



Guidance to Internal Audit Functions of the Banking sector in Pakistan – Response to COVID 19

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This document needs to be read in line with the following :

- Each Financial Institution will have their own unique risks so they should engage with their respective Boards, Audit Committees, regulatory and management accordingly.
- This document provides high level guidance from the Internal Audit Working Group of the PBA to Heads of Internal Audit of the banking sector of Pakistan to consider in response to the COVID-19 situation.
- We recommend that Internal Audit heads should share this document with their respective Audit Committees to considering the impact of COVID-19 on banks and internal audit function.
- This document is only relevant for the banking sector in Pakistan.
- With the rapidly changing business environment due to covid19, the guidance provided in this document may change.
- Also, refer to Websites of the Institute of Internal Auditors and ISACA for additional guidance

Introduction

COVID-19 has emerged as a global pandemic and huge threat to the global economy. The whole world has taken a number of steps to contain the menace of the virus including Pakistan where major urban centers are in a state of lockdown leading to minimal economic activity.

“In the face of the Coronavirus, Internal Auditors must do more than don masks” Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA, is president and CEO of The IIA

The banking sector, being a critical service, continues to operate albeit on a war footing with priority to deliver essential services to customers and at the same time navigating through the evolving risk environment. The State Bank of Pakistan (SBP) is constantly evaluating the situation and implementing a number of measures to ensure the continuity of banking services during these difficult times and providing relief to wider public and businesses on loans and borrowings.

In light of the above, as per Institute of Internal Auditors (IIA) recommendations, Internal Audit functions propose to adopt a dynamic and agile approach over the short to medium term to better serve the needs of the bank’s stakeholders in this evolving risk environment.

Due to these challenges, the impact of COVID-19 on the activities of the Internal Audit Function are to be evaluated to determine the right path to remain functional in adding value to the organization.

It is important that the Internal Audit Function identifies the key risks that are emerging in present scenario and advises the management/board of the bank on ways to mitigate them.

This document provides high level guidance for the Internal Audit Functions (IAF) of the Banking sector of Pakistan to consider and discuss with their stakeholders.

Impact of COVID-19 on Internal Audit

Wider business availability to Audit

- The availability of areas to audit has been severely disrupted due to limited staff availability across the bank.
- Requests are being received for delay and postponement of audits due to auditee challenges to perform BAU tasks.
- Internal Audit (IA) Functions may not be able to complete their 2020 Audit Plans.
- Audits are either on hold, being performed remotely or performed with limited scope.

Minimum disruptions to Auditees

- Where activities are ongoing the expectation from auditees is to reduce the interaction and flow of documents/information for audit.
- Assessment of business continuity plans has become important.

Branch and overseas audits and travel restrictions

- Physical branch and overseas audit visits have stopped due to the introduction of social distancing and travel restrictions in early March.
- A number of branches in Pakistan have been closed as per SBP BPRD circular and remaining are operating on limited staff.

Staff deployment

- Work from Home (WfH) approach has been adopted. However, this has been challenging for IA staff due to travel restrictions and availability of audit evidence.
- The critical staff working from home have been provided remote working facility to minimize business continuity issues.

Emerging risks

- A number of new and / or increased emerging risks have arisen in particular disruption to customer services, health & safety, segregation of duties, fraud, uncertainty, operational errors due to pressure on limited staff, cyber security, market, credit and liquidity risks.
- This is in addition to the higher risk environment around AML/CFT in light of upcoming FATF review.

Use of technology

- As social distancing is key, more usage of VPN or other software to remotely access the bank's systems.
- Knowledge of Data analytics and CAATs and their use in the wider fieldwork is required for the auditors.

Audit Strategy and Plan

- Internal Audit Functions will need to reassess their Audit Strategies, Risk Assessments and 2020 Annual Audit Plan to consider the impact of COVID-19.
- IA Functions may not be able to meet the regulatory requirements (audits, validations, certifications etc.).
- IA Functions may not be able to provide optimum value addition to the business and management due to changes in audit scope.



Emerging

The IAWG of the PBA has currently assessed the following emerging or heightened risks as a result of COVID 19 pandemic across the banking sector in Pakistan:

Governance and Oversight	<ul style="list-style-type: none"> Lack of centralized oversight and decision making of senior management in ensuring bank's readiness and response to COVID 19 impact.
Business Strategy	<ul style="list-style-type: none"> Decrease in profit projections due to sharply lower rate environment and poor credit environment. Need for banks to adapt and find efficiencies and synergies in processes.
Health and Safety	<ul style="list-style-type: none"> Adequate measures (incl social distancing etc.) not taken by Banks putting the customers and employees at risk.
Crisis Management and Business Continuity	<ul style="list-style-type: none"> Ineffective crisis management frameworks. Unavailability of systems, access to systems, vendor support and staff (business/ operations).
Information and Cybersecurity	<ul style="list-style-type: none"> Increased level of cyber threats. Security protocols may be relaxed to enable greater business continuity. Increased use of VPN connections and digital footprint may result in confidential information and data leakage.
Alternative Delivery Channels (ADC)	<ul style="list-style-type: none"> Increased dependency on ADC for banking services due to branch closures and lock downs. Increased frauds on Branchless Banking channels e.g. social engineering etc.
Credit Risk	<ul style="list-style-type: none"> Credit environment worsening in particular export driven sectors. Inadequate identification of watchlist customers and estimation of provisions in light of SBP relaxations.
Capital and Liquidity Risk	<ul style="list-style-type: none"> Declining profits may impact capital adequacy. Possible liquidity crunch due to inability of borrowers to repay loans.
Market Risk	<ul style="list-style-type: none"> Volatility in stock markets, interest rates and FX.
Customer Services	<ul style="list-style-type: none"> Unavailability of essential banking services to retail customers. Compromised service standards due to staff shortages. Increased customer complaints.
Regulatory Compliance	<ul style="list-style-type: none"> Non compliance to SBP requirements to deal with Covid-19 regulations regarding relaxations on loan portfolio, biometric verification requirement on enhanced limit, fee waivers, etc. In light of the FATF review and social distancing, the implementation of AML/ CFT protocols may not be achieved.
Fraud / Reputational Risk	<ul style="list-style-type: none"> Possible diversions from dual control processes to cut corners for facilitating customers increase chances of frauds. Inappropriate implementation of Government programs such as Ehsas etc.
Security Risk	<ul style="list-style-type: none"> Worsening law and order situation may impact physical security of premises and ATMs etc.



Guidance to Internal Audit Functions – response

COVID-19 is one of the most significant events globally which will impact governments, corporates and individuals. It will change the way we operate. Internal audit functions in their role as the Third Line of Defense will need to evolve given the rapid changes in the business environment. In light with the previous slides on impact of COVID-19 on Internal Audit and Key Emerging Risks, The Internal Audit Working Group of PBA recommend the following guidance to internal audit functions:

Risk Assessment and Audit Plan

- Revisit Risk Assessment with special focus on emerging risks
- 2020 Audit Plan maybe put on hold during lockdown
- 2020 Audit Plan need to be updated
- IA Strategy will need to be revisited

Alternative Ways to Audit

- Find ways to audit with minimum disruptions to business
- Identify alternate ways to audit to add value to the organisation
- Desktop reviews, limited scope reviews, special reviews, continuous monitoring, remote /offsite reviews
- Agility – use of Data Analytics, CAATs etc.
- Alternative audit evidences acceptable to internal audit
- Update Audit Methodology

Focus on 1LOD and 2LOD controls

- Get initial inputs from 1LOD and 2LOD review processes (credit risk, compliance etc.) to identify and prioritise areas of high emerging risks
- Close interaction with 1LOD and 2LOD to identify and address risks as they arise
- Use of Key Risk Indicators and MIs (Operational Risk Incidents, Increasing trends in TM alerts, high aged recon items etc.)

Staff Engagement and Development

- Health and safety
- Continuous engagement with your staff
- Development of their competencies to audit Emerging Risks
- Develop skills to audit in alternative ways – working from home approach
- Use of system access to all IA staff
- Online learnings

Continuous Stakeholder Engagement

- Board
- Board Audit Committees and other Board Committees
- Governance and Risk Committees
- Leadership and senior management
- Regulator
- IA Staff
- Social distancing - Connect via Video and Mobile apps

Regulatory Compliance

- Transparent and open discussions with the SBP on current scenario
- Obtain relaxations on IA related regulatory compliance
- Audit coverage (inc COVID 19 related SBP circulars)

