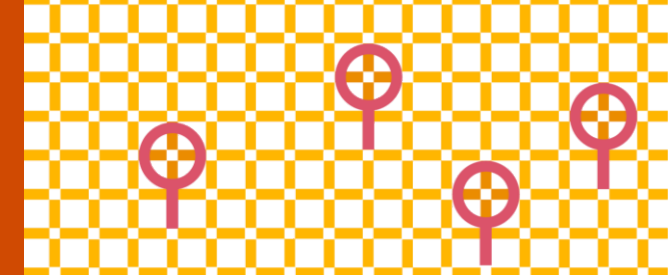


Internal audit of Hong Kong branches of foreign banks

Roles and expectations of local and head office internal audit functions?



Overview

- As indicated in the Supervisory Policy Manual (“SPM”) IC-2 issued by the Hong Kong Monetary Authority (“HKMA”), banks are required to establish a robust Internal Audit (“IA”) function to give assurance to the Board and senior management on the effectiveness and efficiency of each core function of the bank. The IA function is expected to be able to perform a structural risk assessment, observe external events and perform targeted audits using a risk-based approach.
- Based on our knowledge of the market, IA functions in Hong Kong face certain common challenges and constraints in meeting the HKMA regulatory requirements. This situation is even more prominent for **Hong Kong bank branches of foreign banks**, where they rely on their Group IA function to audit the Hong Kong operations.
- Where Hong Kong branches (of foreign banks) follow the Group's framework, policies and procedures, one of the common observations is that there is a **lack of assessment** to ensure that the Group's policies suit the Hong Kong operations. Whilst the HKMA allows a Group's framework to be applied, it expects the Group's policies and parameters to be **assessed and justified** by the local management, and to be **customised** to align with **local regulatory requirements**, taking into account the **size and operations** of the Hong Kong business, where appropriate.

Common challenges



Lack of Resources

Hong Kong bank branches may have insufficient scale and resources to implement a formal 3 lines of defence model, especially in areas that require specific expertise (e.g. cybersecurity, AML, use of data analytics). IA functions are often stretched to tackle one-off independent assessment requests due to new regulatory requirements or to address ad-hoc requests raised by the HKMA.



Lack of Insights of Local Regulatory Requirements

For Hong Kong bank branches without any local IA function, there is an increased challenge for the Group IA function to understand the HKMA's expectations on the robustness of processes and controls required in managing each key and / or emerging risks (e.g. credit risk, liquidity risk, mis-selling, outsourcing risk, etc), as well as the review approach (e.g. sampling vs use of data analytics) and review focus at the HKMA on-site review.

In accordance with the SPM, AIs are expected to have an IA function to perform audits of certain areas on a regular basis. This may pose challenges to the Group IA function given the lack of familiarity and on-going updates of local requirements.

Options to tackle common challenges

- For AIs that rely on their Group IA function to audit the Hong Kong operations, the HKMA is expected to assess whether the Group IA function is able to satisfy the HKMA standards.
- The HKMA has different expectations for locally incorporated banks and bank branches in certain areas, such as governance and management oversight. The audit plans needs to be designed having due regard to these different entity types.
- From a cost-and-benefit perspective, AIs may consider **outsourcing or co-sourcing** all or some of its local internal audit reviews to address the resource and/or competency constraints.
- Outsourcing or co-sourcing can give access to specialised expertise and knowledge for a special audit project otherwise not available within the organisation.
- Should an AI choose to outsource its internal auditing activities, the HKMA expects the AIs to still assign a **designated individual** to liaise with the service provider on the internal auditing work to be performed and to follow up on audit findings and the rectification of weaknesses identified.

How we can help?

We can act as your company's **outsourced or co-sourced internal auditor** and assist you in establishing an effective IA function that gives assurance to the Board and senior management on the effectiveness and efficiency of each core function of the bank. Our service can be customised in accordance with the level of support you require.

Year 1.....

Internal audit policies and procedures

- ✓ Leveraging the Group Policies and Procedures, develop an Internal Audit Manual Template for management's customisation - which includes an internal audit charter template (for Hong Kong) that defines the mission, scope, authority and responsibility of the IA function, as well as the indicative end-to-end methodology.

Risk assessment and internal audit plan

- ✓ Understand via interviews with stakeholders the audit universe, key auditable units and the existing governance structure.
- ✓ Perform risk assessment and assist management to develop a risk-based internal audit plan for the Hong Kong branch, considering the size and complexity of the business, the products and services offered / to be offered, customer base, industry practices, regulatory focus, etc.

Internal audit review(s)

- ✓ Perform risk-based internal audit reviews for Year 1 based on the agreed internal audit plan. The internal audit report will consist of observations and recommendations.

Year 2 (and onwards).....

- ✓ Update the risk assessment and the risk-based internal audit plan as appropriate.
- ✓ Follow up on the remediation status of significant observations identified in the previous year.
- ✓ Perform risk-based internal audit reviews for the year (e.g. Year 2) based on the agreed internal audit plan.
- ✓ Liaise with the coordinator of the internal auditor function from head office, where necessary.
- ✓ Status reporting.
- ✓ Assist management to respond to ad-hoc advisory questions, where necessary.



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