BDO MALTA

SYSTEMS AUDIT

for Innovative Technology Arrangements

INTRODUCTION

Blockchain and other innovative technologies are reinventing the way we do business. The unprecedented rate of new technology developments brought about significant opportunities for disruption on a global scale, including in healthcare, logistics, financial services and several other areas. Distributed Ledger Technologies ("DLT") have led to the advent of digital assets, such as virtual coins or tokens for capital raising, facilitating transactions by, amongst other reasons, removing the 'middle man'.

Malta has developed a regulatory framework which positions it at the forefront of technological business opportunities, thus creating a comprehensive platform for innovators with the primary aim of providing transparency, legal certainty and investor protection.

Read on to understand how BDO Malta can assist your business harness the benefits of Malta's powerful regulatory framework.

MALTA'S REGULATORY LANDSCAPE

"This regulatory framework positions Malta at the forefront of technological business opportunities, thus creating a sound platform for innovators."

Source: MDIA

THE REGULATORY FRAMEWORK CONSISTS OF THREE LAWS THAT CAME INTO EFFECT ON 1ST NOVEMBER 2018:

- The Virtual Financial Assets Act (VFA Act) which regulates Initial Virtual Financial Asset Offerings (IVFAO) such as ICOs, the setting up of exchanges, other platforms or service providers and ancillary matters.
- The Innovative Technology Arrangements and Services Act (ITAS Act) regulates, amongst others, designated innovative technology arrangements (ITA) whereby an arrangement having the characteristics of an ITA is eligible to be recognised as such by the Malta Digital Innovation Authority. The Act defines ITAs as those elements including software, codes, computer protocols and other architectures used in designing and delivering distributed or decentralised ledger technology (DLT), smart contracts and related applications including DAOs and any other ITAs which may be added from time to time.
- The Malta Digital Innovation Authority (MDIA) Act provides for the setting up of a new regulatory body to act as the primary Authority on matters related to the promotion, certification and governance of ITAs and innovative technology services, amongst other technological innovation.

As a result of this new regulatory body, Systems Audits are required in at least three instances:

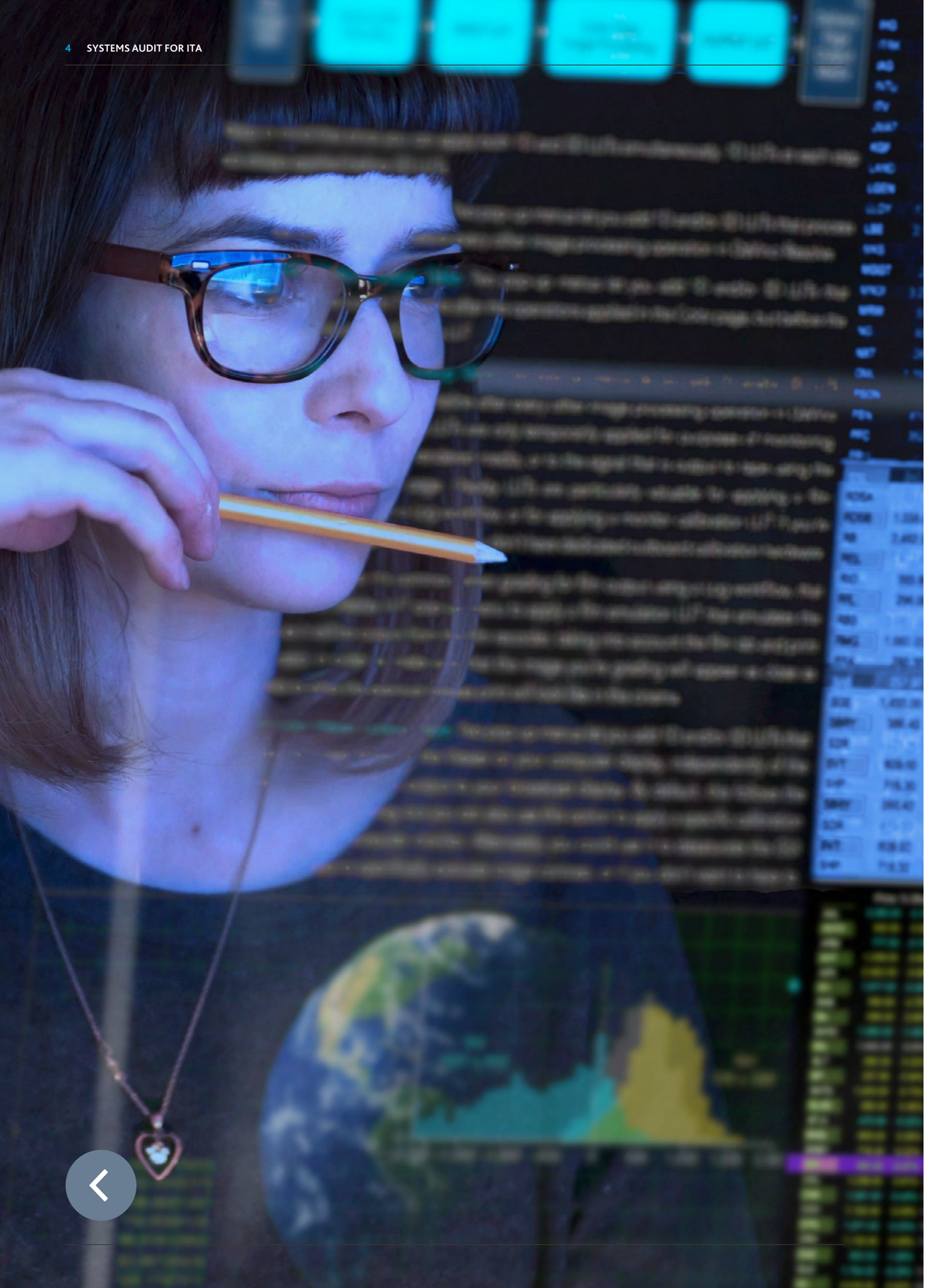
- In the case of a VFA issuer
- In the case of a VFA Service Provider
- In the case of an Innovative Technology Arrangement seeking a voluntary certification of its technology and applications.

If it is determined that an issuer or service provider falls under the proceedings of the VFA Act, the issuer or service provider, together with the guidance of the appointed VFA Agent, will engage with a licensed Systems Auditor to conduct the mandatory technology audit process under MDIA rules.

WHAT ARE INNOVATIVE TECHNOLOGY ARRANGEMENTS?

Innovative Technology Arrangements (ITAs) are defined in the ITAS ACT, 2018 as follows:

- software and architectures which are used in designing and delivering DLT which ordinarily:
  - uses a distributed, decentralized, shared and, or replicated ledger
  - may be public or private or hybrids thereof
  - is permissioned or permission-less or hybrids thereof
  - is secure to a high level against retrospective tampering, such that the history of transactions cannot be replaced
  - is protected with cryptography
  - is auditable
- smart contracts and related applications, including decentralised autonomous organisations, as well as other similar arrangements
- any other innovative technology arrangement which may be designated from time to time.



THE SYSTEMS AUDIT

Innovative Technology Arrangements are to be reviewed by a registered and independent Systems Auditor in accordance to the MDIA guidelines.

The guidelines issued by the MDIA focus on five key principles, having their foundations in the AICPA SOC2 auditing guidelines. The SOC 2 report is one of the most common compliance requirements that technology-based companies must meet as a respected industry standard.

THE KEY PRINCIPLES

Security

The system must be protected and completely secure from unauthorised access (both physical and logical).

Availability

The system is available for operational use as committed and/or agreed.

Processing Integrity

Processing is complete, accurate, timely, and authorised.

Confidentiality

The system will protect any information or data that is designated as confidential.

Privacy

The system will collect, use, retain, disclose, or dispose of personal information in full conformity with the commitments in the organisation's privacy notice.

The audit report will also provide assurance to the MDIA regarding the suitability of the design and the effectiveness of the controls implemented by the ITA. The regulator defines two types of audits:

Type I is an audit and a report that is carried out on a certain and specified date and takes an in-depth look at the control design. Through the audit report, the Systems Auditor expresses their opinion about whether the ITA has successfully designed the controls, in order to meet the requirements defined through the five key principles.

Type II is an audit and a report that is carried out over a certain period of time, usually six – twelve months. The focus of the Type II audit is to ascertain the operational effectiveness of the controls that are in place. Apart from providing what is included in a Type I report, a Type II report also gives an opinion on the operating effectiveness of the controls during the audited period.

WHY SHOULD AN ITA SEEK AN MDIA VOLUNTARY CERTIFICATION?

ITAs can be certified on a voluntary basis following an application process with the MDIA. Certification of an arrangement shall be granted based on a number of criteria, including that the ITA:

- is fit and proper for the purposes for which it was established
- software or parts of it, as designated by applicable rules, has been reviewed by a registered independent systems auditor (such as BDO Malta)
- has a registered Technical Administrator in office at all times who can demonstrate to the Authority the ability of the ITA.

The commercial value of obtaining this certification is expected to be high in view of the seal of endorsement, trust, transparency and legal certainty that it provides to the ITA. Issuers or service providers running on a certified ITA will be able to leverage their voluntary certification for commercial benefit, for example when building new B2B and B2C relationships. This will come as a result of the value attributed to such a certification, especially the trust that the certification builds with customers and third parties, whilst also adding value to the reputation of the certification holder.

Above all, an MDIA certification can be equated to a seal of approval by a leading blockchain-friendly jurisdiction in the world, thus mitigating reputation, trust and technology governance issues surrounding this innovative space.

HOW CAN BDO MALTA HELP?

At BDO, you will find the right business and technology advisors to help you stay ahead of your competitors. In order to keep up with the fast pace of technological change, we have taken a very specific approach of working in small and agile teams of professionals who all add individual perspectives and skill sets to the discussion. Our clients requirements will be covered from every angle.

BDO Malta can provide the following assistance to businesses requiring a mandatory Systems Audit under the VFA Act, and to businesses voluntarily registering their ITA with the MDIA:

SYSTEMS AUDIT

BDO Technology Advisory Limited is licenced by the MDIA to conduct both Type I and Type II Systems Audits.

READINESS ASSESSMENT

BDO Malta can assess the state of an entity's SOC 2 readiness by evaluating the kind of ITA that is being offered, the specific Control Objectives that are applicable, and any controls that are relevant to the delivery of the service. Additionally, processes, privacy, information security, procedures, system configuration, and organisational structure are examined and evaluated in detail, prior to a Systems Audit being conducted.

REMEDIATION

Once any gaps or shortcomings have been identified, BDO Malta can help with their remediation. Through audit scoping, compiling the ITA system description, risk management, control selection, and the definition of control effectiveness metrics, you can have a full overview of where you stand in terms of compliance with the requirements.

FOR MORE INFORMATION:

BDO MALTA

Triq it-Torri
Msida MSD 1824
Malta

Tel: +356 2342 4000

technology@bdo.com.mt

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