



# EFFECTIVE INDEPENDENT TESTING OF BANK SECRECY ACT/ ANTI-MONEY LAUNDERING COMPLIANCE

**Prepared for:**



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# Anti-Money Laundering Program



## THE FOUR PILLARS

**Internal Controls**



**BSA Officer/Staff**



**Training**



**Independent Testing**



# Anti-Money Laundering Program



## PILLARS SHOULD MAKE SENSE

**Internal Controls**



**BSA Officer/Staff**



**Training**



**Independent Testing**



# Anti-Money Laundering Program



**ONE WEAK PILLAR CAN HAVE SERIOUS CONSEQUENCES**





## Effective Audit Program



- Appropriate for the institution's risk profile
- Cover all applicable regulations and guidance
- Effective scoping and planning
- Ensure adequate transaction testing
- No gaps in the program - program covers all appropriate areas
- Well-organized workpapers
- Establish clear paper trails

**Extracts from a regulatory exam report:**

***Audit did not include steps that would provide appropriate testing, especially of ..... the BSA/AML Program (of the bank) is deemed inadequate.....violation of regulations...***



## Effective Audit Program *(continued)*

- Communicate exceptions effectively
- Identify violations and explain risks
- Recommend appropriate corrective action
- Track corrective action
- Communicate results to Board of Directors/Audit Committee and senior management
- Document resolution of audit observations not carried to audit report.

**Extracts from a regulatory exam report:**

***While the BSA/AML audit report was issued to the General Manager, who forwarded a copy to Head Office.... Audit did not report its findings to the board of directors or its audit committee.....Consistent with FFIEC guidance, audit results should be reported to the board of directors or a designated committee in a timely manner.***



## Efficient & Effective Planning



- Document your understanding of the AML risk profile
- Identify high risk services, products and clients
- Identify new regulations and regulatory guidance issued since prior audit
- Consider results of the most recent audit and regulatory examinations
- Consider results of other independent or self compliance reviews
- Identify resolution of past recommendations



## Efficient & Effective Planning *(continued)*



- Consider factors that have changed since prior audit, such as:
  - Changes to Organization's risk profile since last audit
  - Changes in the compliance function since prior audit
  - New regulations introduced since the prior audit
  - New regulatory guidelines issued since the prior audit
  - IT enhancements introduced
  - Changes in monitoring parameters
  - Changes in key compliance and operation staff
  - New products or services



## Frequency of Independent Testing

- Not defined in any statute
- FFIEC BSA/AML Examination Manual incorporates that a 'sound practice' is to conduct independent testing every 12-18 months, 'commensurate with the BSA/AML risk profile'
- Industry practice - annually



## Areas/Activities To Be Tested

- Adequacy of policies and procedures
  - Fully addresses all elements of regulations and regulatory guidance
  - Provides sufficient guidance/instruction
  - Granular; includes process
- Ensure comprehensive test procedures
  - Cover the “other” three pillars of AML Program
  - Assess the integrity of specific processes/controls/systems
  - Assess the quality and accuracy of MIS
  - Assess framework for reporting exceptions to policies/control breakdowns
  - Test all requirements of applicable regulations



## Areas/Activities To Be Tested *(continued)*

- Effectiveness of the Customer AML Risk Rating Methodology
- Adequacy of High Risk Customer identification
- Adequacy of Customer Due Diligence (CDD)
- Effectiveness of CDD and compliance with documented Policies and Procedures
- Adequacy of Enhanced Due Diligence (EDD)
- Adequacy of EDD and compliance with documented Policies and Procedures
- Adequacy of Customer Identification Program (CIP)
- Adequacy of Internal Controls and Reporting
- Technical correctness of Suspicious Activity Reporting
- Appropriateness of SAR sharing with Head Office (for FFIs)



## Areas/Activities To Be Tested *(continued)*



- Investigation and suspicious activity monitoring process
  - Effectiveness of monitoring system
  - Automated or manual system
  - Effectiveness of alerts, filters, rules and routines
  - Documentation of investigation results
  - Effectiveness of escalation procedures
- AML monitoring of Trade Finance activities
- AML monitoring of Remote Deposit Capture activities
- AML monitoring of International ACH transactions
- Reporting & Record Keeping
- Compliance with Unlawful Internet Gambling Enforcement Act (UIGEA)



## Areas/Activities To Be Tested *(continued)*

- Funds Transfer recordkeeping and Travel Rule compliance
- USA PATRIOT Act - Test for compliance with:
  - 314(a) and 314(b)
  - 311
  - 312
  - 313/319
- Ensure adequate Transaction Testing
- Validate corrective action taken to address last audit and examination findings

**Extracts from a regulatory exam report:**

***Other than obtaining USA PATRIOT Act certifications, .....risk rating and CDD/EDD were not uniformly applied to Foreign Correspondent Bank.....***



## Areas/Activities To Be Tested *(continued)*

- Evaluate BSA & OFAC training curriculum and its administration
- Determine if BSA Officer responsibilities are adequately defined
- Is the BSA Officer satisfactorily fulfilling responsibilities
- Does the BSA Officer inform senior management of new guidance/regulations timely
- Determine if the OFAC Officer's responsibilities are adequately defined

**Extracts from a regulatory exam report:**

***Management has assigned considerable responsibility to the BSA Officer to oversee the execution of the branch's BSAI AML and OFAC programs... management has not introduced measures to monitor the performance of the Officer..... nor adequately defined the performance standards within the job description.***



## Areas/Activities To Be Tested *(continued)*

- Bank Risk Assessment
  - Suitability for the bank's profile
  - Identification of all key AML risks
  - Incorporate mitigating factors and controls
  - Includes all products and services
  - Includes both qualitative and quantitative analysis
  - Has been reviewed and approved
  - Appears to be reasonable

**Extracts from a regulatory exam report:**

***The branch's BSA/AML and OFAC risk assessment documents do not address the level of inherent risk ..... and are not well-supported by analysis. Descriptive terms such as a "few" are used .... discussion about the quality of mitigating controls is largely absent. Consequently, the risk assessments do not provide meaningful insight.***



## Areas/Activities To Be Tested *(continued)*

- Cash activities and CTRs
  - cash aggregation, ATM transactions
- Exemption procedures
- Monetary Instruments
- Recordkeeping requirements
- OFAC
  - Policy and Procedures
  - Enterprise-wide Risk Assessment
  - Screening and periodic scrub
  - Rationale/documentation for waivers
  - Integrity and updating of OFAC Filters



## Areas/Activities To Be Tested *(continued)*

- CMIR and FBAR
- New requirements
- FFIEC Examination Manual April, 2010
  - Bulk Cash Shipments
  - International ACH Transactions
  - Trade Finance
  - Funds Transfers: MT 202 Cov
  - E-Cash
  - Remote Deposit Capture
  - Third Party Payment Processors



# Workpaper Documentation



- Maintain adequate documentation to support test work conducted:
  - Identify total population and your sample
  - Document the sampling methodology
  - Document the justification for sample size
  - Identify attributes tested
  - Record test results
  - Reconcile test work with conclusions
- When reviewing processes/key controls, you should sufficiently describe and document what you evaluated, why you did what you did, and the test conducted



## Communicate Results



- Discuss materiality of issues uncovered
  - Violations, exceptions to P&P, deficiencies.....
- Discuss likely cause(s) of the exceptions/control gaps identified
- Prioritize audit findings according to materiality
- Ensure that time frames for corrective actions align with the materiality of the issues concerned
- Repeat issues should be appropriately highlighted
- Audit rating should align with the significance of the audit issues/recommendations noted



## Track & Monitor Corrective Actions



- Track all actionable issues
- Document responsibility for resolution of issues
- Ensure completeness of corrective action
- Validate closure of audit issues
- Maintain adequate support on all closed issues
- Where the corrective action involves the implementation of a new system, validate successful implementation and ensure data integrity



## Audit Resources & Auditor's Expertise

- Independent Audit Function within the Institution
- Head Office audit (Foreign Financial Institutions)
- Outside audit firm
- Staff performing the testing should possess the expertise to assess compliance with BSA and OFAC regulations
  - Technical expertise
  - Specialized training
  - Familiar with new regulations/guidance
  - Attendance at industry forums/conferences



# Key Audit Deficiencies



- Failure in planning
  - Serious deficiencies can result in a violation of the Regulation – in adequacy of AML Program
- Frequent deficiencies
  - Failure to properly document the audit
  - Insufficient transaction testing
  - Major gaps in the audit
  - Not all areas tested adequately
  - System/ MIS Integrity not tested
  - Observations/findings unresolved – not in report
  - Recordkeeping compliance not tested



## Key Audit Deficiencies *(continued)*



- Frequent deficiencies *(continued)*
  - Lack of clear indication of what was reviewed
  - Documents retained had no relevance to testing
  - No noting regarding exceptions or lack thereof
  - Documents reviewed had deficiencies, which audit failed to identify
    - Lack of Technical Skills
  - Ineffective communication of findings
  - Delayed issuance of audit reports
  - Failure to require appropriate corrective action



# Key Audit/Examination Findings



## BSA/AML Risk Assessment

### Contents

- Use of a canned Risk Assessment
  - Not tailored to the institution
  - Excludes products or services
  - Does not incorporate appropriate quantitative and qualitative analysis
  - Does not include existing mitigating controls

### Approval/Sharing

- No evidence of involving key stake holders
  - Not presented to the Board/ Senior Management
  - Not updated for changes - products/ services/ geographies, etc.



## Key Audit/Examination Findings *(continued)*

### BSA/AML Policy & Program

#### Approval

- Approval not granted by appropriate authority
  - Not in accordance with Regulation-K (for Foreign Banks)

#### Contents

- Lack of timely policy updates
  - Final Rules
  - FinCEN Guidance

#### ***Regulation-K:***

***“The compliance program shall be reduced to writing, and either:***

***(i) Approved by the foreign bank’s board of directors and noted in the minutes, or***

***(ii) Approved by a delegatee acting under the express authority of the board of directors to approve the Bank Secrecy Act compliance program.”***



## Key Audit/Examination Findings *(continued)*

### BSA/AML Policy & Program

#### Training

- Non-coverage of ALL appropriate personnel
- Common Training material: Annual Training
- Training not aligned to:
  - role/ function and products/services
  - no reference to policy and procedures
- Employee's failing tests:
  - No follow-up on low scores
  - The issue of repeat failures not addressed
- Not enough training for 'new' BSA Officer
- New staff/ expatriates not trained timely
- Senior Management did not attend training
- Training of Board of Directors not arranged

# Key Audit/Examination Findings *(continued)*



## BSA/AML Policy & Program

### Reporting – Currency Transaction Report (CTR)

- Lack of aggregation of ALL currency transactions
  - ATM transactions excluded
- System validation not performed by auditors
  - Accuracy of amounts reported open to question
- Incorrect TIN reported
- IRS Correspondence:
  - Inaccuracy of TIN on CTR, when CIF has correct TIN
  - Delays in responses
- Exemptions:
  - Belief that ALL cash transactions are reasonable
  - Reviews not documented



## Key Audit/Examination Findings *(continued)*



### BSA/AML Policy & Program

#### Reporting – Suspicious Activity Report (SAR)

- Increased scrutiny by examiners - Quality is critical
- Period of review and related amount was incorporated
- No evidence of compliance with the 30 day/ 60 day time limit
- Some SARs were not reported to the Board
- Narratives did not communicate the events clearly
- Review for follow-up SAR not documented
- Delayed review for follow-up SAR / SAR filed after 90 days
- Technical omissions on repeat/ follow-up SAR:
  - Earlier SAR not referenced
  - Follow-up SAR incorporated date/amount only for fresh activity
- Reasons for not filing SAR not clearly documented



## Key Audit/Examination Findings *(continued)*



### USA PATRIOT Act

#### Customer Identification Program (Section 326)

- New accounts for existing customers without adequate KYC
- No Identification of Accounts with Missing TIN
- Lack of physical address/ accounts with only P.O. Box address
- Violations of Institution's policy
  - Primary/secondary Id
  - KYC Information
  - Documentation and Sign-off
- Non timely review of new account documentation



## Key Audit/Examination Findings *(continued)*



### USA PATRIOT Act

#### Correspondent Banking (Sections 311, 312, 313 & 319)

- Non-identification of ALL Correspondent Banking relationships
  - Ignoring Head Office accounts
  - Not covering Treasury and/or Trade Finance functions
- Enhanced Due Diligence policy/ procedures and identification of high risk relationships not tailored to the institution
- Misconception that Foreign Correspondent Accounts can continue for 'commercially reasonable time' after expiration of Certifications
- Non-compliance with Special Measures
  - Non-inclusion in Policy
  - Lack of notification to Correspondents
  - Lack of adequate/ documented monitoring procedures

## Key Audit/Examination Findings *(continued)*



### AML Monitoring

#### AML Monitoring

- Inadequate KYC information
- Inadequate/excessive identification of 'high risk' customers:
  - Inappropriate/canned Risk rating model
  - No review of risk rating
- Monitoring was focused on 'high risk customers':
  - No attention given to high risk products/service
- No involvement/ training of Front-line staff for detecting unusual activity
- Operations personnel had no idea of red flags
  - Lack of adequate training



## Key Audit/Examination Findings *(continued)*



### AML Monitoring

#### AML Monitoring

- Monitoring procedures not documented
- Adequacy of monitoring not determined by Internal Audit
- Lack of escalation procedures
- Automated monitoring tool used without:
  - Post-implementation audit/validation

#### Audit of AML System

- No review by BSA auditors/post-implementation auditors regarding:
  - Data Integrity
  - Controls over AML system
  - Segregation of duties
  - Adequacy of AML reports
  - Rationale for changes in AML monitoring parameters
  - Approval of changes



## Key Audit/Examination Findings *(continued)*

### AML Monitoring

#### Not all activity monitoring may be automated

- No monitoring of activities not captured by AML systems –
  - Safe Deposit Boxes
  - Trade Finance
- AML Monitoring of Trade Finance Activities – no documented process for ensuring:
  - “Customer” is expected to trade in the commodity concerned
  - “Commodity” is expected for customer’s line of business
  - “Price” is reasonable for the commodity being traded
  - “Country” is expected to be normally trading in that commodity



## Key Audit/Examination Findings *(continued)*

### Office of Foreign Assets Control

#### OFAC

- In-adequate Policy and Procedures:
  - International wires not screened against country list
  - Confusion between 'blocking' and 'rejection'
- Issues with OFAC screening:
  - Non-timely dissemination of Latest OFAC Update
  - Considerable delay in updating OFAC filters
  - Secondary relationships were not covered
  - Inadequate periodic screening/ documentation
- Risk Assessment generic or canned:
  - Common AML and OFAC risk assessment
  - No differentiation between AML Risks and OFAC risks
- Integrity of OFAC filters:
  - Capability to identify aka's, misspelling, glue-words, etc.



## Thank you

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