



Deposit Guarantee Corporation of Manitoba
La Société d'assurance-dépôts du Manitoba

Guideline

Subject: Audit Committee & Internal Audit

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1.0 Overview

On July 1, 2022, DGCM issued new Standards of Sound Business Practice (SSBP) pursuant to s. 159.1 of *The Credit Unions and Caisses Populaires Act*. All credit unions and caisses (cu/caisse) must comply with SSBP that apply to them (s. 159.1). The SSBP are available at this link:

<https://web2.gov.mb.ca/laws/regs/annual/2022/089.pdf>

The SSBP contain rules respecting cu/caisse capital, liquidity, investments, lending, and other matters. The SSBP also contain a set of principles that assist cu/caisse to direct and manage their institution in a prudent, effective, and appropriate manner. These are further defined in DGCM's **SSBP Guidance Framework**.

The Audit Committee and Internal Audit Guidelines better define DGCM's expectations on how a cu/caisse can comply with the SSBP with respect to Standard # 4 – Internal Control Structure.

These Guidelines draw upon other published standards and are not intended to be exhaustive. DGCM recommends that each cu/caisse consider recognized professional standards for internal auditing such as those published by the Institute of Internal Auditors (IIA) and the Basel Committee for Banking Supervision.

Application to CUCM

DGCM is the prudential oversight body for Credit Union Central of Manitoba (CUCM). DGCM has issued Prudential Standards applicable to CUCM. These Guidelines also better define DGCM's expectations on how CUCM can comply with the Prudential Standards with respect to establishing and maintaining an effective internal control structure.



2.0 Internal Audit Function

The objective of Standard # 4 – Internal Control Structure is to establish and maintain effective internal controls and ensure these controls are reviewed and validated on a regular basis. Validation includes both external and internal audits.

The CEO and senior management are accountable for establishing the control and organizational structures and processes of the cu/caisse. The internal audit function provides the Board and senior management with a vital and independent review of those structures and processes.

The IIA defines Internal Auditing broadly:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

An effective internal audit function is recognized as a best practice among deposit taking institutions in Canada and internationally. As stated by the Basel Committee on Banking Supervision, “independent, competent and qualified internal auditors are vital to sound corporate governance.”

DGCM recognizes the diversity within the Systems due to differences in size, complexity, and level of risk. The sophistication of a cu/caisse’s internal audit function should vary correspondingly.



3.0 Audit Committee Governance Standards

3.1 Audit Committee Functions

Every cu/caisse is required under *The Credit Unions and Caisses Populaires Act (Act)* to have an Audit Committee. The core external and internal audit functions of a cu/caisse's Audit Committee are set out in *The Credit Unions and Caisses Populaires Regulations*:

- Review the annual audited financial statements with the Board, the manager, and the auditor.
- Review the changes in the accounting principles and practices followed by the cu/caisse.
- Recommend the appointment of an auditor to the Board.
- Review the audit fees.
- Review the scope, timing, and coordination of the external and internal audit plans.
- Review any difficulties or restrictions experienced by the auditor in carrying out the audit and the findings of the audit.
- Review all significant recommendations made by the auditor to the cu/caisse's management on the subject of internal control and the management response to the recommendations.
- Review all significant differences of opinion between the auditor and the cu/caisse's management, and whether or not the issues are resolved.
- Perform such other duties and carry out such other functions as may be determined by resolution of the cu/caisse's Board.

Members of the Audit Committee serve as the primary liaison between the Board and the internal and external auditors. The Board should appoint independent committee members that collectively have sufficient understanding of the audit functions.

There should be a functional reporting relationship and direct communication line between the internal audit function, the external auditor and the Audit Committee. The Committee should probe, question, and hold regular in-camera meetings with the internal and external auditor.

3.2 Terms of Reference

Each cu/caisse should have terms of reference for its Audit Committee that are regularly reviewed and approved. These terms of reference should include the Audit Committee's mandate with respect to internal audit, external audit, and its relationship to the Board.



3.3 Audit Committee Independence

Section 111 of the Act states that the Audit Committee must be comprised of at least three members of the Board, none of whom is the chair. DGCM recommends each cu/caisse Board examine whether they should employ further standards for independence.

“Independence” generally means the absence of any direct or indirect material relationship between a director and the cu/caisse. This would include any relationship which could, in the view of the Board, reasonably interfere with that director’s judgment.

For federally regulated financial institutions and publicly traded companies in Manitoba, regulators impose fairly strict standards for independence. DGCM recognizes these standards must be examined in light of the size and complexity of a Manitoba cu/caisse and in light of the cooperative structure. As a co-op, Board members are also members and customers of the cu/caisse and may have longstanding community and business connections to their cu/caisse.

DGCM recommends that each cu/caisse Board consider the following guidance:

Individuals may have a material relationship and therefore not be independent, where:

- (a) They or an immediate family member are or have been, within the last three years, a member of the cu/caisse’s senior management team;
- (b) They or an immediate family member are a partner, owner, or employee of a firm that provides internal or external audit services to the cu/caisse;
- (c) They accept, directly or indirectly, any consulting or other type of fee from the cu/caisse or its subsidiary other than remuneration for acting in their capacity as a director or committee member; or
- (d) They are materially involved or have an ownership interest in a business entity that is a subsidiary of or partially owned or controlled by the cu/caisse.



3.4 Audit Committee Expertise

The Board should consider the level of experience and expertise its Audit Committee members should collectively possess. If gaps are perceived, the Board should allocate appropriate resources, including training, to assist the Audit Committee in fulfilling its mandate. As a cu/caisse grows in size and complexity, additional training and resources should be allocated to ensure the Audit Committee has the necessary expertise.

Members of the Audit Committee should collectively have the financial literacy and the ability to discuss financial statements, processes, and internal controls with the internal or external auditors.

Expertise, for the Audit Committee as a whole means:

- (a) Through training or experience, the Committee understands financial statements, internal control concepts, and the accounting principles used by the cu/caisse to prepare its statements.
- (b) Audit Committee members do not necessarily need to be credentialed. An individual may have gained sufficient knowledge or experience by virtue of past experience or supervision of persons preparing financial statements or supervising internal controls. They may have gained this experience as an executive or Board member involved in other businesses or government.



4.0 Internal Audit Standards & Practices

4.1 Standards

Standard # 4 states that the purpose of the internal audit function is to evaluate the effectiveness of the internal control environment. Furthermore, the SSBP specify that a cu/caisse's internal audit function should:

- Execute the mandate established by the Board and Audit Committee.
- Independently assess compliance with internal controls.
- Implement an appropriate and consistent risk-focused framework and approach.
- Provide recommendations to improve processes and internal controls.
- Follow-up on all recommendations.
- Have access to the Audit Committee including in-camera meetings.
- Provide independent reporting to the Audit Committee and the Board.
- Be independent from the operations under review.
- Have adequate expertise, including qualified audit professionals, and sufficient financial and other resources as required.

Every cu/caisse should have an internal audit function that addresses the requirements listed in the Regulations and SSBP. The audit function will vary among institutions depending on their size, complexity, and level of risk.

4.2 Outsourcing of Internal Audit Services

A credit union may partially or completely outsource internal audit services to external experts. However, oversight and responsibility for the internal audit activity cannot be outsourced. The Audit Committee remains accountable for ensuring the internal audit functions are effective. Administrative oversight should be the responsibility of the CEO or another senior manager.

DGCM recommends that a cu/caisse hire an external resource where a business function is highly specialized or complex and internal audit resources are not available in house for that function (e.g. commercial/agricultural lending and IT security).



4.3 Internal Audit Charter

The mandate of the internal audit function should be set out in an internal audit charter. The final approval of the charter resides with the Board or a committee of the Board.

The internal audit charter should be reviewed and updated on a regular basis and should include:

- Roles and responsibilities of the internal audit function.
- Functional reporting relationship of the internal audit function to the Audit Committee. This would include access to the Audit Committee and provision for in-camera meetings between an internal auditor and the Audit Committee.
- Internal audit access to all relevant corporate resources, employees and records.
- Administrative reporting relationship between senior management and the internal audit function.

These guidelines draw upon other published standards and are not intended to be exhaustive. The IIA and the Basel Committee have detailed descriptions of what can be included in an internal audit charter. DGCM recommends that each cu/caisse examine other professional standards when developing its internal audit charter.

4.4 Internal Audit Plan

The Audit Committee must approve and regularly review an internal audit plan that sets out a schedule for the areas to be reviewed. Priorities should be set on a risk basis.

An internal audit plan should be prepared by the person responsible for the internal audit function, usually with senior management and Audit Committee input. The plan must include a budget, appropriate staff, and financial resources.

When setting priorities, the Audit Committee should ensure the plan is integrated with the cu/caisse's enterprise risk management (ERM) process. The plan should be responsive to the findings of supervisory officials such as DGCM examinations and FINTRAC audit findings.

An audit universe may be documented to support the creation of this risk-based plan. Every key process or significant business activity of the cu/caisse should fall within the scope of the internal audit function and within the documented audit universe.



Administrative or compliance functions that are part of operations do not constitute internal audit activities. These functions should be considered for an independent audit on a regular basis.

4.5 Internal Audit Recommendations

Responsibility for ensuring that internal audit recommendations are followed up rests with the cu/caisse's management. However, the Audit Committee should ensure its processes, including its terms of reference and audit plan, allow for sufficient tracking and follow-up of recommendations.

4.6 Expertise & Resources

Professional competence, including the knowledge, training, and experience of internal auditors, is essential to the effectiveness of the cu/caisse's internal audit function. Effectiveness should be assessed by senior management and the Audit Committee.

The internal audit function should have a combination of expertise and resources (including outsourced) to effectively audit the cu/caisse's key processes or significant business activities. In-house auditors should be given sufficient training opportunities to understand key areas of the cu/caisse's business and processes.

Familiarity with established professional standards such as those published by the IIA (the International Standards for the Professional Practice of Internal Audit) is strongly recommended.

Areas identified under the audit plan requiring specialized knowledge not available in-house should be outsourced. When functions are outsourced, the cu/caisse's in-house internal auditor(s) or senior manager with the administrative responsibility for the internal audit function should oversee the third party's work and be capable of analyzing the third party's findings.

4.7 Independence & Objectivity

Internal auditors must be independent of the activities they are auditing.

The internal auditor's administrative reporting relationship should be with the CEO or, at a minimum, a member of senior management. To ensure independence, an internal auditor must functionally report to the Audit Committee and have unrestricted access to this Committee.



Guideline – Audit Committee & Internal Audit

The cu/caisse's senior management is accountable for developing and managing internal controls. The independence of the internal audit function should not prevent senior management from requesting input from internal auditors in relation to those internal controls. However, in order to ensure independence, an internal auditor should not be charged with developing policies, processes, or controls.

Internal auditors must be able to carry out the assignments, as directed by the Audit Committee, with objectivity. Based on the audit plan approved by the Audit Committee, an internal auditor must be able to perform assignments independently.

An internal auditor must have unrestricted access to relevant information throughout the organization and be free to report its findings and assessments internally through clear reporting lines that are defined in the Audit Committee terms of reference, internal audit charter, and cu/caisse organizational chart.

