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Anti-Money Laundering Independent Testing Regulatory Expectations and Trends

Designing AML Independent Test Plans Regulators Will Like

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Federal regulations require banks and other financial services companies to maintain *Bank Secrecy Act*/ anti-money laundering (BSA/AML) compliance. At a minimum, a compliance program provides for a system of internal controls, independent testing of BSA/AML compliance, designated personnel responsible for managing BSA compliance, and training of appropriate individuals.[1] In recent years, regulators have been paying greater attention to the second of these elements – independent testing.

Regulatory Trends

Banks, broker-dealers, money service businesses, and other financial services companies report greater examiner presence with respect to AML supervision. In addition to regulatory enforcement actions, consent orders, and penalties having become more frequent, regulatory actions and consent orders have become more complex. Many of the recent AML-related enforcement actions have included identification of deficiencies in the quality of an institution's AML independent testing program.

Regulatory guidance related to AML independent testing is limited, but the foundational requirements have been defined: independence, frequency, qualifications, coverage, and reporting. In this article, regulatory expectations for each of these requirements are summarized and suggested checkpoints are detailed for people with AML responsibilities to consider so their institutions are able to meet those expectations.

1. Independence

To maintain independence, anyone who participates in AML testing is not permitted to be involved in establishing or performing ongoing AML compliance processes. This rule applies both to staff members and to any external party to which financial institutions cosource or outsource testing responsibilities. Auditors completing the test plan should report directly to the board of directors, audit committee, or other supervisory committee of the financial institution.

Checkpoints

- If using an external party under an outsourced or a cosourced independent test plan, evaluate the independence of those approving and signing the third-party arrangement, as well as those responsible for approving the scope.
- If using in-house personnel to execute the test plan, evaluate the day-to-day reporting lines of audit personnel and verify independence when reporting audit results. Reporting lines should be evaluated for each audit segment, including full-scope audits and follow-up audits.
- During planning, establish formalized reporting lines to maintain independence throughout all phases of the test plan.

2. Frequency

The "Bank Secrecy Act Anti-Money Laundering Examination Manual" of the Federal Financial Institutions Examination Council (FFIEC) recommends that financial institutions conduct independent testing every 12 to 18 months, or more often if required by a risk profile. An acquisition or a money laundering incident, for example, could trigger the need for more frequent testing.

When determining the frequency of independent testing, it's important for an organization to consider the scheduling of other reviews, such as regulatory examinations and self-testing programs, as well as strategic initiatives in the business unit. By considering these factors, the independent test plan can be executed efficiently and structured to provide the most value to the financial institution.

Checkpoints

- Formalize annual audit planning and assessment of risk. Include an evaluation of planned business unit initiatives, as well as planned self-testing and regulatory examination schedules.
- Schedule periodic check-in and planning meetings with business units.
- Document the supporting rationale and appropriateness for any delayed audit segments.
- Evaluate cosourced or outsourced testing alternatives if the level of dedicated resources limits the ability to meet planned testing schedules.
- Evaluate audit segmentation and partial testing coverage for areas that warrant testing delays.

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3. Qualifications

Examiners are putting greater emphasis on the qualifications of the individuals performing the AML independent testing. Qualification requirements extend to both those carrying out internally executed test plans and those conducting outsourced test plans. Testing should be executed and supervised by people with expertise in the subject matter, auditing requirements, and institution type. Experience with specific AML systems or models is also a primary consideration when determining an individual's qualifications.

Examiners consider not only an individual's audit experience but also his or her professional credentials, such as those offered by the Association of Certified Anti-Money Laundering Specialists.

Checkpoints

- Focus on providing audit personnel with continuing professional education.
- Obtain documentation of AML certification earned by audit personnel.
- To increase the qualifications of the planned audit team, consider and evaluate cosourced or outsourced testing alternatives with firms that have subject-matter expertise.
- Evaluate the resumes and qualifications of any cosourced or outsourced audit personnel.

Both internally executed and outsourced testing should be conducted and supervised by people with expertise in the subject matter, auditing requirements, and institution type. Experience with specific AML systems and models is also a consideration.

4. Coverage

One of the biggest challenges financial institutions face related to independent AML testing is demonstrating appropriate audit coverage. Institutions struggle to demonstrate that audit coverage exists for all applicable risks and to retain sufficient documentation to support the decisions made when defining the audit scope. Although the following list of risks or factors to be considered during an independent AML audit is not all-inclusive, areas of increased examiner scrutiny include:

Planning. It is important for the audit team to develop a scoping document that details the areas that are in scope and the testing processes to be applied to each of the areas. To determine the scope, the team needs to consider various sources, including conversations with management, the AML risk assessment, results of prior regulatory or independent exams, self-testing programs, and relevant metrics. It is equally important to fully document and support all scoping considerations and decisions.

Fieldwork. Regulators often review and use audit work papers to conduct examinations. Therefore, it is important that work papers be structured to easily demonstrate the audit team's work. One way to do this is to align the work papers to risk factors or processes highlighted in the FFIEC examination manual. Examiners should be able to tie work papers directly back to the agreed-upon scope developed during the planning phase.

AML systems and models. It is critical for AML auditors to have experience with the AML systems and applications that the institution uses. By understanding system capabilities, AML auditors will be able to better evaluate how a financial institution has chosen to deploy or integrate a given AML system. This knowledge enables auditors to provide the bank with recommendations for improving existing customer or transactional monitoring processes.

Suspicious activity monitoring. Auditors need to review the financial institution's transaction monitoring program, decision-making processes related to suspicious activity reports (SARs), and process for completing and filing SARs. Objectives to consider having in an audit test plan include the following:

- To check that the bank has adequate monitoring coverage for all products, services, and customer types, the auditor should assess the bank's methods for identifying potentially suspicious activity.
- The auditor should confirm that the institution has developed appropriate standards and guidelines for reviewing alerted transactional activities.

- The auditor should determine whether the organization maintains appropriate processes for completing and filing SARs in a timely manner.
- To independently confirm that the institution's program for monitoring suspicious and unusual activity effectively identifies high-risk customers and transactions, the auditor should carry out transaction testing procedures.

Management of high-risk customers. When evaluating how a bank identifies high-risk customers, auditors should review the organization's processes for collecting customer due diligence information, analyzing customer risk, and performing enhanced due diligence for high-risk customers. Specific items that should be considered in an audit test plan include the following:

- When evaluating an organization's customer due diligence program, an auditor should determine whether the collected information would be sufficient for an organization to identify potentially high-risk customers.
- To determine whether the factors being considered are appropriate and comprehensive, the auditor should evaluate the bank's processes to identify new or existing customers that pose a higher level of risk to the organization.
- The auditor should evaluate the enhanced due diligence processes applied to high-risk customer relationships. An enhanced due diligence program should be designed to mitigate the risk posed by customers previously identified as high risk.

Checkpoints

- Develop formal planning documents that summarize scoping decisions and conclusions about planned audit coverage.
- Develop standardized work papers to account for sampling methodology, including population selection criteria.
- Use an established audit sample guide or other regulatory guidance related to sampling.
- Use AML risk assessments and organizational charts as checkpoints for audit coverage.
- Verify that testing processes account for the identification of new products, services, customer types, and entities.
- Establish standardized AML audit programs to verify consistency among executed test plans.

5. Reporting

Written reports should clearly outline the audit scope, objectives, and reporting exceptions – if any – to allow the reader to reach an informed conclusion on the adequacy of the AML compliance program. An audit rating scale may be used to document the conclusion reached from the AML audit. Reports should be issued in a timely manner and distributed to important stakeholders and parties independent of the AML compliance program.

Checkpoints

- When applicable, thoroughly document in the audit work papers the rationale for not reporting certain issues that have been identified.
- Include an executive summary or a conclusion section in audit reports.
- Provide risk analyses or ratings – high, moderate, or low – for identified audit issues.
- Include a root-cause analysis section in exception work papers or audit reports.
- Incorporate into the report action plans and other responses by management to audit observations.

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[1] See OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance,” Oct. 30, 2013, http://occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html, and SR 13-19, “Guidance on Managing Outsourcing Risk,” Dec. 5, 2013, http://www.federalreserve.gov/bankinforeg/srletters/sr1319.htm#access

Focus on Quality

The emphasis regulatory agencies place on independent testing when assessing BSA/AML compliance is designed to help financial institutions prevent money laundering, a practice long associated with terrorist financing, drug trafficking, tax evasion, and other serious crimes. By focusing on the quality of their AML independent testing programs, banks can comply better with today’s heightened regulatory expectations and mitigate the risk of criminals using the organizations to perpetuate their deeds.

“Anti-Money Laundering Independent Testing – Regulatory Expectations and Trends,” a recording of a Nov. 5, 2014, Crowe webinar presentation by Maureen Hellstrom and Gary Lindsey, is available at http://www.crowe.com/ContentDetails.aspx?id=9950.

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