



Interaction Between Internal Audit and Compliance Functions

CAFRAL

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Agenda

Internal Audit & Compliance - What's the difference

Different functions similar goals

Today's Compliance Environment

Themes of interaction

KYC / AML – an example of interaction

Reliance on each others work - prerequisites



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What's the difference ?

Business Groups	<ul style="list-style-type: none">● Primary responsibility for compliance with internal guidelines, laws and regulations● Principal responsibility for laying down processes that are robust and compliant	First line of defense
Compliance	<ul style="list-style-type: none">● Primary responsibility for laying down internal rules & guidelines that allow for smooth functioning of business within the 'boundaries' of the law● Liaison between regulator and the organisation● Periodic compliance risk assessments● Monitoring compliance to extant rules and regulations	Second line of defense

What's the difference ?

Internal Audit	<ul style="list-style-type: none">● Provides an objective assurance to the stakeholders about an organisation's internal controls, risk management and governance framework● Scope of Internal Audit includes the compliance function of the Bank	Third line of defense
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Basel Committee on Banking Supervision: The scope and breadth of the activities of the compliance function should be subject to periodic review by the internal audit function



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Different functions similar goals

- **Both functions strive to achieve the same goal of risk identification and mitigation**
- **Both functions are expected to be independent of business and typically report to an independent governing body (e.g. Audit Committee)**
- **Compliance is focused on ensuring that the organisation functions within the boundaries laid down by its governing law & regulations and limits itself to evaluating risks related to non compliance with relevant rules and regulation**
- **Internal audit encompasses all functions of the organisation, including compliance**



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Issues	Corporate Reaction
<ul style="list-style-type: none">● Increased regulatory fines	Expand compliance function
<ul style="list-style-type: none">● Increased regulatory complexities / multiple regulators	Increase oversight and reporting of control groups
<ul style="list-style-type: none">● Desire for more assurance	Expand Internal Audit Group
<ul style="list-style-type: none">● Increased business and environment risks	Expand risk management function
<ul style="list-style-type: none">● Capital adequacy framework under Basel guidelines	Seek expert advice

Result: Complex reporting structures; separate mandates; separate processes; duplicative efforts; lack of coordination; different schedules & formats



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Themes of interaction (1/2)

- **Risk assessment of compliance related risks**
 - While risk perceptions may differ broad directions need to be aligned
- **Monitoring and review mechanism – co-ordination would result in increased focus and cost savings**
- **Scheduling of work such that duplication and audit fatigue is avoided**
- **Sharing of issues observed and risks**
- **Regulator feedback – sharing with internal audit**
- **Alignment of reporting formats and timing**
- **Coordinated approach at Board Committee meetings and with regulators**



Themes of interaction (2/2)

- **Facilitating internal audit oversight on compliance activities and processes**
- **IA can play a advisory role in view of its enterprise wide knowledge**

Result of coordinated interaction:

- ***Provides a holistic view: Compliance risks are integrated in every function of the Bank***
- ***Avoids:***
 - ***Disparate risk management methods & views***
 - ***Duplication of efforts***
 - ***Varying risk perceptions to Senior Management***
- ***Reduced cost of compliance***



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KYC / AML – an example of interaction

	Compliance	Internal Audit
1.	Design KYC / AML policy	Audit sourcing mechanism at branches
2.	Implement transaction monitoring	Concurrent / internal audit of account opening
3.	Define rules for alerts	Seeding / mystery shopping
4.	Transaction monitoring; File STRs	IS Audit of AML system
5.	Impart training	Coverage and adequacy of AML monitoring & quality of alerts
Possible Interaction	<ul style="list-style-type: none"> ● Compliance is an auditee and also provides expert opinions to IA ● Compliance can make changes to policies, rules, training methodologies based on IA findings ● Compliance & IA can synergise audit scope and compliance monitoring based on each others work schedules and findings ● Compliance can reduce work load of monitoring or rely on IA for certain aspects 	



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Reliance on each others work – prerequisites

- Things to consider while relying on each others work:
 - Maturity of the organisation
 - Reporting structures of IA and Compliance
 - Robustness of processes
 - Independent validation of processes of compliance groups by internal audit
 - Understanding and knowledge levels of the respective groups of each others processes
- Reliance can only reduce extent of work and not replace independent testing



