

## COMMUNIQUE ON PRINCIPLES REGARDING THE INTERNAL AUDITING SYSTEMS OF BROKERAGE HOUSES

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### SECTION ONE

#### Purpose, Scope, Legal Basis and Definitions

##### Purpose and Scope

**Article 1-** The purpose of this Communiqué is regulating the fundamental principles and procedures to be adopted by brokerage houses in the establishment of their internal auditing systems which would help them monitor and control all the risks that they are exposed to.

##### Legal Basis

**Article 2-** This Communiqué has been issued pursuant to the amended Article 34 of Capital Markets Law No: 2499 July 28, 1981.

##### Definitions

**Article 3-** For the purposes of this Communiqué, the following definitions shall apply:

- Board** : The Capital Markets Board of Turkey.
- Internal Audit System** : The integrated process of both the internal control system and the inspection/ surveillance system.
- Internal Control System** :
  - o The organizational plans and all principles and procedures relating thereto, adopted by brokerage houses in order to, ensure the operation of all activities of brokerage houses including those of their field offices in line with management strategies and policies in an orderly, efficient and effective way in accordance with current rules and regulations; to ensure the

integrity and reliability of recording and account keeping systems and accessibility of the information in the data systems in a timely and accurate manner and to ensure detecting and preventing errors, fraudulent activities and irregularities.

- Inspection System** : Depending on the organizational structure and on the needs of management of the brokerage house, inspectors examine whether the brokerage house has adopted policies and strategies that are in compliance with the related legislation and regulations. Examination is conducted independently from the daily routine operations of the brokerage house and all areas of operations, including the internal control system and all functions of the departments within the brokerage house get inspected and evaluations are made related to these areas of operations. Furthermore, any evidence and findings that is used in evaluation should be obtained as a result of reporting, supervising and inspecting the brokerage house.
- Senior Management** : General manager, deputy general managers, and director of each department within the brokerage house.
- Internal Audit Department** : Staff employed within the internal control department of the brokerage house and inspectors.
- Inspector** : Member of staff who is responsible for controlling and inspecting the adherence of intermediary institution's operations to the provisions of the Capital Markets Law, related legislation, regulations, corporate statute of the brokerage house and any applicable written procedures for internal control.
- Internal Audit Program** : Documents that explain in detail the scope and nature of the audit process

to be conducted within each separate department at the brokerage house. These documents shall take into account the risks that the brokerage house is exposed to during the conduct of the internal audit.

- Internal Control Department** :. Department that organizes, manages and coordinates the brokerage house's internal control procedures
- Personnel in Internal Control** : Member of staff at the brokerage house, other than inspectors, who are authorized by the management of the brokerage house to continuously monitor, examine and control the activities of the brokerage house.
- Expert Personnel** : Employees of the brokerage house whose attributes are described in Article 5 of the Communiqué Serial: VIII, No:34 on Principles Regarding Licensing and Registration for Professionals Engaged in Capital Market Activities" as published in Official Gazette dated 11 august 2001 No: 24490 .

## **SECTION TWO**

### **Fundamental Principles Regarding the Internal Auditing System**

#### **Internal Audit System**

**Article 4-** Brokerage houses shall establish, maintain and improve their internal audit systems in accordance with the organizational structure of the brokerage house in order to be able to cope in a sufficient, efficient and sound manner with the changing conditions of operations.

#### **Internal Control System**

**Article 5-** All brokerage houses are required to keep in writing information about the policies and procedures for internal control systems adopted at brokerage houses. The decision of the board of directors of the brokerage house is needed for the approval and effectiveness of these written procedures. All operations that are within the scope of the internal control function shall be carried out by the board of directors, the brokerage house's personnel at all levels and by the personnel who is responsible for conducting the internal audit of the brokerage house.

Internal control activities of brokerage houses shall be arranged and maintained as an inseparable part of the routine daily activities in a manner that would provide the opportunity to monitor the defined risks.

In order to ensure the adoption of an efficient internal control system, the authority and responsibilities of all personnel concerning carrying out their duties compatible with the written procedures and reporting of activities which are inconsistent with professional ethics or are against the brokerage house policies or are illegal to the senior management shall be set out in written form and notified to related personnel. Procedures for the brokerage houses shall be established in a manner that would ensure the participation of personnel from all levels in the internal control system of the brokerage house.

### **Authority and Responsibility**

**Article 6 -** The authorities, duties and responsibilities of the manager and personnel from all levels of the brokerage house shall be determined and made available in writing. New employees recruited in the brokerage house shall be provided with a job description of their duties, authorities, and responsibilities and work flow procedures in return for their signature. In the same manner, the modifications related to the duties, authorities, responsibilities and work flow procedures shall be delivered to the personnel in return for their signature.

### **Responsibilities of the Board of Directors**

**Article 7-** The Board of Directors;

a) Takes all the necessary measures in order to establish and maintain an efficient internal audit system and internal audit program which is well suited to the institutional structure of the brokerage house. The internal audit system shall be implemented within the managerial structure of the brokerage house and shall define the principles and procedures in relation to the managerial structure, quality maintenance and human resource issues of the internal audit system.

b) Approves significant strategies and policies pertaining to the internal control activities and procedures of the brokerage house and investigates their implementation on a regular basis

c) Regularly reviews the evaluations made by the senior management, the internal audit department or by the organization that is responsible for conducting the independent audit of the brokerage house in connection to the internal auditing system, assesses the proposals that are made by the internal auditing department or by the organization that is responsible for conducting the independent auditing of the brokerage house in connection to strengthening the internal auditing and controls and checks whether these proposals and demands are taken into account by the senior managers or not.

d) Takes all the necessary measures for improving the professional and ethical standards of the brokerage house. Also, ensures that personnel from all levels adhere to these standards.

### **The Member of the Board of Directors Responsible For Internal Control**

**Article 8** –The board of directors shall appoint one of its members, who is not in charge of any other department within the brokerage house, to be in charge of the internal control function as the 'Board Member in Charge of Internal Control'

The member of the board of directors responsible for internal control shall undertake the following;

a) Ensure that the internal control system of the brokerage house has been implemented in accordance with the appropriate regulations, professional rules and written procedures of the brokerage house. Determine and manage the risks that can arise and provide information on these issues to the Board of Directors.

b) Determine the level of risk that is acceptable in accordance with the regulations of the Board and policies of the brokerage house; approve the internal control program prepared by the internal auditing department of the brokerage house. He/she is responsible for preparing the policies and procedures for internal control and for reporting these to the board of directors for approval.

c) Assess the accuracy in achieving the beforehand set internal control targets. Ensure that the activities conducted within internal control are made in an independent, objective and reliable manner.

### **Allocation of Duties and Assignment of Responsibilities**

**Article 9** – In order to establish and operate a sound and efficient internal control mechanism, the brokerage house's operations shall be functionally separated from each other. In this context, the authorizations and responsibilities listed below shall each be granted as separate functions and shall not be designated to the same member of staff:

a) During the lending process; obtaining documents which help review and assess the creditworthiness of the applicant ; assessment on the sufficiency of these documents ; assessment and if applicable approval of the creditworthiness of the applicant and, monitoring the customer after the loan has been extended.

b) In connection to payments, the approval for the settlement of payments as opposed to the actual payments having taken place,

c) In connection to securities trading, the actual settlement of a transaction and the recording of the transaction,

d) In connection to the physical delivery of securities, the approval for the transaction to take place and the actual execution of the transaction,

The internal audit department shall determine the functions which may pose risks to the brokerage houses and shall allocate each of these

functions and responsibilities to separate members of staff so as to enable cross checks when required.

### **Workflow Procedures**

**Article 10** – In order to efficiently perform the tasks within internal control, brokerage houses, shall prepare and implement their own workflow procedures in written form, by addressing at a minimum, the below stated issues:

- a. Opening accounts for the customer,
- b. Delivering capital market instruments to the customer and from the customer de facto,
- c. Transactions of electronic fund transfer (EFT) and money orders that originate from the customer or that are made to the customer,
- d. Money received from the customer and payments made to the customer,
- e. Internal transfers of capital market instruments,
- f. The transfers of capital market instruments extended to parties outside the brokerage house or that arise from outside of the brokerage house,
- g. Internal cash transfers
- h. Transmission and execution of customer orders,
- i. Managing and creating the portfolio of the brokerage house,
- i. Recording transactions into the accounting system,
- j. Sending account statements and other relevant documents to customers as required by the regulations of the Board,
- k. Defining risks, assessing the level and limit of risks and controlling these risks,
- l. Portfolio management functions,
- m. Investment consultancy services
- n. Transactions of repurchase (repo) and reverse repurchase,
- o. Public offerings,
- ö. Financial statements and reports to be prepared in connection to the financial structure
- p. Methods and procedures for safe-keeping documents,
- r. Fundamentals regarding the personnel of the brokerage house to undergo transactions,
- s. Methods to be adopted in cases where there wrongdoings in a transaction,
- t. Personnel policy,
- u. Security of information technology systems
- ü. The working methods and bases of the internal audit unit.

### **Minimum Issues that Must be Included in the Workflow**

**Article 11-** In accordance with Article 10, all brokerage houses are obliged to include the below stated issues in their workflows:

- a) When opening a new account the operations that must be conducted and the documents that must be prepared in relation to customer identification, signing the contract of engagement relevant to the account being opened and completion of the customer identification form shall be specified, Workflows in this context will include as a minimum prior to the opening of the account; the provision of the customer's identification card, driving license, passport or any other official document which can be used for identification purposes or copies of these documents that are approved by notary public by the customer to the brokerage houses personnel,
- The provision of legible copies of the originals or approved copies by the notary public,
- Signing and completing the name and address sections of the contract of engagement and of the identification forms that include the risk and return preferences of the customer and the signature cardboards by the customers own handwriting which is to be written with inerasable writing tools.
- Principles for checking these procedures.

b) Documents that would be required and procedures that shall be adopted during the actual delivery of cash and/or shares from the brokerage houses main or field offices to the customer or by customer to the brokerage houses main office or field offices shall be determined. The minimum amount of cash that can be held in the vault in the brokerage house's main or field office shall be determined. The amount of lump sum payment that can be paid from the account of the brokerage house or that can be accepted from the customer shall be determined.

c) Documents that would be required in the execution of an electronic funds transfer (EFT) payment to be made by the brokerage house on behalf of its customers account shall be clearly determined. In addition to other procedures, the work flow procedures are required to state the date as was requested by the customer, the signature of the customer, contact details including the telephone number of the customer etc that should be in the customer's instruction. With regards to the execution of an electronic funds transfer (EFT), money orders and securities payments, the signatures of each customer shall be properly verified and the approval procedures with respect to the authorities defined in the job outline shall be examined. The customer shall be contacted via phone in order to obtain the customers approval and the relevant original copies of the required documents.

d) The necessary steps that shall be taken and the documents that shall be disclosed during the cash and securities transfer settlements among the customers of the brokerage house shall be determined.

In addition to other procedures, the workflows are required to state the date as was requested by the customer, the signature of the customer, contact details including the telephone number of the customer etc that

should be in the customer's instruction. With regards to payments of cash and or securities, the signatures of each customer shall be properly verified and the approval procedures with respect to the authorities defined in the job outline shall be examined. The customer shall be contacted via phone in order to obtain the customers approval and the relevant original copies of the required documents.

e) The documents that would be required in the process of executing the brokerage houses customers' orders shall be determined.

f) Activities and documents that would be required for drawing up the financial statements or reports of the brokerage house shall be determined. Workflows shall include besides other issues, the fundamental principals for making confirmation on the entries of assets and liabilities, monitoring the total asset value of mortgages, the value commitment that are not recorded and guaranteed or blocked amounts. Moreover, the fundamental principles for monitoring the total value of assets and liabilities and calculating whether there are sufficient provisions to cover for any possible expenditure, loss or debts shall also be included.

g) The relevant principles about the procedures of sending account statements, customer securities flow chart and the other documents that are compulsory by the regulations of the Board shall be defined. These principles, shall also set forth issues about procedures to be adopted in order to ensure that the account statements reach the customer, and that any returned account statement be properly delivered to the customer, and that the written approval of the customers be taken on a periodical basis about the transactions realized at their accounts, and fulfillment of the extract sending to the customer from one center except the units related with customer transactions.

h) Within the framework of the limits of the legislation and the risk policies of the brokerage house, an alert system shall be established in order to signal a warning in cases where the level of exposed risk has exceeded its limit. The alert system shall assess, besides other issues, whether there is sufficient cash or securities in the relevant customer account during the execution of an order and whether margin trading and short sales are made within the limits defined in the risk policies regulated by the Board and the brokerage house.

i) The means for recording all the activities of the brokerage house and confirming actual and recorded transactions shall all be clearly defined. All confirmation activities that are to take place on a daily, weekly or monthly basis shall be clearly defined in the workflow.

j) Principles on issues regarding recruitment, appointment, promotion and deposition of staff and employee rights shall be defined.

k) The brokerage house shall authorize its staff members by taking into consideration their job definitions and by paying special attention to the security of its information systems. All issues with respect to authorizations and the assurance of information systems involving back up transactions shall be clearly determined.

**SECTION THREE**  
**Principles Related to the Inspection Department**

**Inspection**

**Article 12-** The inspection of a brokerage house encompasses the surveillance of all departments of the brokerage house. Each brokerage houses is obliged to establish an internal inspection department and employ a sufficient number of inspectors to work exclusively at this department. Brokerage houses, which are allowed to use banks or private financial institutions as agencies, may use the inspection department of banks or private financial institutions limited with the capital market activities performed by their agencies.

The inspection department shall report directly to the board of directors and shall work in close connection with the board of directors. The board of directors may delegate its authority in this department to at least two members of the board of directors except to the general manager.

Inspectors shall be responsible for auditing and examining the level of compliance of activities performed by the brokerage house (both its headquarters and representative offices) with the provisions of the capital market legislation, the corporate statute of the brokerage house, and with the written procedures regarding internal control.

The audit process shall include on-site examination of all material information, accounts, records, documents kept within brokerage houses and all other issues, which could affect the safety of the personnel, and the brokerage houses. Also, the audit process shall include off-site examinations depending on the brokerage houses organization and nature of its business conduct. When deemed necessary, launching an investigation, taking testimonies, asking for defenses, seizing documents and information, and when deemed necessary proposing to the board of directors of the brokerage house the suspension of the involved members of staff from their duties until the examination process is fully completed.

The results of the inspectors' investigation shall be documented in reports and be kept at the headquarters of the brokerage house. Inspectors shall present these reports to the board of directors of the brokerage house. It is mandatory that these reports and all relevant documents pertaining to these reports be preserved for at least 5 years, or in cases where there is a judicial dispute, be kept until the resolution of the dispute.

In cases where the inspection department observes the emergence of a situation that imposes extraordinary consequences or may weaken the financial status of the brokerage house, the report to be prepared shall be presented to the board of directors as soon as possible, and a copy of this report shall be sent to the Board.

**Duties of the Director of the Inspection Department:**

**Article 13-** In addition to inspection and its coordination, the director of the inspection department will:

a) In accordance with the regulations and objectives of the organization, prepare a risk-based internal control program, which would refer to the level of acceptable risk as specified by the board member as the basis point.

b) Define sources (software, hardware, working hours/number of specialists) that would be needed for the actual implementation of the approved internal control program; calculate the effects of all anticipated restrictions on the source and present this for the approval of the relevant board member

c) Monitor the workflows at all stages and, if necessary, inform the related board member about the need for change.

d) While performing his/her duty, when deemed necessary, the director may request assistance to maintain a healthy internal control system, in cases where there has been a lack of support and when the information provided was insufficient, he/she will explicitly state these issues in the report.

### **Principles for the Work of Inspectors**

**Article 14-** Inspectors are authorized to have access to all documents. The authority of inspectors to access these documents shall be clearly stated in the written policies.

Inspectors shall have a systematic and sufficient record keeping system related with their duties.

Inspectors shall keep records by drawing up and filing working papers. Working papers are requisite documents that demonstrate the methods and techniques are used for inspection, the inspection tests applied, and state the results of the investigation.

### **Appointment and Resignation of the Inspector and the Board Member Responsible for Inspection and Internal Control**

**Article 15-** Inspectors shall commence work upon the decision of the board of directors.

If an inspector or board member responsible for internal control gets discharged for any reason or resigns, then the Board must be notified in writing within 15 days by the brokerage house and the pertinent inspector or board member about the reasons for the resignation or discharge.

### **Principle of Professional Proficiency**

**Article 16-** Brokerage houses are obliged to require professional proficiency in the inspectors that they choose to employ at their inspection department. Professional proficiency implies a university graduate and post-graduate degree and also implies sufficient professional experience to perform the investigation.

Candidates for inspector positions are required to be graduates from universities providing 4 years of education with majors in economics, business management, public administration, accounting, finance and law.

In addition to higher education, candidates are required to have had at least 3 years of professional experience in capital markets, accounting, taxation, banking and foreign exchange, analytical management and organization, auditing or law.

#### **Remuneration and Employee Personal Rights**

**Article 17-** The board of directors determines the remuneration and other personal employee rights of the inspectors.

#### **Objectivity**

**Article 18-** Inspectors shall not participate in any activity or be involved in any relationship that would impair the impartial conduct of their business and they shall refuse tasks and responsibilities that could impair the impartiality conduct of their business. During the inspection activities, if a condition that impairs objectivity arises, the inspector shall be obliged to inform the head of the inspection department about this case. Furthermore in the course of any other activities in cases where a condition that impairs the objectivity of the inspector arises the inspector shall be required to disclose such conditions along with the results of the related task.

#### **Confidentiality**

**Article 19-** Inspectors shall keep information acquired in the course of their duties confidential. They shall not under any circumstances; use such information for their personal benefits or in any manner that would violate the law or conflict with the ethical objectives of the organization.

#### **The Relation between Independent External Auditing and Internal Auditing**

**Article 20-** The independent auditing company shall verify the adherence of the brokerage houses practices to the internal control procedures of the brokerage house. Moreover, the independent auditor is obliged to state in a report his/her opinion about how well the brokerage house adheres to the internal control systems policies and procedures.

### **SECTION FOUR**

#### **Principles Related to the Internal Control Department**

##### **Internal Control Department**

**Article 21-** Brokerage houses may establish internal control departments and employ a sufficient number of personnel in line with the structure and scope of their activities in order to monitor, assess and control the reliable operation of their functions via internal control mechanisms. The control personnel who will be responsible for control activities on a permanent basis shall not assume any other responsibilities besides internal

control. In doing so, care should be given to act in accordance with the policies and procedures established in the internal control department.

The internal control department shall monitor and control the adherence of practices to the policies and procedures of the internal control system. The internal controllers shall request information about the internal control activities, control or review various internal control documents and tools by general or specific means of monitoring, and shall make examinations thereof. Internal controllers shall state their findings in reports, or shall produce reports that would provide warnings and inform the relevant departments. Internal controllers shall be authorized to request additional information from the personnel of the brokerage house on issues that have been monitored, reviewed or controlled. Furthermore internal controllers shall be authorized to seek the opinion of the personnel of the brokerage house where they consider necessary, and shall be able to provide warnings to inspection or other related departments.

In cases where a separate internal control department has been established, the tasks concerning internal control to be carried out by the inspection department shall be performed by the internal control department. The activities to be performed by the head of the inspection department in relation to internal control activities shall be performed by the head of the internal control department. The inspection department shall monitor the activities of the internal control department.

Internal control division reports directly to the board member responsible for the internal control function.

#### **Rules Applicable to the Personnel Working in Internal Control**

**Article 22-** Issues mentioned in this Communiqué regarding the appointment, termination of contracts, professional proficiency, remuneration, employee personnel rights and working procedures and principles for inspectors are also applicable to the personnel working within internal control.

#### **Overruled Provisions**

**Article 23-** Articles 32, 33, 34, 35 of The Communiqué Serial V No: 46 on "The Principles on Intermediary Activities and Intermediary Institutions" published in the Official Gazette dated 09 July 2000 No: 24163 has been overruled.

#### **Entry into Force**

**Article 24-** Articles 10 and 11 of this Communiqué shall enter into force 3 months after the date of its publication and all other articles shall enter into force at the day of its publication.

#### **Execution**

**Article 25-**The provisions of this Communiqué shall be executed by the Capital Markets Board.