhancing modern corporate governance principles in the banking industry.

### **Sec. 2: Rationale**

In modern times, the role of good governance in corporate institutions is becoming increasingly recognised as many institutional failures have been attributed to bad governance. It is therefore important that a culture of good governance be enhanced in the banking industry in Malawi. The audit function is a key player in this endeavour. This directive therefore serves to provide minimum requirements that would provide the Reserve Bank with a mechanism of obtaining assurance that sound corporate governance principles are entrenched in licensed institutions.

## **PART III: AUDIT COMMITTEE**

### **Sec. 1: Establishment of Audit Committee**

Licensed institutions shall have an Audit Committee consisting of at least three members appointed by the board of directors. The majority of the audit committee members shall not be senior management officials or employees of the licensed institution.

### **Sec. 2: Functions of Audit Committee**

The functions of the Audit Committee shall be to:

- 1) Establish appropriate accounting standards and controls for the licensed institution, and supervise compliance therewith.
- 2) Assist the board of directors in its evaluation of the adequacy and efficiency of the licensed institution's internal control systems, accounting practices, information systems, and auditing processes applied within the licensed institution concerned in the day-to-day management of its business.
- 3) Facilitate and promote communication regarding the licensed institution's internal control systems, accounting practices, information systems,

auditing processes, risk management, or any other related matters between the board of directors, senior management officials, internal auditor, and external auditor.

- 4) Approve the appointment and dismissal of internal and external auditors.
- 5) Provide oversight of the internal and external auditors, and take measures to enhance their independence by ensuring that the auditors report directly to the board of directors or to its audit committee.
- 6) Review and approve the audit scope and frequency.
- 7) Receive and review internal and external audit reports including the management letter, and ensure that senior management officials take appropriate and timely action to correct weaknesses in internal control, non-compliance with policies, laws, regulations and directions, and other problems disclosed by the auditor.
- 8) Introduce such measures as it deems necessary to enhance the credibility and objectivity of the licensed institution's financial statements and reports.
- 9) Deliver opinions on any matters submitted to it by the board of directors or that it wishes to address.

#### **PART IV: ANNUAL INDEPENDENT AUDIT**

##### **Sec. 1: Appointment of an independent auditor**

- 1) On an annual basis and upon the recommendation of its Audit Committee, each licensed institution shall appoint an independent external auditor to fulfill the requirements of Sections 19 and 20 of the Banking Act and this directive.
- 2) The independent auditor appointed must be professionally qualified and satisfactory to the Reserve Bank:
  - a) Be properly licensed and in good standing;
  - b) Have relevant professional experience and competence;
  - c) Be subject to a quality assurance program;
  - d) Demonstrate objectivity and impartiality; and
  - e) Comply with national ethical standards for auditing and the "Code of Ethics for Professional Accountants" of the International Federation of Accountants.
- 3) The independent auditor must not have any interest in the licensed institution other than as a depositor or borrower in the ordinary course of

business. Specifically, the following persons are not qualified for appointment as independent auditor of a licensed institution:

- a) Any insider or related person of the licensed institution;
- b) A director or senior management official of the licensed institution, or of any insider or related person of the licensed institution;
- c) A person who is a partner, employee, or employer of a director or senior management official of the licensed institution or of any insider or related person of the licensed institution; and
- d) A person who alone, or with a partner or employee, regularly performs the duties of secretary, bookkeeper, or similar position to the licensed institution or for any insider or related person of the licensed institution.

**Sec. 2: Letter of engagement**

The letter of engagement between the licensed institution and the independent auditor must stipulate that the auditor shall:

- 1) Fulfill the requirements of Sections 19 and 20 of the Act;
- 2) Conduct the audit and prepare the audit report, audit opinion, and management letter in accordance with International Standards on Auditing; and
- 3) Submit the audit report, audit opinion, management letter, and other documents required by Section 19 of the Banking Act to the licensed institution no later than six months from the end of each financial year;

**Sec. 3: Notification to the Reserve Bank**

Not later than the first day of each financial year, each licensed institution shall submit to the Reserve Bank the following information:

- 1) The audit period;
- 2) Identification of the independent auditor, including: name, address, telephone number, and a copy of the letter of engagement;
- 3) Certified excerpts from the minutes of the meetings of the audit committee and of the board of directors approving the appointment of the independent auditor;
- 4) When a licensed institution is a branch or subsidiary of a foreign bank, a statement of either “approval” or “no objection” from the home country supervisor of the parent foreign bank regarding the appointment of the independent auditor; and

- 5) When a licensed institution has failed to re-appoint an independent auditor, the reason(s) for such decision.

**Sec. 4: Requirement for annual independent audits**

Licensed institutions shall be audited on an annual basis by the duly appointed independent auditor. The auditor shall have the right of access at all reasonable times to the books, minutes, accounts, records, documents, and information from the licensed institution, and to information and explanations from senior management officials of the licensed institution.

**Sec. 5: Submission of independent audit report to the Reserve Bank**

Within six months after the close of its financial year, each licensed institution shall submit to the Reserve Bank under the signatures of the executive officer and at least two of its directors:

- 1) The audit report, audit opinion, management letter, and other documents required by the Banking Act;
- 2) A certification that the licensed institution has met the requirements to publish and exhibit its audited financial statements and audit opinion pursuant to the Banking Act and this directive.

**Sec. 6: Submission of independent audit report to Shareholders**

The audit report shall be read together with the report of the board of directors at the annual meeting of the shareholders of the licensed institution.

**PART V: PUBLICATION OF AUDITED FINANCIAL STATEMENTS**

**Sec. 1: Publication of Statements in the Media**

Within six months after the close of its financial year, each licensed institution shall publish in at least one newspaper of general circulation in Malaŵi its audited balance sheet and profit and loss account, on both an individual and consolidated basis as applicable, and audit opinion.

**Sec. 2: Exhibition of Statements at Head Office**

Within six months after the close of its financial year, each licensed institution shall exhibit in the head office of the licensed institution its audited balance sheet and profit and loss account, on both an individual and consolidated basis as applicable, and audit opinion. Such exhibit shall be maintained in a conspicuous place at all times throughout the year.

**PART VI: COMMUNICATION BETWEEN THE RESERVE BANK AND INDEPENDENT AUDITORS**

**Sec. 1: Communication from the Reserve Bank**

The Reserve Bank may, if it considers it desirable or necessary in the interests of depositors, from time to time communicate with the independent auditor of a licensed institution.

**Sec. 2: Communication from the Independent Auditor**

A licensed institution's independent auditor shall notify the Reserve Bank, as soon as practicable, in the following circumstances:

- 1) There has been a serious breach of, or non-compliance with, the provisions of the Banking Act, the Reserve Bank of Malawi Act, the Companies Act, any regulations issued under those acts, any directives issued by the Reserve Bank, conditions attached to a license to conduct banking business, or the licensed institution's articles of association, charter, or by-laws;
- 2) A criminal offence involving fraud or other dishonesty has been committed;
- 3) Audit adjustments or changes in significant accounting policies or practices that have, or could have, a material effect on the financial statements of the licensed institution;
- 4) The auditor knows of facts that adversely affect the licensed institution's ability to continue as a going concern;
- 5) The auditor discovers a material conflict within or between the board of directors and senior management officials of the licensed institution;
- 6) A senior management official in a key function has unexpectedly left the licensed institution's employ;
- 7) The auditor intends to resign, or is removed, during the audit of the licensed institution;
- 8) There have been material adverse changes in the risks of the licensed institution's current or possible future business;
- 9) The auditor intends to issue a "qualified" audit opinion due to an irreconcilable difference with senior management officials regarding a material aspect of the financial statements of the licensed institution; and

- 10) The licensed institution has failed to comply with a recommendation by the auditor that a matter be communicated to the Reserve Bank.

## **PART VII: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **Sec. 1: Remedial Measures**

- 1) When the Reserve Bank determines that a bank has not met the requirements of this directive, it may impose remedial measures as specified under Section 31 of the Banking Act.
- 2) When the Reserve Bank determines that a bank's deficiency is severe, it may petition the High Court to sanction procedures as called for under Section 32 of the Banking Act.

### **Sec. 2: Administrative Sanctions**

In addition to the remedial measures available to it as given above in Part II Section 2, the Reserve Bank may impose any or all of the following administrative sanctions with regards to a bank that has a capital deficiency by failing to meet the capital requirements of this directive:

- 1) Prohibition from declaring and/or paying dividends;
- 2) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;
- 3) Suspension of access to credit facilities of the Reserve Bank;
- 4) Suspension of lending operations;
- 5) Suspension of the opening of letters of credit;
- 6) Suspension of the acceptance of new deposits;
- 7) Suspension of acquisition of fixed assets.

## **PART VIII: EFFECTIVE DATE**

With effect from 13 March 2006

**Questions relating to this directive should be addressed to the Bank Supervision Department of the Reserve Bank.**

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**Victor Mbewe**  
**GOVERNOR**