



Use of Independent AML/CFT Audit as a Supervisory Tool: A Unique Opportunity for New Zealand's AML/CFT Supervisors

Introduction

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009¹ (the **Act**) came fully into force in New Zealand on 30 June 2013 bringing with it the requirement for entities caught by the Act (**reporting entities**) to be subject to an independent AML/CFT audit. A reporting entity must have an audit every two years (or at any other time at the request of its AML/CFT supervisor)² which means that around 1,600 reporting entities must have an initial audit completed by 30 June 2015.

This statutory audit requirement provides a powerful tool for New Zealand's AML/CFT Supervisors (being the Reserve Bank of New Zealand (**RBNZ**), the Financial Markets Authority (**FMA**) and the Department of Internal Affairs (**DIA**), together, the **Supervisors**). Such audits have the potential to improve the level and quality of compliance by reporting entities while lessening the workload for the Supervisors, who have a unique opportunity to optimise the audit framework for their purposes during this initial period of audits.

Key Challenges

This paper explains the background and status of the Act, and explores three key challenges apparent in effectively implementing the audit requirements of the Act:

- Clarifying audit standards for AML/CFT audits, especially where confusion and inconsistent application of traditional audit standards exist amongst experienced audit professionals. In particular, considering whether the focus on “limited assurance” and “reasonable assurance” is consistent with international practice for AML/CFT audits or whether this focus will cause unnecessary confusion.
- Setting consistent and clear expectations for the level of AML/CFT audits, and ensuring that the threshold to be able to undertake AML/CFT audits is not too low.
- Considering AML/CFT risk in determining the timing of a reporting entity's audit.

While some of these issues may work themselves out over time, by addressing them now, the Supervisors can improve the quality of audit outcomes for all stakeholders, while potentially lowering costs or maximising investment.

This paper provides a framework for financial institutions to understand the Act and the key role of AML/CFT audit, and offers suggestions for refining and implementing the Act to successfully meet these key challenges.

¹ A copy of the Act is available at:

<http://www.legislation.govt.nz/act/public/2009/0035/latest/DLM2140720.html>

² Section 59 of the Act.

New legislation and a new AML/CFT audit framework

On 22 October 2013, Justice Minister Judith Collins announced that New Zealand had received a “stamp of approval” from the Financial Action Task Force (**FATF**) for its new anti-money laundering and terrorist financing laws³ (with the key piece of legislation for FATF purposes being the Act). While it provides a punchy headline for a press release, what is meant by “stamp of approval” in this case?

By way of background, FATF’s third mutual evaluation report of New Zealand was adopted in October 2009, with New Zealand placed in a regular follow-up process due to various deficiencies⁴ within its anti-money laundering framework. The “stamp of approval” in this case means that, following a second follow-up report, New Zealand has now been removed from the follow-up process⁵.

While well-drafted legislation is a first step, a crucial next step is to ensure that the Act will be enforced. In the 2009 Mutual Evaluation Report, FATF highlighted, amongst other issues⁶, the lack of supervision under the Financial Transactions Reporting Act 1996 (**FTRA**):

“New Zealand has implemented AML/CFT preventative measures through the application of the [FTRA], the [Terrorism Suppression Act] and four related regulations. [...]

*These measures and requirements apply equally to the entire financial sector. However, it is not possible to establish whether preventative measures are being implemented effectively since there is no systematic monitoring of compliance through the supervisory system”.*⁷

The Act has addressed these earlier concerns by bolstering the supervisory framework (see ‘*The enforcement challenge*’ below). One of the tools in this framework is the use of independent AML/CFT audits.

The FMA’s view on the use of independent audits generally reflects the approach taken by the Supervisors:

“FMA will use the audit report as a supervisory tool. It will give us a good insight into a reporting entity’s AML/CFT compliance and be an effective way of helping us to supervise. If the audit report does not provide us with sufficient assurance that a

³ <http://www.voxy.co.nz/politics/nzs-anti-money-laundering-laws-pass-muster/5/171549>

⁴ The Regulatory Impact Statement in the Explanatory Note to AML/CFT Bill notes that a 2003 assessment of New Zealand’s implementation of FATF’s Recommendations found New Zealand to be non-compliant or materially non-compliant with 8 of the 40 Recommendations and 2 of 8 (latterly extended to 9) Special Recommendations.

⁵ <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/FUR-New-Zealand-2013.pdf>

⁶ The other key deficiencies reported were:

- financial and non-financial businesses are not required to implement AML/CFT systems, involving, for example, customer due diligence and record keeping procedures, to the standards set out in the FATF Recommendations; and
- not all businesses included in the scope of FATF Recommendations fall within New Zealand’s regime.

⁷ Para 20, <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20New%20Zealand%20ful.pdf>

*reporting entity's compliance is robust and effective, we may adopt a more vigorous supervisory approach.*⁸

A key question therefore is whether the current New Zealand framework for AML/CFT audits maximises their effectiveness as an enforcement tool.

The Enforcement Challenge

Reporting entities' compliance with their AML/CFT regulatory obligations is monitored and enforced by the:

- **FMA** for issuers of securities, trustee companies, futures dealers, collective investment schemes, brokers, and financial advisers;
- **RBNZ** for banks, life insurers, and non-bank deposit takers; and
- **DIA** for casinos, non-deposit taking lenders, and money changers, and other financial institutions not supervised by the FMA or RBNZ.

The FMA and DIA have released public lists of those entities which it considers are reporting entities supervised by them – with FMA listing 686 as at the start of 2014⁹ and DIA listing 862 as at 1 July 2013. While the RBNZ have not released a public list of reporting entities, the number of reporting entities supervised by them is estimated to be around 60¹⁰.

The sector risk assessments released by each of the Supervisors provide further detail on the size of the enforcement challenge, with a breakdown of each sector including the extent of existing supervision under other legislation.

Of the Supervisors, the DIA appears to have the most difficult job ahead of it given the number and diversity of reporting entities under its supervision. The DIA also have two of the highest risk areas - money remittance (141 reporting entities) and trust and company service providers (**TCSPs**) (103 reporting entities) – which have not been subject to regulatory supervision previously. Generally speaking, the entities supervised by the RBNZ and FMA are already regulated by them under existing legislation.

⁸ <http://www.fma.govt.nz/help-me-comply/anti-money-laundering-and-counteracting-financing-of-terrorism-reporting-entities/monitoring-and-surveillance/>. See also the FMA's Compliance Focus for 2013 at http://www.fma.govt.nz/media/1513558/fma_s_compliance_focus_for_2013.pdf.

⁹ <http://www.fma.govt.nz/laws-we-enforce/registers/list-of-aml-reporting-entities/>

¹⁰ The number of registered banks is 23. The number of non-bank deposit takers required to maintain a credit rating is 15. There are also approximately 100 licenced insurers, although a number of these will be excluded on the basis that they do not provide life insurance or otherwise fit into one of the many exemptions under the Act and associated regulations (e.g. for low value insurance contracts).

The New Zealand framework for independent AML/CFT audit

The framework for independent AML/CFT audits in New Zealand consists of the Act and the *Guideline for audits of risk assessments and AML/CFT programmes* released by the Supervisors (the **Guideline**)¹¹. Under New Zealand law, the Guideline is provided for information only and cannot be relied on as legal advice from the Supervisors. As such, the Guideline is persuasive but not binding. That said, as the key guidance document for AML/CFT audits, it is still important to test whether the Guideline provides an optimal outcome for the Supervisors while also considering the interests of audit providers and reporting entities.

Under the Act¹²:

- A reporting entity must ensure its risk assessment¹³ and AML/CFT programme are audited every two years or at any other time at the request of their Supervisor. The audits must cover:
 1. In respect of the risk assessment, whether it identifies the entity's AML/CFT risks and describes how the risk assessment is kept up to date.
 2. In respect of the programme, whether:
 - a) it complies with all the obligation in the Act¹⁴;
 - b) it is based on the risk assessment;
 - c) it contains policies, procedures and controls that are adequate; and
 - d) the policies, procedures and controls have operated effectively during the audit period.
- The audit must be carried out by an independent person¹⁵ appointed by the reporting entity who is appropriately qualified to conduct the audit. The Act specifically states, however, that a person appointed to conduct an audit is not required to be a chartered accountant or qualified to undertake financial audits.
- The audit report must be provided to the Supervisor on request.¹⁶

¹¹

http://www.fma.govt.nz/media/1339626/guideline_for_audits_of_risk_assessments_and_aml_cft_programmes.pdf

¹² Section 59 of the Act.

¹³ The audit of the risk assessment is limited to an audit of whether the reporting entity's risk assessment fulfils the requirements in section 58(3).

¹⁴ Section 57 of the Act sets out the minimum requirements for the programme.

¹⁵ A person appointed to conduct an audit must not have been involved in the establishment, implementation, or maintenance of the reporting entity's AML/CFT programme or the undertaking of the reporting entity's risk assessment.

¹⁶ Under s59(1) of the Act, there is a separate requirement for reporting entities to review their risk assessments and programmes. There are no requirements around independence or AML/CFT expertise in relation to this review requirement. As such, this suggests an internal review especially given that to

I will look at some of the key aspects of the Guideline relevant to the optimal use of AML/CFT audits as an enforcement tool.

Who can carry out an audit?

The Guideline reinforces that the audit does not need to be carried out by a chartered accountant or a person qualified to undertake financial audits:

“An audit conducted for the purposes of the AML/CFT Act does not have to meet the auditing and assurance standards set by the External Reporting Board (XRB) or professional accounting bodies. Note that where a member of a professional body is appointed to perform the audit, the professional body may require that person to comply with any applicable professional standards.”

Certain XRB standards are cited in the Guideline for further guidance¹⁷.

Given the audit does not need to be carried out by a qualified *financial* auditor, then who can carry out such an audit? The Guideline provides that the following may undertake an audit, subject always to the requirements of independence and expertise:

- A member of the reporting entity’s staff.
- An external firm.
- A similar company as part of a reciprocal audit arrangement.
- People with AML/CFT or relevant financial experience in the entity’s sector.

The reporting entity must be able to justify to its Supervisor how the auditor is appropriately qualified, that is, the burden of proof sits with the reporting entity (as opposed to the Supervisors maintaining a list of approved auditors for example).

What level of assurance should an AML audit provide?

As to the level of assurance required, the Guideline provides the following:

“You should note that your auditor may give you some options regarding the level of assurance to be obtained by the auditor when conducting the audit.”

“The auditor can perform a limited assurance audit or a reasonable assurance audit.”

determine currency of the risk assessment and AML/CFT programme requires detailed knowledge of the reporting entity operations (products, customers, channels, jurisdictions and institutions).

¹⁷ These include the Explanatory Guide Au1 *Overview of Auditing and Assurance Standards*; the International Standard on Assurance Engagements (New Zealand) 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* (ISAE (NZ) 3000); the Standard on Assurance Engagements 3100 *Compliance Engagements* (SAE 3100); and the International Standard on Assurance Engagements 3402 *Assurance Reports on Controls at a Service Organisation*.

“The AML/CFT Act does not require your auditor to provide a specific level of assurance. You have the option to choose. You will need to balance the costs of the audit against the degree of confidence you require from the audit.”

“The auditor will provide a report containing a conclusion that conveys the assurance the auditor obtained when conducting the audit.”

“The Supervisors may take into account the robustness of the audit and the extent of the detail with which the audit assessed compliance when planning their own supervisory work.”

This emphasis on levels of assurance potentially diverts the focus of the AML/CFT audit from the key requirement for the auditor to have demonstrable AML/CFT expertise. Consider this in the context of the application of such traditional audit standards in the context of AML/CFT audits, both domestically and internationally.

Limited and Reasonable Assurance

Before considering the levels of assurance under the Guideline, it is worth clarifying what these terms mean in a New Zealand context. The Explanatory Guide Au1 *Overview of Auditing and Assurance Standards* provides the following:

“In a reasonable assurance engagement, the assurance provider expresses the conclusion in the positive form, for example: “In our opinion internal control is effective, in all material respects, based on XYZ criteria”.¹⁸

In a limited assurance engagement, the assurance provider expresses the conclusion in the negative form, for example, “Based on our work described in this report, nothing has come to our attention that causes us to believe that internal control is not effective, in all material respects, based on XYZ criteria”.¹⁹

So what does this mean practically in the context of AML/CFT audits? The Guideline somewhat simplistically states “the reasonable assurance audit requires more work from the auditor than a limited assurance audit”. In reality, this is likely to translate to increased scrutiny in testing the effectiveness of policy, procedures and controls (for example, through increased sampling sizes). This increased work by the auditor is likely to be reflected in increased cost to the reporting entity for the audit.

¹⁸ Para 78 of EU AG1

¹⁹ Para 79 of EU AG1

The international approach

While the focus is on the New Zealand framework, a review of international approaches is beneficial in determining whether there is a best practice for AML/CFT audits including levels of assurance. Indeed, one of the benefits of being “late to the party” is that New Zealand can learn and borrow from the experience in other jurisdictions.

The interpretive notes to FATF Recommendation 18 (Internal Controls and Foreign Branches and Subsidiaries) state that financial institutions’ AML/CFT programmes should include “an independent audit function to test the system”. The notes in relation to this section generally also state that “the type and extent of measures to be taken should be appropriate having regard to the risk of money laundering and terrorist financing and the size of the business”. The natural reading of this is that the approach and extent of the independent audit function should also be risk-based.

The international approach to AML/CFT audits has already been examined by Ross Delston and Martin Owen, who contrasted the AML audit requirements of the USA and the UK and EU²⁰. While they were looking at the issue of whether an independent AML audit is an “essential element or nice to have”, their article still provides a useful summary of approaches to audit in other jurisdictions.

Delston & Owen note that the US requires “an independent audit function to test programs²¹” and that independent audit is considered to be one of the “four pillars” of an AML program. Singapore, Hong Kong and Canada were also found to have similar independent AML/CFT audit or testing requirements. This is contrasted with:

- The EU which simply requires firms to have appropriate policies and procedures for “internal control”²². Delston & Owen conclude that we can “charitably assume that “appropriate” must include provision for independent review, but the terms of the Article do not suggest that review, let alone independent review, are AML priorities”.
- The UK where it is the Money Laundering Reporting Officer, not an independent party, who has to report at least annually on the operation and effectiveness of the AML systems and controls, with the entity itself carrying out a regular assessment of the systems and controls to ensure their continued compliance with the rules.

It is also worth considering New Zealand’s closest neighbour, Australia, which has both an independent review and an independent external audit:

- Under the AML/CTF Rules²³, Part A of the AML Program (covering the risk assessment, risk awareness and employee due diligence) must be subject to regular independent review to assess its effectiveness, that it complies with the AML/CTF Rules, that it has been effectively implemented and whether the entity has complied with its program. The review may be carried out by either an internal or external party.

²⁰ *Independent AML audit – essential element or nice to have?* Ross Delston, Martin Owen <http://www.jdsupra.com/legalnews/independent-aml-audit-essential-elemen-62693/>

²¹ USA Patriot Act s352

²² EU Third Directive

²³ Part 8.6, Anti-Money Laundering and Counter-Terrorism Financing Rules (Australia)

- Under the AML/CTF Act²⁴, the AUSTRAC²⁵ CEO may, by written notice given to the reporting entity, require the reporting entity to appoint an external auditor and arrange for that external auditor to carry out an external audit of the reporting entity's capacity and endeavours to identify, mitigate and manage its money laundering and terrorism financing risk.

In the case of an external audit, the reporting entity must select the auditor from the approved list. The auditor must be external to the reporting entity i.e. not an officer, employee or agent of the reporting entity.

These comparisons suggest that there is no consistent international approach to the application of FATF's independent audit recommendation (although New Zealand appears to be in line with those closer to the FATF Recommendations). In addition, the terms 'testing', 'review' and 'audit' are often used to describe seemingly similar assurance processes. The question is whether the terms suggest different levels of assurance.

The International Auditing and Assurance Standards Board (IAASB) Handbook states:

“For assurance engagements regarding historical financial information in particular, reasonable assurance engagements are called audits, and limited assurance engagements are called reviews.”²⁶

This is supported by the Explanatory Guide Au1 *Overview of Auditing and Assurance Standards* (one of the additional resources referred to in the Guideline) which states that *“a review is a limited assurance engagement designed to provide a moderate level of assurance.”²⁷*

I can find no evidence to suggest that use of the term “audit” in the context of the Act suggests a particular level of assurance, instead seemingly just mirroring the language in the FATF Recommendations. This is consistent with the Guideline which allows for either a limited and reasonable assurance “audit”. References to assurance standards in the Guideline are therefore potentially confusing.

Looking at international guidance, New Zealand appears unique in specifying standards of reasonable and limited assurance for AML/CFT audits in guidance material. To further consider this point, we look then to the how these different levels of assurance have been applied for traditional assurance services in New Zealand to date.

²⁴ Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Australia)

²⁵ Australian Transaction Reports and Analysis Centre. AUSTRAC oversees the compliance of Australian businesses with their requirements under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 and the Financial Transaction Reports Act 1988.

²⁶ International Auditing and Assurance Standards Board Handbook of International Quality Control, Auditing Review, Other Assurance and Related Service Pronouncements, 2012 Edition, Volume 2, Footnote 2, Page 3.

²⁷ Para 33 of EU AG1

A competitive disadvantage for traditional audit firms?

There is a potential side-effect from the use of the term “audit”. For traditional audit firms, there are defined processes and procedures covering each level of assurance (such as appropriate sampling sizes, peer reviews, etc.). Use of the term “audit” and references to limited and reasonable assurance may pull AML/CFT audits under the Act into those firms’ existing, defined audit processes. There is already potential inconsistency for such audit firms noted under the Guideline which says:

“Note that where a member of a professional body is appointed to perform the audit, the professional body may require that person to comply with any applicable professional standards.”

These firms may then be at a competitive disadvantage by having to apply traditional audit approaches where other AML/CFT auditors will not. This is not to say that those other AML/CFT auditors will deliver less robust audits. To the contrary, I consider that a focus on specialist AML/CFT experience and professional judgment is more important than a focus on traditional audit approaches. By comparison, if the Act had chosen the term ‘review’ instead of ‘audit’ (as in the Australian legislation), this would represent a markedly different proposition for these traditional audit firms.

The New Zealand experience with levels of assurance in financial audits

In 2010, a study²⁸ was undertaken to ascertain the extent of the supply of limited assurance engagements by chartered accounting firms in New Zealand, comprising the Big 4 firms²⁹ and Audit New Zealand (the **Big 5**) and small/medium firms (the **Non-Big 5**).

The study found that the Big 5 all offered limited assurance engagements while only 10% of the respondents for the Non-Big 5 did. While all the Big 5 offered limited assurance, in certain circumstances they would not offer this standard - notably the top two reasons that the Big 5 would not offer limited assurance engagements to a particular client were “limited usefulness of reports” and “the client would not understand the level of assurance provided”.

Firms were also asked to identify the percentage of confidence that they believe they provide when they give an opinion in a reasonable assurance engagement and a limited assurance engagement:

		Min	Max	Mean
Limited Assurance	Big 5	15%	80%	50%
	Non-Big 5	20%	100%	72%
Reasonable assurance	Big 5	60%	95%	80%
	Non-Big 5	40%	100%	87%

Given these results, and assuming a similar approach to confidence levels is taken to AML/CFT audits, it is difficult to see how the Supervisors can gain an appreciation of the robustness of the

²⁸ Dr Nives Botica Redmayne, FCA and Sue Malthus, FCA.

²⁹ Being Deloitte, Ernst & Young, PWC and KPMG.

audit simply from a conclusion based on a level of assurance. The key reasons for this conclusion are:

- While the difference in means for limited assurance between the Big 5 and Non-Big 5 (72% vs. 50%) reflects a difference in practice between the groups, the range in the level of confidence for limited assurance provided by Big 5 firms (a minimum of 15% through to a maximum of 80%) reflects inconsistency of approach even amongst the largest firms.
- Based on these results, at a confidence level of, say, 70%, it is foreseeable that one Big 5 firm would provide a reasonable assurance opinion while another would only issue a limited assurance opinion. If we focus simply on the conclusion reached, we would assume that the reasonable assurance report provides a higher level of confidence although this is not strictly the case.

An alternative approach to levels of assurance

Rather than focus on reaching a conclusion under a certain level of assurance, it would provide more clarity and consistency to the reporting entities and the Supervisors for an audit report to provide clear descriptions of:

- the scope of the audit and work undertaken by the auditor;
- the AML/CFT expertise of the auditor, both generally and as appropriate for the reporting entity taking into account the sector in which it operates; and
- the manner in which the auditor has applied their AML/CFT expertise and professional judgment in the context of the reporting entity's particular circumstances.

While the first point is captured by the Guidelines (although the scope of the audit is generally considered to be a separate document to the audit report which is producible on request), there is no requirement for the audit report to include detail on AML/CFT expertise despite it being one of the key criteria under the Act. This is especially important given that the burden of determining AML/CFT expertise sits with the reporting entity (see sidebar).

Who should determine AML/CFT expertise?

While leaving it to a reporting entity to determine AML/CFT expertise of a potential auditor shifts the burden from the Supervisors, one of the dangers is that, especially during the initial compliance period, the quality of audits may be deficient. The worst case scenario for reporting entities is that the audit is disregarded by a Supervisor resulting in a loss of time and money but with the same or increased level of supervisory scrutiny.

While this problem could eventually work itself through, in the meantime it is likely to cause frustration for reporting entities and the Supervisors. Possible solutions to this would be the Supervisors maintaining an approved list of auditors (similar to Australia) or requiring pre-approval of auditors. Further guidance and education on appropriate AML/CFT expertise would also assist with this.

By including scope, work undertaken and expertise in the report itself, a Supervisor can ultimately reach its own conclusion as to the level of assurance gained. This would provide a better outcome as, given the inconsistency and confusion amongst experienced assurance professionals on the differences between limited and reasonable assurance, it is difficult to see how other potential providers of AML/CFT audits contemplated under the Guideline will sensibly apply them in a meaningful way for use by reporting entities and Supervisors.

In any event, it is clearly beneficial for reporting entities and auditors to discuss proposed scope and work to be undertaken with the relevant Supervisor where possible prior to undertaking the audit. This will reduce a reporting entity's chance of being subject to "a more vigorous supervisory approach" from its Supervisor.

Optimal assurance level vs. cost

Presumably, the optimal assurance level for Supervisors would be for reporting entities to be audited to a high or reasonable level of assurance. The decision to offer the option of limited assurance seems to be a concession around cost. This concession could, however, have negative consequences for the overall quality of audits.

While the Guideline suggests that it is the determination of the reporting entity as to the level of assurance they receive³⁰, it will be natural for a large number of entities to gravitate towards the minimum cost of compliance – that is, if a limited assurance audit is cheaper yet will "tick the box" for the independent audit requirement, then that will be where the standard for AML audits will land³¹.

This would be especially true for smaller entities which from experience make up large proportions of the money remitters and TCSP sectors. In this case, noted high risk sectors may trend towards limited assurance resulting in more work for the Supervisors³².

Once again, this reflects the benefits of active, two-way discussions between Supervisors and reporting entities and their auditors as to proposed scope and work for an audit. Such communication should decrease the likelihood that the audit report will be disregarded by a Supervisor.

³⁰ The Guideline, paragraph 26, states *"The AML/CFT Act does not require your auditor to provide a specific level of assurance. You have the option to choose. You will need to balance the costs of the audit against the degree of confidence you require from the audit."*

³¹ This is arguably a false economy, however, as it is generally better for issues to be picked up during an audit rather than during a supervisory visit.

³² The study suggests that for a limited assurance audit the level of confidence provided may be as low as 15% for a Big 5 firm and 20% for a Non-Big 5 firm. The Supervisors may wish to consider what value an AML/CFT audit completed to this confidence level would provide them and whether they would be willing to accept this.

Timing of audits

The Act has a defined timeframe for audits, being every two years. While this provides certainty to reporting entities around the obligation, it is arguably out of step with the FATF Recommendations in respect of the independent audit function and the general risk-based approach of the legislation.

While New Zealand sets a legislated timeframe for independent AML/CFT audits, other jurisdictions tend to favour a risk-based approach³³ (e.g. both the US and Australia use “regular” or “regular basis”³⁴). While the certainty of a timeframe does have some benefits, the danger is that the bar is set too low for higher risk entities.

It is arguable that for higher risk entities or business areas an independent audit every two years is too long a period. If we compare it to the US approach, for example, the Federal Financial Institutions Examination Council recommends a period of 12-18 months for banks³⁵. Delston & Owen also reach a similar conclusion on timeframes in their analysis, recommending an annual audit but generally no more than 18 months³⁶.

The Supervisors may wish to consider shifting to a risk-based approach to independent audit which would better correlate with international practice. The two year period could remain as a statutory maximum period. While the Supervisors can choose to force entities to have an audit at any time as required (which would be maintained), this approach would shift the burden from the Supervisors to the entities.

This would necessitate a change to the Act itself – not that extreme a step as there are already some areas of the Act which have been flagged for amendment in the future (e.g. issues of beneficial ownership in the context of managing intermediaries) so perhaps this could be considered at that point.

In the meantime, it would be prudent for higher risk entities or entities with higher risk business areas to undertake AML/CFT audits on a more regular basis for their own assurance and governance.

³³ A risk-based approach to audit essentially results in an additional risk assessment to determine appropriate audit timeframes for business areas. Such an assessment may include a consideration of the original AML/CFT risk assessment plus other factors (e.g. history of non-compliance, complexity of obligations).

³⁴ The UK has an annual review requirement, however, it is not required to be independent so is closer to New Zealand’s review rather than audit requirements.

³⁵ Page 34, Bank Secrecy Act/Anti-Money Laundering Examination Manual 2010.

³⁶ *‘Independent AML audit – essential element or nice to have?’* Ross Delston, Martin Owen <http://www.jdsupra.com/legalnews/independent-aml-audit-essential-elemen-62693/>.

Conclusion

In order to fully realise the potential of AML/CFT audits as a supervisory tool, some further consideration of the practical aspects of its application need to be worked through. While some changes to the AML/CFT audit framework itself would assist, there are some key steps that stakeholders can take to maximise the benefits of AML/CFT audits under the current framework including:

- Proactively discussing expectations of the scope and work to be undertaken for an audit amongst interested parties. Any potential issues with expertise or independence should also be discussed with the relevant Supervisor prior to undertaking the audit.
- Auditors including additional detail in the audit report including scope, work undertaken and expertise to head off any queries from the Supervisor.
- Reporting entities voluntarily undertaking audits more regularly than the legislated two years, especially where they operate in high risk sectors



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Martin has consulted full time as an AML/CFT specialist since June 2012. In that time, he has assisted a wide range of entities including registered banks (both local and foreign), large insurance companies, money remitters, foreign exchange traders, funds managers and trustee companies.

Martin is a Certified Anti-Money Laundering Specialist. He is the first person in Australasia to complete CAMS-Audit.

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