

Expectations of a banking supervisory agency on CM and CA

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Ladies and gentlemen, good morning,

It is really my pleasure to have the opportunity to speak on the expectations of a banking supervisory agency on continuous audit and monitoring (CM & CA). Allow me first to talk about the key features that are essential for the effective operation of an internal audit function. According to the publication entitled “The internal audit function in banks issued by the Basel Committee on Banking Supervision, three pivotal elements form the basis of an effective internal audit function, i.e. first, independence and objectivity, second, professional competence and due professional care, as well as third, professional ethics.

With regard to independence and objectivity, the internal audit function must be able to perform its assignments on its own initiative in all areas and functions of the bank based on the audit plan approved by the board of directors. It must be free to report its findings and assessments internally through clear reporting lines. In addition, the internal audit function should not be involved in designing, selecting, implementing or operating specific internal control measures.

It is also a sound practice to periodically rotate internal audit staff within the internal audit function. In addition, a bank may rotate staff from other functional areas of the bank to the internal audit function or from the internal audit function to other functional areas of the bank under the principles of avoiding conflicts of interest.

The remuneration of the head of the internal audit function should be determined in accordance with the remuneration policies and practices of the bank. Remuneration to reward the performance of the head of internal audit or internal audit staff members should be structured to avoid creating conflicts of interest and compromising independence and objectivity.

In short, the bank's internal audit function must be independent of the audited activities, which requires the internal audit function to have sufficient standing and authority within the bank, thereby enabling internal auditors to carry out their assignments with objectivity.

Referring to the second element, professional competence and due professional care, the head of internal audit should be responsible for acquiring human resources with sufficient qualifications and skills to effectively deliver on the mandate for

professional competence and to audit to the required level. The skills required for senior internal auditors should include the abilities to judge outcomes and make an impact at the highest level of the organization.

The head of internal audit should ensure that the internal audit staff acquires appropriate ongoing training in order to meet the growing technical complexity of banks' activities and the increasing diversity of tasks that need to be undertaken as a result of the introduction of new products and processes within banks and other developments in the financial sector.

Internal auditors must apply the care and skills expected of a reasonably prudent and competent professional. Due professional care does not imply infallibility; however, internal auditors having limited competence and experience in a particular area should be supervised by more experienced internal auditors.

At any rate, professional competence, including the knowledge and experience of each internal auditor and of internal auditors collectively, is essential to the effectiveness of the bank's internal audit function.

As for the third element, professional ethics, integrity establishes trust as it requires the internal auditor to be straightforward, honest and truthful. This provides the basis for reliance on the internal auditor's professional judgment.

Internal auditors should respect the confidentiality of information acquired in the course of their duties. They should not use that information for personal gain or malicious action and should be diligent in the protection of information acquired.

Internal auditors should apply the bank's code of ethics or should adhere to an established international code of ethics for internal auditors, such as that of The Institute of Internal Auditors. A code of ethics should at a minimum address the principles of objectivity, competence, confidentiality and integrity.

It should be borne in mind that internal auditors must act with integrity.

In Taiwan, the supervisory agency has required that the internal audit function must be directly under the board of directors and report to the board of directors since 1997.

I would now turn to the roles and responsibilities of the board of directors and senior management.

The bank's board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control system and, accordingly, the board should support the internal audit function in discharging its duties effectively.

Regarding the senior management, senior management is responsible for developing an internal control framework that identifies, measures, monitors and controls all risks faced by the bank. It should maintain an organizational structure that clearly assigns responsibility, authority and reporting relationships and ensures that delegated responsibilities are effectively carried out. It is an established practice for senior management to report to the board of directors on the scope and performance of the internal control framework.

Senior management should inform the internal audit function of new developments, initiatives, projects, products and operational changes and ensure that all associated risks, known and anticipated, are identified and communicated at an early stage.

Senior management should be accountable for ensuring that timely and appropriate actions are taken on all internal audit findings and recommendations.

At the end of the day, senior management should ensure that the head of internal audit has the necessary resources, financial and otherwise, available to carry out his or her duties commensurate with the annual internal audit plan, scope and budget approved by the audit committee.

From year 2010, 13 banks in Taiwan have undergone administrative sanctions due to the violations of the rules and regulations governing internal control with 22 cases. It clearly shows that local banks still have rooms to improve their internal control and internal audit. I would like to conclude by saying that internal audit is an ongoing and unending task, and continuous audit and monitoring itself is an expectation of the supervisory agency for the internal audit function. Thank you very much indeed.