TURKS & CAICOS ISLANDS
FINANCIAL SERVICES COMMISSION
GUIDELINE ON MINIMUM REQUIREMENTS
FOR INTERNAL AUDITS OF BANKS & TRUST COMPANIES

CONTENTS

OVERVIEW

Effective internal control is the foundation for the safe and sound operation of a financial institution. The board of directors and senior management of an institution are responsible for ensuring that the system of internal control operates effectively. Their responsibility cannot be delegated to others within the institution or to outside parties. An important element in assessing the effectiveness of the internal control system is an internal audit function. When properly structured and conducted, internal audit provides directors and senior management with vital information about weaknesses in the system of internal control so that management can take prompt, remedial action[1].

The Institute of Internal Auditors (IIA) defines internal auditing as *"an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control and governance processes."* Periodic internal audit reviews therefore can play a critical role in establishing and maintaining the best possible internal control environment within a financial institution.

Moreover, following from the IIA's definition, an internal audit function within a financial institution is a key mechanism for assessing the adequacy and effectiveness of its controls and operations and contributes to sound corporate governance. It supports management's attempts at ensuring compliance with legal and regulatory requirements, safeguarding of assets, adequacy of records, prevention and /or early detection of fraud and other irregularities. Likewise, through the relationship with the Audit Committee, internal audits are a primary source of objective and important information on a licensee's operations to the Board of Directors.

It is against a background of the above, that the Financial Services Commission (Commission) **requires bank and trust licensees to conduct an internal audit of their operations at least annually**.

[1] Taken from the Interagency policy statement on the internal audit function and its outsourcing issued by the Federal Reserve in the USA

OBJECTIVES

The purpose of this guideline is to outline the Commission's minimum expectations with regard to the internal audit review of the operations of licensed financial institutions (licensees). In so doing, the guideline seeks to:

- provide further guidance to the internal audit function already in existence at licensees;
- provide guidance for licensees in establishing an internal audit function or alternatively in outsourcing this function ; and
- provide minimum standards / requirements for the conduct of internal audit reviews at an institution. It is not intended to be exhaustive nor to provide detailed steps to be performed at internal audits.

AUTHORITY AND SCOPE OF GUIDELINE

This guideline is issued by the Commission pursuant to Section 43 of the FSCO and in furtherance of its responsibility to regulate and supervise licensees. The guideline applies specifically to banks and trust companies and takes effect from its issue date July 9, 2014.

THE INTERNAL AUDIT REVIEW

The raison d'etre of an internal audit review is to independently and objectively evaluate a licensee's operations so as to maintain or improve the efficiency and effectiveness of its risk management, internal controls and corporate governance. This is achieved through the following:

- an evaluation of the adequacy and effectiveness of accounting and other operating controls;
- a determination of whether the licensee's internal controls result in prompt and reliable recording of transactions and proper safeguarding of assets;
- a determination of whether the licensee complies with laws and regulations and adheres to its established internal policies; and
- a determination of whether management is taking appropriate steps to address control deficiencies and audit recommendations.

"Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations;
- reliability of financial reporting; and
- compliance with applicable laws and regulations."[2]

The person/s conducting an internal audit review must be acquainted with the licensee's strategic direction, objectives, products and services. The scope of the internal audit review, whether performed using quarterly, semi-annual or annual cycles will largely depend on the size and complexity of the institution's operations and resulting risk profile.

Adequacy and Effectiveness of System of Internal Controls

The Board of Directors and / or senior management of a licensee is responsible for establishing a system of internal controls and overseeing its effectiveness. The internal audit review should determine whether the established system of internal controls is effective. The review should also assess whether proper segregation of duties is practised and that existing controls are adequate for the risk profile of the licensee. The review of the system of internal controls should be on-going and at a minimum annually, to ensure that internal controls continue to effectively support the successful execution of the licensee's business strategies.

Reliability of Information and Safeguarding of Assets

The internal audit review should make an assessment of the reliability and integrity of financial and operating information generated, as well as the means used to identify, measure, classify and report such information. In addition the internal audit review should make a determination on whether information is provided to management on a timely basis for their decision making. Accordingly, the review should ascertain whether:

- financial and operating records and reports contain accurate and relevant information and are prepared in compliance with applicable laws and standards;
- control procedures over record keeping and reporting are adequate and effective; and
- the process in which information is captured, recorded and protected is satisfactory.

The audit review must also encompass an assessment of the adequacy of the controls that are in place to safeguard a licensee's assets against losses from theft, fire and unauthorized use. While the detection of theft, fraud and other irregularities is not the focus of an internal audit review, the reviewer should be alert particularly when the control environment is

[2] COSO Internal Control - Integrated Framework

weak, thereby increasing the risk of errors and omissions and the perpetration of theft or fraud.

The internal audit review should help the licensee in determining whether:

- the system of internal control is such that errors and omissions are detected promptly irrespective of their materiality;
- situations exist which foster the concealment of errors, omissions, thefts and fraud by an individual's manipulation of records and assets; and
- deviations from internal policies and procedures are investigated and corrective action taken

Compliance with Laws, Regulation and Internal Policies

An internal audit review should evaluate whether a licensee is in compliance with all applicable laws and regulations, as well as guidelines and directives issued by the Commission. The internal audit review should also make an assessment of the institution's compliance with its internal policies and procedures. Where non-compliance of laws, regulations, guidelines and directives have been found and are due to control weaknesses, these should be promptly brought to the attention of management. Failure to comply with applicable laws, regulations and other regulatory requirements can adversely impact a licensee through the imposition of monetary penalties or other more severe disciplinary action.

Control Deficiencies and Audit Recommendations

Prior to the completion of an internal audit review, if significant control deficiencies which can adversely impact the condition of the licensee were discovered, the individual or body carrying out the internal audit review should promptly report this information to the Audit Committee of the licensee. In the absence of an Audit Committee, the report should be made the CEO or Managing Director. Moreover, the internal audit review should also assess whether management has acted upon prior audit recommendations and taken the appropriate steps to address control deficiencies that were identified.

OUTSOURCING OF INTERNAL AUDIT

The Commission is aware that there are small non-bank licensees where no formal internal audit function is established. In some instances internal audit review responsibilities may lie with officers / employees who carry out management functions. It is imperative however, irrespective of size, that both Bank and Trust licensees conduct an internal audit at least annually.

In the absence of an in-house internal audit function, outsourcing of the internal audit review to a qualified service provider is an acceptable alternative. Licensees should be aware however that entering into outsourcing arrangements has the potential to increase operational risks. The service provider may be engaged to perform all or part of the internal audit as agreed upon.

In outsourced internal audit arrangements, a licensee must maintain ownership of the internal audit review and provide active oversight of the outsourced activities. In the context of a licensee with a small staff capacity, it is advisable that a competent employee be appointed to oversee the provider and act as the liaison between both parties.

Outsourcing arrangements must be governed by written agreements, which outline terms, conditions and specify the roles and responsibilities of the licensee and provider. Additionally, it is the expectation of the Commission that the internal audit will be conducted in compliance with sound internal auditing standards, such as The Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.

The management of a licensee must ensure that the service provider to whom the function is outsourced is a person of integrity. This means that the person is able to perform the required tasks with honesty, diligence and responsibly. It also implies that this person observes the law and has not been a party to any illegal activity.

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