CLARIFICATION NOTE ON THE GUIDELINES ON MINIMUM AUDIT STANDARDS FOR INTERNAL AUDITORS OF LABUAN BANKS

1.0 PREAMBLE

1.1 This Clarification Note is issued to provide clearer regulatory expectations on exit meeting and audit plan requirements for Labuan banks, as outlined in the *Guidelines on Minimum Audit Standards for Internal Auditors of Labuan Banks* (the Guidelines) issued on 6 June 2014. The extracts of the Guidelines and their further detailing are meant to provide greater guidance so that Labuan banks can better effect the relevant requirements as intended by the said requirements.

2.0 EXIT MEETING

Excerpt of the Guidelines

<u>Paragraph 8.7.2</u>

"Internal auditors are to comply with these requirements at all times in the performance of their audit. Internal auditors would need to have an exit discussion with Labuan FSA after their audit. Labuan FSA reserves the right to extend the scope of the audit of such other matters as may be necessary based on its supervision of the Labuan bank."

<u>Paragraph 9.2.1</u>

"…A copy of the final audit report should be forwarded to the Audit Committee or any independent group of management that has been given the responsibilities to review the audit report on a timely basis. An exit meeting with Labuan FSA to highlight preliminary significant findings shall be carried out immediately upon completion of the physical audit."

2.1 As clarified during the bilateral meeting with the Association of Labuan Banks on 28 October 2015, Labuan FSA reaffirms that the exit meeting requirement under paragraphs 8.7.2 and 9.2.1 of the Guidelines, is required only for significant findings. This measure is intended to ensure that Labuan banks convey material audit issues to the Authority in an appropriate manner.

2.2 In determining the significance of the audit findings, internal auditors are expected to assess their materiality based on the potential impact and likelihood of the finding occurrence. Such material audit findings may include, but are not limited to:

(i) Breaches of laws and regulations;

(ii) Non-compliance with internal policies and procedures that could result in financial loss;

(iii) Major control flaws that may lead to errors, fraud or operational failures affecting business performance;

(iv) High-risk exposures or deficiencies in risk management processes or systems for identifying and measuring its regulatory capital and assessing the adequacy of its capital resources in relation to the Labuan bank's risk exposures, including any excessive concentration, inability to honour liabilities or insufficient liquidity; and

(v) Findings requiring immediate corrective action due to their potential to compromise the safety and soundness of the Labuan bank, such as:

(a) Fraud or misappropriation of funds; and

(b) Control gaps relating to the handling of the Labuan bank's clients. This includes client confidentiality breaches (e.g. unauthorised access, leakage or mishandling of client information) and operational gaps that can potentially impact the Labuan bank's reputation (e.g. delays in client's money withdrawals or unattended client complaints).

2.3 Labuan banks are required to ensure that all relevant audit findings are timely submitted to Labuan FSA, regardless of their materiality, where such findings can be considered relevant for Labuan FSA's supervisory oversight of their organisation. In addition, Labuan banks are strongly encouraged to engage in regular dialogues with Labuan FSA's supervisors to promptly discuss or address any relevant matters.

3.0 AUDIT PLAN

Excerpt of the Guidelines

> Paragraph 6.6.2.2
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> "For subsidiaries, the audit cycle should be at least twice a year. At least one of the audits should be a full audit while the other can be, at the discretion of the Chief Internal Auditor, a "specialised or focus" audit."
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> Paragraph 6.6.2.3
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> "For branches, the minimum audit cycle is once a year, and the internal auditors should coordinate with the external auditors to ensure that the timing of the audits do not coincide."

3.1 With regard to paragraph 6.6.2.2 of the Guidelines, a Labuan subsidiary bank, as a separate legal entity under the direct supervision of Labuan FSA, is required to undertake more frequent internal audit cycles compared to a Labuan branch bank. In comparison to a Labuan branch bank, a Labuan subsidiary bank has a distinct legal standing and is expected to institute its own specific corporate governance as expected of a company setup with its relatively higher operational complexity. The regulatory expectations would then need to be commensurate with the differing risk profile between a subsidiary bank and a branch.

3.2 In this regard, for a Labuan subsidiary bank, it is expected for there to be an effective governance framework which employs a robust internal audit assessment undertaken in a regular and comprehensive manner as one of the primary internal controls of the organisation.

3.3 As regards a “specialised or focus” audit referred to by the Guidelines, this relates to targeted internal audits on specific high-risk areas, functions or issues within the Labuan bank, rather than a full operational review. These include high-impact risk areas such as ethics, fraud, information technology, third-party relationships and regulatory non-compliance. The thematic review is expected to be part of the Labuan bank subsidiary’s own compliance and risk management planning.

3.4 The “specialised or focus” audit can target policies or controls related to Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) as indicated in paragraph B.2.7 of the *Guidelines on Anti-Money Laundering, Countering Financing of Terrorism, Countering Proliferation Financing and Targeted Financial Sanctions for Labuan Key Reporting Institutions (AML/CFT/CPF and TFS for Labuan KRIs),* regulatory reporting accuracy, cybersecurity and data privacy compliance.

Labuan Financial Services Authority
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