

Memo 1996-8A Timing of Audits

TO: All State Chartered Banks and Trust Companies
FROM: W. Newton Male, Bank Commissioner
DATE: June 21, 1996
RE: Timing of audits

This memo provides guidance regarding the appropriate timing of audits required to comply with K.S.A. 9-1116 for commercial operations, and K.A.R. 17-23-5, for trust operations. In December of last year, we requested comments regarding our interpretation of this statute and regulation. In response to those comments, the following revised policy has been adopted. We hope it will provide banks and their accountants with flexibility, while allowing this office to fulfill its responsibility to adequately monitor the safety and soundness of Kansas banks and trust companies.

Both K.S.A. 9-1116 and K.A.R. 17-23-5 require quarterly audits and directors' reviews. A review of the audit activity must be done at a board of directors' meeting each calendar quarter. In lieu of the quarterly audits and directors' reviews, a bank or trust company may choose to have one annual audit performed by a CPA or an independent auditor approved by the commissioner. The department's current interpretation of the statute and regulation, issued November 18, 1994, requires either one annual audit or four quarterly audits and directors' reviews every 12 months.

As part of a review of the department's current position of this issue, comments were solicited from the banks, trust companies and various auditors. Most of the comments encouraged a broader interpretation of "annual audit," for banks and trust companies that choose to have an annual audit performed. Many suggested that the November 18, 1994 interpretation eliminates the element of surprise and impedes flexibility in scheduling which is necessary in practical application. We agree with these comments and have revised our policy as follows.

Annual audit option:

If a bank or trust company relies upon annual audits, each annual audit must be performed at least once during each calendar year, and each annual audit must commence no later than 18 months after the "as of" date of the previous annual audit. The annual audit shall include financial information covering at least a 12 month period. As used in this memo:

- a) "Annual audit" means EITHER:
 1. a review of agreed upon procedures performed by a certified public accountant or an independent auditor approved by the commissioner, performed in accordance with the attached "minimum audit guidelines" of this department; OR

2. an audit consisting of an examination of the financial statements, accounting records and other supporting evidence of a bank or trust company performed by a certified public accountant in accordance with generally accepted auditing standards and of sufficient scope to enable the auditor to express an opinion on the bank's or trust company's financial statements as to their presentation in accordance with generally accepted accounting principles (GAAP).
- b) "Commence" means the auditor's physical start date for the audit; the day when the auditor begins work.
 - c) "As of" date means the calendar date to which the bank's or trust company's accounts are balanced and reconciled.

For example, assume an outside annual audit is performed with an "as of" date of January 1, 1994. This audit would be the bank's audit for calendar year 1994. The bank would have until July 1, 1995 (18 months from January 2, 1994) to commence the annual audit for calendar year 1995.

Quarterly audits and directors' reviews option:

If the bank or trust company relies on quarterly audits and directors' reviews (performed by the board of directors or an auditor selected by the board), the following rules apply. For purposes of determining compliance, the examiner will ascertain the date of the last quarterly review by the board of directors. From that date, the examiner will look retrospectively over the 12 months prior to that review and determine whether all of the minimum audit requirements were met during that time period. If they were, the bank or trust company would be in compliance, and will have an additional 12 months prospectively, to perform all of the minimum audit requirements and subsequent directors' reviews again. It is important to note that the department's minimum audit guidelines require certain functions to be performed each quarter. Therefore, to maintain a program of quarterly audits and directors' reviews, in compliance with the statute or regulation, certain audit activity must be performed each quarter. If a quarter passes without the required quarterly audit activity and board review, the institution must have a full blown annual audit within 12 months of the date of the last quarterly audit and directors' review to remain in compliance.

As an example, suppose that the examiner enters a bank on September 10, 1993. The examiner determines the last quarterly audit was conducted during the 2nd quarter and reviewed by the board on June 30, 1993. The examiner would then look back 12 months from that date to June 30, 1992. If four quarterly audits had been conducted and all of the minimum audit requirements had been met, and the results of those audits had been reviewed at the four quarterly director's meetings, between June 30, 1992 and June 30, 1993, the bank would be in compliance. The bank would then have until June 30, 1994

to either complete four more quarterly audits and director's reviews or to have an annual audit performed.

Suppose, however, the examiner enters a trust company on November 10, 1993 and the examiner determines the last quarterly audit was reviewed by the directors on May 31, 1993. Because more than a quarter has already passed, it would be impossible for the trust company to complete and review four quarterly audits by May 31, 1994. Therefore, the trust company would be required to have an annual audit commenced before May 31, 1994. The trust company could then return to doing the four quarterly audits and directors' reviews, or it could have another annual audit performed during calendar year 1995. Assuming the 1994 audit was conducted as of May 31, 1994, the 1995 annual audit would have to be commenced within at least 18 months from that date, or no later than November 30, 1995.

Because there must be an audit every calendar year, a bank may not always have the full 18-month window available to it. Suppose, for example, that the examiner enters a bank on February 10, 1994 and the examiner determines the last quarterly audit was reviewed on September 30, 1993. Again, because more than a quarter has already passed, it would be impossible for the bank to complete four quarterly audits by September 30, 1994. Therefore, the bank would be required to have an annual audit commenced before September 30, 1994. The bank could then return to doing the four quarterly audits, or the bank could have another annual audit performed. Keeping in mind the requirement that an annual audit be performed once every calendar year, under these circumstances, if the bank chooses to have another annual audit performed, and the 1994 annual audit was conducted as of September 30, 1994, the annual audit for 1995 would have to be commenced no later than December 31, 1995. This is true even though the time from September 30, 1994 to December 31, 1995 is 15 months rather than the 18-month outer limit allowed, because there must be an annual audit performed during the calendar year 1995.

Replaces Memo 1995-28