

## **Circular 13: The new role of internal audit in internal control systems**



*Recently, the State Bank of Vietnam (SBV) has issued Circular 13/2018/TT-NHNN to provide more detailed regulations for the internal control systems of commercial banks and branches of foreign banks. The Circular introduces many changes and is a comprehensive regulatory framework for internal controls, aiming to prevent, detect and manage risks.*

*To learn more about the updates and challenges that the internal control and internal audit functions will experience when Circular 13 officially comes into force on 1 January 2019, the Banking Times has interviewed Mr. Nguyen Hoang Nam - Financial Services Leader and Deputy General Director of PwC Vietnam.*

***Compared with Circular 44/2011/TT-NHNN, what are the new requirements for internal controls in commercial banks and branches of foreign banks under Circular 13/2018/TT-NHNN?***

Over the past few years, banks in Vietnam have undergone remarkable changes in many aspects. In order to regulate their internal control and internal audit functions, the SBV issued Circular 44/2011/TT-NHNN in December 2011. The circular has gradually helped banks to set up their internal control and internal audit functions. However, the circular is quite general and does not provide sufficient guidance for implementing effective internal controls in banks.

Circular 13/2018/TT-NHNN, which was recently issued by the SBV, contributes to solving practical problems in the development of the internal control systems in banks. The provisions of Circular 13 are specific and clear. In addition, they are in line with international practices on the establishment of an internal control system. Accordingly, internal controls are characterised by three lines of defence to control, prevent,

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detect and handle risks in banking operations in a timely and thorough manner:

- The first line of defence has the functions of risk identification, control and minimisation, and is carried out by the business departments;
- The second line of defence has the functions of formulating risk management policies and internal regulations on risk management, and measuring and monitoring risk in accordance with laws and regulations; and
- The third protection line is the internal audit function.

Under Circular 13, the internal control system performs five functions, namely senior management oversight, internal control, risk management, internal capital adequacy assessment, and internal audit

### ***What is the new role of internal audit within internal control systems as per Circular 13?***

In general, the internal audit function still follows independent, objective and professional principles in accordance with existing regulations and the code of

professional ethics of internal auditors.

Both Circular 44 and Circular 13 specifically require the internal audit function to have at least one internal auditor to conduct auditing of information technology and its application. According to the new regulations in Circular 13, the scope of work of the internal audit function will fit its purpose as the third line of defence. The internal audit function is responsible for conducting independent audits and assessments of the bank's compliance with internal mechanisms, policies and regulations, including senior management oversight, internal control, risk management and internal assessments of capital adequacy to identify shortages, constraints and causes. In addition, the internal audit function also reviews and assesses the compliance of internal mechanisms, policies and regulations with the state regulations.

In summary, under the high expectations of banks' boards of management and supervisors, the role of internal audits has become more and more important. Internal audits help banks

deal with risks and seize opportunities while complying with the regulatory framework, as well as providing sufficient information to support the decision-making process of the board of management. The role of internal audits needs to change from that of an "auditor" (an assurance role) to a "trusted advisor" (providing counselling and value creation), by enhancing internal audits and focusing on achieving compliance, efficiency and profitability objectives in banking operations. Thereby, banks can meet international standards for internal audits and follow the Basel II roadmap in Vietnam.

### ***Could you elaborate on the challenges that the internal audit function in particular and banks as a whole will face when implementing Circular 13?***

Circular 13 contains a number of new regulations in line with current international practices. In fact, some commercial banks and branches of foreign banks have already developed and applied internal control models in a systematic manner that aligns with the Basel II application roadmap in Vietnam.

However, many other commercial banks will need to step up their efforts to build an internal control system in accordance with the new Circular 13. I think this is not only a matter of compliance, but more importantly, to ensure the safety, survival and development of banks in the competitive banking market. Therefore, commercial banks need to develop a comprehensive roadmap for the application of Basel II in accordance with Circular 41/2006/TT-NHNN and the internal control system should be developed accordingly. In particular, the internal audit function should become the last line of defence to detect and deal with banking risks in a timely manner.

In order for the internal audit function to comply with the requirements of Circular 13, there are two important challenges: the model design and the internal audit team. The development of an internal audit model should follow a risk-based approach to identify and evaluate potential risks that may affect the achievement of the organisation's goals, as well as to focus and optimise resources to deal with significant risks. Meanwhile, internal auditors should be trained to improve their capabilities and to ensure independence, objectivity and professionalism in auditing, and to be an effective last line of defence in risk management of banking operations. This role is particularly important

considering the new requirements regarding senior management oversight, internal control, risk management and internal capital adequacy assessment that Circular 13 has introduced.

***Thank you for sharing your views!***



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