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## Directive 17c

### **Internal Audit at a Payment-System Operator**

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## **1. Introduction**

In accordance with Section 8 of the Payment Systems Law, 5768-2008 (hereinafter: “the Payment Systems Law”), an operator of a controlled payment system shall formulate rules that will ensure the stability, efficiency, and sound functioning of the system.

In accordance with Principle 2 of the Principles for Financial Market Infrastructures (PFMI), published in 2012 by the Committee on Payment and Settlement Systems of the BIS (CPMI) and the International Organization of Securities Commissions (IOSCO), a financial-service infrastructure (FMI) should have have an effective internal audit function, with sufficient resources and independence from management to provide, among other activities, a rigorous and independent assessment of the effectiveness of an FMI’s risk-management and control processes.

Internal audit is part of the ongoing monitoring of a payment-system operator’s internal controls because it is a function that delivers an independent assessment of the adequacy of, and compliance with, policy and procedures. As such, the internal-audit function gives management and the Board of Directors efficient and effective assistance in discharging their responsibilities.

This Directive deals with regulating the internal-audit function, an existentially crucial player for sound corporate governance at a controlled payment-system operator, in order to apply the general principles set forth in the PFMI.



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## 2. Definitions

<b>“Governance” or “corporate governance”—</b>	the set of relationships among a payment system’s owners, its Board of Directors (or equivalent), its management, and other relevant parties, including participants, authorities, and other stakeholders (such as participants’ customers, other interdependent FMs, and the broader market);
<b>“Officer”—</b>	as defined in the Companies Law, 5759-1999;
<b>“Relative”—</b>	as defined in the Companies Law, 5759-1999;
<b>“Internal Audit Law”—</b>	the Internal Audit Law, 5752-1992;
<b>“Internal audit”—</b>	independent and objective assurance and consultation activity that is designed to create added value and improve the payment system’s actions; it helps the payment system to attain its goals by taking a systematic and institutionalized approach toward evaluating and improving the efficacy of risk-management, control, oversight, and corporate-governance processes;
<b>“Internal-audit function”—</b>	an organizational unit that carries out internal-auditing duties;
<b>“Internal auditor”—</b>	head of the internal-audit function of a payment-system operator;
<b>“Internal-audit-function staff”—</b>	payment-system staff who are subordinate to the internal auditor and carry out internal-auditing tasks;



**“Internal control”—**

the totality of processes by management and other staff to achieve adequate confidence to attain the payment system’s objectives and comply with the directives, statutes, and regulations that apply to the payment system;

**“Outsourcing of internal audit”—**

an agreement between the payment system and an outsource provider for the delivery of internal-audit services;

**“First line of defense”—**

managements of the lines of business, including support functions, that are responsible for detecting, evaluating, measuring, monitoring, mitigating, and reporting risks built into in products, activities, processes, and systems for which they are responsible, and for managing an appropriate control environment in the context of risk management.

### **3. Incidence**

- 3.1 This Directive shall apply to every payment-system operator that the Governor has declared a controlled payment system or a designated controlled payment system.
- 3.2 The Bank of Israel may, as circumstances shall indicate, establish certain instructions, different from those specified below, that shall apply to a certain payment-system operator, and may exempt a payment-system operator from the incidence of certain sections of this Directive.
- 3.3 In a payment-system operator that has no Board of Directors function due to its statutory, legal, or organizational structure, the obligations of a Board of Directors established in this Directive shall apply to the function that corresponds to a Board of Directors or the



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highest function that bears responsibility for the business and solidity of the payment-system operator.

- 3.4 In respect of systems that are run by the central bank, this Directive shall apply as tailored to the corporate-governance structure of the central bank.<sup>1</sup>

#### **4. Board of Directors and senior management responsibilities**

- 4.1 A payment-system operator shall appoint an internal auditor who shall head a permanent internal-audit function.
- 4.2 The Board of Directors of a payment-system operator is responsible for:
- 4.2.1 ascertaining the existence of, and applying oversight to, an adequate and effective internal-audit function;
  - 4.2.2 approving the letter of appointment of the internal-audit function, in which the status and powers of said function shall be defined; the relevant instructions laid down in the Internal Audit Law shall be binding;
  - 4.2.3 appointing an audit committee to supervise the internal-audit function;
  - 4.2.4 reviewing, the activity of the internal-audit function and discussing the findings presented at least once per year;
  - 4.2.5 ascertaining the existence of suitable methods for monitoring compliance with statutes, regulations, internal policies, and regulation by Oversight;
  - 4.2.6 ensuring the independence, objectivity, and efficacy of the work of the internal-audit function;
- 4.3 The senior management of a payment system is responsible for:
- 4.3.1 taking all necessary measures to enable the payment-system operator to rely, on an ongoing basis, on an internal-audit function that is adequate for and suited to the size of the operator and the characteristics of its activity. Said measures

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<sup>1</sup> In this context, in August 2015 the BIS published a document titled “Application of the Principles for Financial Market Infrastructures to Central Bank FMIs,” with guidelines as to how the PFMI rules should be applied to payment systems run by a central bank.



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include allocation and availability of resources, including staff, that are suited to the internal-audit function for the attainment of its objectives.

- 4.3.2 ascertaining that the internal-audit function will be impartial and independent of the activities and ongoing internal-control processes of the controlled entity.
- 4.4 The Board of Directors and senior management of a payment-system operator are responsible for ensuring that the internal-control and -auditing system is adequate and effective even if internal-audit operations are outsourced.

## **5. The internal auditor**

- 5.1 The internal-audit function shall be headed by the internal auditor.
- 5.2 The internal auditor shall be an employee of the payment-system operator who has the status of a member of management, is directly subordinate to the chair of the Board of Directors, and reports to the Board of Directors by means of the audit committee.
- 5.3 A person shall neither be appointed nor serve as the internal auditor of a payment-system operator unless he or she meets all conditions set forth in the Internal Audit Law in respect of suitability.
- 5.4 The internal auditor shall be empowered to communicate directly, and at his or her initiative, with members of the audit committee, the chair of the Board of Directors, members of the Board of Directors, and the CPA-auditor, in a manner that shall be determined in the letter of appointment of the internal-audit function.
- 5.5 The internal auditor shall be responsible for carrying out the following:
  - 5.5.1 acting in accordance with accepted professional standards and ensuring compliance with accepted standards of internal auditing;
  - 5.5.2 ascertaining the existence of, and compliance with, written policies and working procedures for staff of the internal-audit function;
  - 5.5.3 ensuring the professional fitness of internal-audit function staff;
  - 5.5.4 apprising the audit committee of all audit reports carried out in the course of the year and advising the chair of the audit committee in regard to material internal-



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audit reports that should be presented in full to the audit committee for discussion;

- 5.6 The internal auditor shall be appointed by the Board of Directors pursuant to nomination by the audit committee;
- 5.7 The term of service of the internal auditor shall be neither terminated nor suspended except per decision of the Board of Directors, in accordance with a motion by the audit committee and subject to rules established in the Internal Audit Law.
- 5.8 In the event of termination or suspension from position, the internal auditor shall be given an adequate opportunity to present her or his case at a meeting of the Board of Directors, after the directors are served with prior notice of the intent to terminate or suspend the internal auditor and of the intended meeting. The decision of the Board of Directors shall be made by a two-thirds majority.
- 5.9 If the internal auditor decides to resign his or her post, he or she shall serve the Board of Directors and Oversight with notice to this effect and shall specify the motives behind his or her resignation.

## **6. Duties and frame of the internal-audit function's work**

- 6.1 The scope of the internal-audit function's work shall include every activity or entity at the payment-system operator and said function shall be capable of carrying out its task, at its initiative, in all departments and functions of the payment-system operator and of the payment system.
- 6.2 The internal-audit function shall audit, *inter alia*, the soundness of operations and compliance of the payment-system operator, its staff, and its officers, in terms of:
  - 6.2.1 compliance with the provisions of law and Oversight directives;
  - 6.2.2 implementation of Board of Directors and management decisions;
  - 6.2.3 ethics;
  - 6.2.4 upholding the efficiency and stability of the system, within the generality of which:



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- 6.2.4.1 the suitability and effectiveness of the internal-control system;
  - 6.2.4.2 the effectiveness of risk-management procedures and processes and the risk-assessment methodology;
  - 6.3 As they are being performed and when they are concluded, internal-audit reports shall be presented to the chair of the Board of Directors, the chair of the audit committee, and other relevant officials, at the discretion of the internal auditor.
  - 6.4 Once per year, a final report on the internal-audit work and its correspondence to the annual work plan shall be presented to the audit committee and the Board of Directors for discussion.

## **7. Independent auditing of the internal-audit function's work**

- 7.1 At least once every five years, the activity of the internal-audit function shall be reviewed by a certified and independent outside reviewer appointed by the audit committee.
- 7.2 The findings of said review shall be presented to the chair of the Board of Directors and the chair of the audit committee, with a copy to the Chief Executive Officer.
- 7.3 The internal-audit function shall carry out an annual internal-quality review and report the results to the audit committee.

## **8. Objectivity and avoidance of conflict of interest**

- 8.1 No person shall be appointed to the staff of the internal-audit function, and the service of no staff member shall be terminated, except with the consent of the internal auditor.
- 8.2 The internal auditor and the internal-audit function staff shall act in an objective and unbiased manner and shall not enter into a conflict of interest with the payment-system operator or with the payment system.
- 8.3 No person who is an interested party in the payment-system operator, an officer in the payment-system operator, or a relative of one of these, and a CPA-auditor or his or her





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agent, shall serve as an internal auditor or as a staff member of the internal-audit function.

- 8.4 The internal auditor and the internal-audit function staff shall not hold any position external to their duties with the payment-service operator that creates, or is liable to create, a conflict of interest with their duties with the internal-audit function.
- 8.5 The internal-audit function staff, for the purposes of the internal audit, shall accept instructions in auditing affairs only from the internal auditor or someone acting on his or her behalf.
- 8.6 The internal auditor and the internal-audit function staff shall have no additional duties with the payment-system operator with the exceptions of Public Compliance Officer or Staff Compliance Officer, and this only if said exception has no injurious effect on the discharge of their principal duties as required.
- 8.7 Remuneration of internal-audit function staff shall be consistent with the objectives of the internal-audit function and shall not be made contingent on the performance of the payment system except under a general remuneration policy that applies to all payment-system staff.
- 8.8 The internal-audit function shall not engage in first-line-defense activity.

## **9. Tendering of opinion on an internal audit**

- 9.1 Notwithstanding the provisions of this Directive, senior management, for the purpose of maximizing work efficiency, may ask the internal-audit function to tender an opinion on specific matters related to internal-control principles in various matters, in consideration of the following, inter alia:
  - 9.1.1 material new organizational measures at the payment-system operator;
  - 9.1.2 the onset of a new activity;
  - 9.1.3 establishing or reorganizing technological systems and infrastructures.
- 9.2 Said tendering of opinion shall not impair the responsibilities, independence, and performance of duties of the internal-audit function, including:



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- 9.2.1 Ultimate responsibility for development and application shall remain in management's hands.
  - 9.2.2 The internal audit shall not be enjoined against auditing the matter on which the opinion is given.
  - 9.2.3 The internal-audit function shall neither approve nor formulate nor apply operational policies or procedures associated with advice that it offers.

## **10. Professional qualifications**

- 10.1 Staff members of the internal-audit function shall be adequately up to date in their knowledge of auditing methods and payment-system activity.
- 10.2 The expertise and professional qualifications of internal-audit function staff shall be maintained with several considerations in mind:
  - 10.2.1 the nature of the duties and capabilities of the function's staff: to gather information, communicate in writing and orally with various players in the payment system for the performance of auditing tasks; identify and evaluate deviation from accepted standards; identify existing or potential problems; and broaden auditing procedures accordingly;
  - 10.2.2 developments in the technical complexity of payment-system activities;
  - 10.2.3 broadening the range of tasks that the internal-audit function needs to assume due to developments at the payment system.

## **11. Letter of appointment**

- 11.1 A letter of appointment for the internal-audit function shall be worded.
- 11.2 Said letter of appointment shall relate to the following matters at the very least:
  - 11.2.1 the scope of the internal auditor's activity vis-à-vis all functions and duties of the payment-system operator;



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- 11.2.2 the status of the internal auditor in the organization and her or his powers, responsibilities, and relations with other control functions;
  - 11.2.3 the conditions and situations in which the internal auditor may be asked to offer advice or carry out special tasks.
  - 11.3 The letter of appointment shall secure the internal auditor's right to demand and receive direct access to any document, information, and asset, and to communicate with any member of the payment-system operator's staff for the purpose of vetting any activity or entity of the payment-system operator.
  - 11.4 The letter of appointment shall be worded, reviewed, and updated periodically by the internal auditor. The audit committee shall discuss improving the letter of appointment and recommending such to the Board of Directors.
  - 11.5 The letter of appointment shall be brought to the knowledge of all members of the payment-system operator's staff.

## **12. Scope of activity**

- 12.1 The scope of the internal-audit function's auditing activity shall include auditing service providers of the payment-system operator.
- 12.2 The internal-audit function shall have access to all assets, records, files, and data of the payment-system operator, including managerial information and minutes of advisory bodies and decision-makers, insofar as such are relevant to the performance of its tasks, except where prohibited by law for reasons of confidentiality.

## **13. Working procedure**

- 13.1 The internal-audit function shall regulate its work by applying a written working procedure that relates to the following matters, *inter alia*:
  - 13.1.1 the method used to draw up annual and multiannual work plans;



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- 13.1.2 the method used to draw up an audit plan;
  - 13.1.3 the method used to draw up an audit report and obtain the audited parties' responses;
  - 13.1.4 proceedings for follow-up of an audited party's responses;
  - 13.1.5 the method used to monitor the correction of deficiencies found in an audit;
  - 13.1.6 establishing methods and schedules for the performance of various reports, including distribution of audit reports to players other than those specified in the internal-audit report;
  - 13.1.7 the way the treatment of an audit report is concluded and determining the competent player to certify said completion of treatment;
  - 13.1.8 cooperation with the CPA-auditor, including prevention of unnecessary redundancies vis-à-vis his or her work. Said cooperation includes periodic meetings for discussion of matters of mutual concern, exchange of audit reports and management letters, and shared understanding of techniques, auditing methods, and terminology.
- 13.2 Auditing work shall be documented with support literature.
- 13.3 The internal-audit function shall retain documentation of tasks performed and audit reports completed.
- 13.4 The audit committee shall approve the internal-audit function's working procedure and validate it at least once every three years.

#### **14. Annual and multiannual work plans**

- 14.1 Ahead of every calendar year and before the beginning of the year, the internal auditor shall present the audit committee with the following for its approval, with a copy to the chair of the Board of Directors and the Chief Executive Officer:
- 14.1.1 a draft annual work plan;
  - 14.1.2 a draft multiannual work plan for a term that shall not exceed four years.



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- 14.2 The multiannual work plan shall address itself to the frequency and scope of internal-auditing work in every area of payment-system activity on an annual basis.
  - 14.3 The plan shall be based on a survey of risks that bears in mind the map of system activities and specifies that all payment-system activities shall be audited once every four years and every material activity at least once every two years.
  - 14.4 The annual work plan shall include reference to the topics of the audit, resources and personnel, schedules, and a plan for monitoring the correction of deficiencies carried out pursuant to the audit, including reference to an audit performed via outsourcing;
  - 14.5 Said work plan shall be reviewed and updated in an orderly manner whenever necessary, commensurate with developments at the payment system.
  - 14.6 The chair of the Board of Directors and the chair of the audit committee may give the internal auditor internal-auditing tasks additional to those laid down in the work plan.

## **15. The audit report and its distribution**

- 15.1 Shortly after an audit is performed, a written audit report shall be produced.
- 15.2 In said audit report, the internal auditor shall specify the findings (whether or not there is consensus about them at the time the task is completed), the conclusions, and the recommendations of the internal-audit function.
- 15.3 In the audit report, the following shall be noted:
  - 15.3.1 the purpose and scope of the audit;
  - 15.3.2 evaluation of the framework of internal control at the audited entity;
  - 15.3.3 recommendations given, ways of correcting deficiencies found, and the schedule for their correction;
  - 15.3.4 the relative importance of deficiencies discovered;
  - 15.3.5 the audited entity's response, including schedules and responsibilities for implementing each recommendation.
- 15.4 The internal auditor shall present the internal-audit report to the chair of the Board of Directors, the chair of the audit committee, the Chief Executive Officer, the audited entity,



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the management of the audited entity, and any other relevant player as the internal auditor shall see fit.

## **16. Monitoring the correction of deficiencies**

- 16.1 Senior management shall ascertain that the findings of the internal audit are treated properly.
- 16.2 The internal-audit function shall monitor the implementation of its recommendations in order to determine whether they have been applied.

## **17. Outsourcing**

- 17.1 The requirements appearing in this Directive shall apply, *mutatis mutandis*, to internal-audit activity performed via outsourcing.
- 17.2 If activity has been outsourced, the internal auditor shall ensure that the knowledge acquired from the expert is assimilated into the internal-audit function wherever possible.
- 17.3 Any outsourcing arrangement for internal auditing shall be made in writing and the contract shall address itself to the following matters at the very least:
  - 17.3.1 ensuring information confidentiality;
  - 17.3.2 defining the outsource provider's tasks and responsibilities;
  - 17.3.3 determining that all documents and records pertaining to the tasks of the outsource provider, including its annual audit work plan, audit reports, and working papers, shall be the property of the payment system'
  - 17.3.4 reference to the internal auditor's responsibility for the work of the outsource provider and the resources provided to it for this purpose, such as the possibility of vetting the provider's work both during and at the end of the work;
  - 17.3.5 conditions for revisions the terms of the contract, especially in reference to expanding the auditing work pursuant to the detection of significant findings.



## **18. Information reported and frequency of reportage**

18.1 At least once per year and no later than March 31 for the year past, the internal auditor shall present the Board of Directors, by means of the audit committee, and the Chief Executive Officer, with a final report on the activity of the internal-audit function during the reporting period, including:

- 18.1.1 an update on the performance of the work plan, drawn up in such a way as to facilitate comparison of plan and performance;
- 18.1.2 a list of audit reports;
- 18.1.3 a condensed presentation of material deficiencies, at the auditor's discretion;
- 18.1.4 the internal auditor's recommendations on ways to correct said deficiencies;
- 18.1.5 the status of implementation of the recommendations, including aging;
- 18.1.6 the auditor's conclusions as the result of monitoring the correction of deficiencies;
- 18.1.7 the internal auditor's recommendations in audit reports that are being implemented at an unreasonable delay.

### **Reportage of exceptional findings:**

18.2 The internal auditor shall immediately report exceptional findings to the manager of the audited area, the Chief Executive Officer, and the chair of the Board of Directors or the chair of the audit committee, at his or her discretion.

18.3 If the internal auditor believes that measures to correct deficiencies reported have not been taken as set forth in the previous section, she or he shall bring the matter to the knowledge of the Board of Directors plenum.

18.4 If, in the course of an audit of the payment-system operator, the internal auditor encounters exceptional findings that pertain to activity of the Board of Directors, she or he shall immediately report this to the chair of the Board of Directors.



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## **Reportage to Oversight**

- 18.5 The payment-system operator shall immediately report the following to Oversight:
- 18.5.1 detection of a conflict-of-interest event in the internal audit of the payment-system operator;
  - 18.5.2 dismissal or resignation of the internal auditor, including the rationales for said dismissal or resignation;
  - 18.5.3 exceptional findings reported by the internal auditor.
- 18.6 Once per year, the internal auditor shall report the following to Oversight:
- 18.6.1 the annual work plan approved by the audit committee, within a month of the date of its approval;
  - 18.6.2 a list of audit reports performed during the reporting period and planned for the successive year;
  - 18.6.3 key emphases in the work of the audit function;
  - 18.6.4 main findings for improvement;
  - 18.6.5 an overall picture of the internal-audit findings.
- 18.7 The system operator shall forward to Oversight the internal auditor's letter of appointment at the time it is approved and after any revision.
- 18.8 The system operator shall forward to Oversight a copy of the minutes of any discussion that the audit committee holds about the activity of the internal-audit function and the findings presented.
- 18.9 The system operator shall forward to Oversight the findings of the external independent review of the activity of the internal-audit function as performed by an outside player that the audit committee has appointed.

## **19. Forwarding information to the Bank of Israel**

- 19.1 The payment-system operator shall forward the information under this Directive by means of secured communication—the Kasefet application. Said application shall be used





after prior coordination with Oversight. Oversight may allow the information to be forwarded in other ways.

19.2 The information under this Directive shall be forwarded by the system operator to the contact persons whom Oversight shall appoint for this purpose.

19.3 A payment-system operator who forwards information under this Directive shall ascertain by telephone or by electronic mail that the contact persons received the information.

19.4 A payment-system operator who sits within a Bank of Israel structure and makes use of Bank of Israel systems shall forward the information under this Directive by means of the internal electronic-mail system of the Bank of Israel.

19.5 Reportage to Oversight shall be carried out in digital form and not in handwriting.

19.6 Reportage shall be carried out in accordance with the deadlines established in this Directive. Insofar as a payment-system operator believes that a given report will not be presented by the specified deadline, he or she shall present Oversight, by electronic mail, with a written request to revise the deadline for the presentation of the report. Said request shall include, *inter alia*, the actions taken up to said request for revision, the reasons for requesting the revision of the reporting deadline, and the requested target date for the presentation of the report in question. A reporting deadline for which revision is not approved by Oversight shall be presented by the deadline established for said report.

## **20. Promulgation and update of Directive**

<b>Date of promulgation</b>	<b>Essence of update</b>
April 3, 2024	Promulgation of directive

The translation is intended solely for the convenience of the reader. This translation has no legal status and although every effort has been made to ensure its accuracy, the Bank of Israel does not assume any responsibility whatsoever as to its accuracy and is not bound by its contents. Only the original Hebrew text is binding and the reader is advised to consult the authoritative Hebrew text.