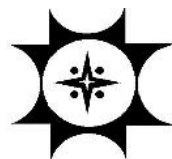


Internal Control & Compliance Policy 2015



Sonali Bank Limited

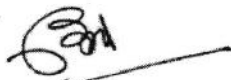
Preface

Banking is a highly risk sensitive industry. It covers diversified and multifarious financial activities which involve high degree of risk. Establishing sound control environment and effective compliance culture are crucial to the bank to manage these risks. The banks that are stronger in sound control environment and effective & efficient compliance culture are able to lead the others.

Risk is inherent in all aspects of banking operation. It is an essential factor that needs to be managed in pre-defined ways. Proactive control environment and sound compliance culture, backed by appropriate control and compliance policy, are the pre-conditions to address the operational risk of a bank. In addition to that, control and compliance risk management needs to be a robust process that enables banks to manage proactively banking operations. Effective and efficient internal control environment and compliance culture has become more crucial to ensure effective risk management practices to achieve the desired success. There is no alternative to establish sound internal control and compliance culture through adopting effective control and compliance policy.

The main object of this policy is to provide directives on internal control and compliance guidelines to the concerned officials of Sonali Bank Limited to improve the quality of control and compliance risk management pattern, establish best standards for segregation of duties and responsibilities, and to assist in the ongoing improvement of the control and compliance culture of the bank. Considering the compliance of the Bank Company Act-1991(Amended up to 2013), requirements of regulators, the importance of ICC framework, magnitude of future expansion and to ensure the implementation of the best practices of ICC in overall banking operations of Sonali Bank Limited, the Internal Control and Compliance Policy (ICC Policy) for the Bank has been framed and approved by the Board of Directors in its 461st meeting held on April 25, 2016.

Internal Control and Compliance Policy-2015 is a supplement to, and not a substitute for, those circulars and guidelines that have already been issued by the Central Bank-Bangladesh Bank that remain in force. I request to follow the policy and expect highly that this policy helps to establish pragmatic control environment and robust compliance culture within the bank to address all sorts of operational risk. I also like to thank all concerned engaged in preparing the policy and grateful to the Bank's Board of Directors for extending kind approval to this effort.



(Pradip Kumar Dutta)
Managing Director & CEO
Sonali Bank Limited

Date: May 22, 2016

Table of Contents:

Chapter-1		Page No.
1.	Internal Control and Compliance (ICC) Policy of Sonali Bank Limited: Bangladesh Bank Guidelines Aspect	1
1.1	Overview	1
	1.1.1 The Basic objective of ICC	
1.2	Internal Control & Compliance System	1
	1.2.1 Definition	1
	1.2.2 Control Environment	2
	1.2.3 Objective of Internal Control & Compliance	2
1.3	Policy Guidelines for Internal Control & Compliance	2
	1.3.1 Role of Board of Directors	2
	1.3.2 Role and Responsibilities of Board Audit Committee	3
	1.3.3 Role and Responsibilities of Board Risk Management Committee	3
	1.3.4 Role and Responsibilities of the MD & CEO	3
	1.3.5 Responsibility of the Management	4
	1.3.6 Risk recognition and Assessment	4
	1.3.7 Control Activities and Segregation of Duties	4
	1.3.8 Management Reporting System	4
	1.3.9 Monitoring Activities and Correcting Deficiencies	4
	1.3.10 Role of External Auditors in Evaluating Internal Control System	5
	1.3.11 Regulatory Compliance	5
	1.3.12 Establishment of Compliance Culture	5
	1.3.13 Way to establish Compliance Culture	5
1.4	Process Guidelines	5
	1.4.1 Internal Control Process	6
	1.4.2 Departmental Control Function Check List (DCFCL)	6
	1.4.3 Loan Documentation Check List (LDCL)	6
	1.4.4 Quarterly Operations Report (QOR)	6
	1.4.5 Foreign Exchange Documentation Check List	6
1.5	Internal Control and Compliance Structure of a Bank as per Bank Company Act, 1991 (Amended upto 2013) and Bangladesh Bank Guidelines	6
	1.5.1 Head of Internal Control & Compliance (ICC) of the Bank	8
	1.5.2 Head of Audit	8
	1.5.3 Head of Control	8
	1.5.4 Head of Compliance	9
1.6	Reporting	10
	1.6.1 Departmental Control Function Checklist (DCFCL) to be Maintained by the Branch, Treasury Division and Treasury Back Office.	10
	1.6.2 Quarterly Operations Report (QOR)	11
	1.6.3 Certificate of Documentation (Loan Documentation Check List)	11

Chapter – 2		Page No.
2.	Implementation Aspect: Internal Control and Compliance Policy of Sonali Bank Limited	12
2.1	ICC Details Structure of Sonali Bank Limited	12
2.2	Board of Directors: Oversight	14
2.3	Board Audit Committee : Oversight	15
	2.3.1 Role and Responsibilities of Audit Committee	15
2.4	Board Risk Management Committee: Oversight	16
	2.4.1 Role of Risk Management Committee	17
2.5	Duties and Responsibilities of the MD & CEO Regarding ICC	17
2.6	Responsibilities of the Senior Management (MANCOM)	17
2.7	Role of Head of Internal Control & Compliance (ICC)	18
Chapter –3		
3.	Internal Control and Monitoring Policy	20
3.1	Overview	20
3.2	Definition and Purpose	20
3.3	Mission	22
3.4	Organizational Structure of Control & Monitoring Functioning of Sonali Bank Limited:	22
3.5	Objective of Control and Monitoring Division (CMD)	24
3.6	Purpose and Scope	24
3.7	Control & Monitoring Environment	24
3.8	Components of Internal Control System	25
	3.8.1 Control Environment	25
	3.8.2 Communication	25
	3.8.3 Assessing & Managing Risk	26
	3.8.4 Control Activities	26
	3.8.5 Monitoring	26
3.9	Policy Guidelines of Internal Control	26
	3.9.1 Risk Recognition and Assessment	26
	3.9.2 Process Guidelines	27
	3.9.3 Control Activities and Segregation of Duties	27
	3.9.4 Responsibilities of Control & Monitoring Division	28
	3.9.5 Management Information System(MIS)	28
	3.9.6 Internal Control & Monitoring Charter	29
	3.9.7 Control Perception: Employee's Perception of Internal Control	29
	3.9.8 Critical Control Function	30
	3.9.9 Evaluation	30
	3.9.10 Testing Factors	32
	3.9.11 Internal Control Process:	33
	I) Departmental Control Function Checklist (DCFCL)	33
	II) Loan Documentation Checklist (LDCL)	33
	III) Quarterly Operations Report Appendix	33
3.10	Risk Analysis of Control Functions	34
3.11	Monitoring & Follow-up	35
3.12	Reporting	35

Chapter –4		Page No.
4.	Audit & Inspection Policy	37
4.1.	Overview	37
4.2	Internal Audit: Its relationship with External Audit and Internal Control:	37
4.2.1	Internal Audit	37
4.2.2	Relationship With Statutory Audit	38
4.2.3	Internal Check, Internal Audit and Internal Control	38
4.2.4	Internal Check	38
4.2.5	Internal Control	39
4.3	Organogram of Internal Audit & Insp. Functioning of the Bank	39
4.4	Objectives of Audit & Insp. Divisions	41
4.4.1	Major Roles and Functions of Audit & Insp. Divisions	42
4.4.2	Roles & Responsibilities of Head of Audit and Inspection Divisions	43
4.4.3	Roles & Responsibilities of the Audit and Inspection Divisiion-1 (AID-1)	45
4.4.4	Roles & Responsibilities of the Audit and Inspection Division-2 (AID-2)	46
4.4.5	Roles & Responsibilities of the Foreign Exchange Audit and Inspection Division	48
4.5	Audit & Insp. Philosophy	49
4.5.1	Basic Principles of Internal Audit	49
4.6	Scope of Audit & Inspection Functioning	51
4.7	General Duties of an Internal Auditor	52
4.7.1	General Duties	52
4.7.2	Some additional duties	55
4.8	Working Papers and Secrecy	56
4.9	Qualities of an Auditor	56
4.10	Policy to Conduct Risk Based Audit	56
4.11	Risk Based Annual Audit & Insp. Planning	57
4.12	Audit & Insp. Procedure	57
4.13	Important Guidance for the Internal Auditor	58
4.14	Information Technology (IT) System Audit	58
4.14.1	System Auditor's Qualification	59
4.14.2	Audit Procedure for IT Audit	59
4.14.3	Software	61
4.14.4	Others	61
4.15	Financial Crime Risk (FCR)	64
4.16	Gradings of Audit Findings/Observations and its consequence	65
4.16.1	Fundamentals of Audit Report Writing	65
4.17	Reporting and Disposal of Audit Report	66
4.18	Follow-up and Disposal of Audit Report	67
4.19	Code of Conduct and General Discipline for Internal auditor	67
4.19.1	Internal Auditor: Code of Ethics	67
4.19.2	Code of Ethics- Principles	67
4.19.3	Code of Conduct: Rules	67
4.19.4	General Discipline for Internal Auditor	68
4.19.5	Auditors' Failures and its Subsequent Administrative Action	69

Chapter –5		Page No.
5.	Compliance Policy	70
5.1	Overview	70
5.2	Compliance Risk Management	70
5.3	Compliance Risk Definition	71
	5.3.1 Compliance Division -Internal	73
	5.3.2 Compliance Division -External	73
5.4	Policies, Procedures and Limits	73
5.5	Identification, Measurement and Monitoring of Compliance Risk	74
5.6	Management Information System(MIS)	75
5.7	Objectives of Compliance Division	75
5.8	Functions	75
5.9	The Role of Head of Compliance	76
5.10	Basic Compliance Methodology	76
5.11	Role of External Auditors in Evaluating Compliance System of the Bank:	76
5.12	Regulatory Compliance	76
5.13	Establishment of a Compliance Culture	77
5.14	Focus of Compliance	77
5.15	Compliance Checking	77
5.16	Compliance Division Charter	78
5.17	The Activities of Compliance Division	78
5.18	Specific Responsibilities of Compliance Division	78
5.19	Independence and Accountability	79
	5.19.1 Authority	79
	5.19.2 Standards	79
	5.19.3 Relationship With Other Divisions	79
5.20	Compliance Risk Aspect	79
	5.20.1 Risk Assessment	80
	5.20.2 Compliance Staff	80
5.21	Four Corner Stones of Compliance	80
5.22	Work Methodology of the Compliance Division	80
5.23	Other Activities	82
5.24	Guidance for Compliance Officers	83
5.25	Checklist/Implementation	84
5.26	Reporting	84

CHAPTER- 1

1. Internal Control and Compliance Policy of Sonali Bank Limited: Bangladesh Bank Guidelines Aspect

1.1. Overview:

Banking is a diversified and complex financial activity, which involves high level of risk. In the prevailing situation the issue of effective internal control and compliance system has become more significant in order to encourage sound risk management practices and ensure smooth performance of the banking industry throughout the world. A system of effective internal control and compliance is a critical component of the bank management and a foundation for the safe and sound operation of banking organization. Sound internal control and compliance system of a bank consists of three major areas of activities i.e. **(a) Controlling Function (b) Audit & Inspection Function, and (c) Compliance Function.**

Bangladesh Bank suggests Internal Control and Compliance (ICC) framework for all the scheduled commercial banks operating in Bangladesh with recommendations to implement related guidelines even in a more sophisticated way as deemed necessary for adjustment to the type, scope, size and complexity of individual bank's activities as well as the risks associated with such activities.

Internal control and compliance systems are put in place to keep the bank in more safe position and to ensure attainment of targeted profitability and goals and achievement of its mission and to minimize loopholes along the way. Internal control system promotes efficiency & effectiveness of bank personnel to reduce risk of asset loss and help to ensure the reliability of financial statements in conformity with existing laws and regulations.

Bangladesh Bank has delineated essential elements and guidelines of a sound internal control and compliance system that will help to achieve the organizational objectives and goals.

The guidelines comprise five basic fundamentals such as:

- a) Internal Control Policy
- b) Organizational Structure
- c) Process Guidelines
- d) Internal Control Process
- e) Compliance Process

1.1.1 The Basic objective of ICC

To ensure corporate governance, accountability, integrity, transparency and regulatory compliance in operation of the Bank within the stringent frame work to achieve the International Standard of Banking and keep the Banking operations accurate and efficient in convergence with International best practices.

1.2 Internal Control System & Compliance

The basic focuses of guidelines as recommended by Bangladesh Bank are described below:

1.2.1 Definition:

Internal control system & compliance are the processes, effected by the Board of Directors, Senior Management and all levels of personnel, designed to provide reasonable assurance regarding the

achievement of objectives in the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with applicable laws, regulations and internal policies. In fact, internal control system & compliance are the reflection of Internal Audit, Internal Monitoring & Compliance culture of the Bank.

In other words Internal Control system & Compliance refer to the policies and procedures established and implemented alone, or in concern with other policies and procedures, to manage and control a particular risk or business activity, or combination of risks or business activities, to which the bank is exposed.

1.2.2 Control Environment:

It is the framework under which effective and sound internal control system over the whole operations of the Bank is developed, implemented and monitored by the management of the Bank with the oversight and corporate governance of the Board of Directors as well as facilitated, established and ensured with the support of effective information system and independent audit mechanism.

1.2.3 Objective of Internal Control & Compliance

The primary objective of internal control system & Compliance is to help the Bank to perform in a sound and prudent manner with its available resources. The main objectives of the internal control system & compliance process are categorized as under:

- 1) Performance Objective : It relates to the effectiveness and efficiency of the Bank in using its assets and other resources and protecting the Bank from loss.
- 2) Information Objective : It addresses the preparation of timely, reliable, relevant reports needed for decision-making and other financial related disclosures.
- 3) Compliance Objective : It demonstrates that all banking activities are performed in compliance with applicable laws, rules and regulations of the regulatory body and the bank's own policy, plan and procedures.

1.3 Policy Guidelines for Internal Control & Compliance

1.3.1 Responsibility of Board of Directors (BoD):

The Board of Directors is the prime mover of internal policies, plans and guidelines. The Board is to approve overall business strategic plan, significant policies and organizational structure. It provides strategy and guideline to the Top and Senior Management and ensure that adequate and effective system of internal control & compliance is established and maintained within the Bank.

The responsibility of the Board of Directors is to oversee and give direction to the management for taking necessary steps to establish sound and effective internal control system and compliance culture within the bank to ensure the safety and security of the total loans and investments of the Bank as well as to protect the interest of the depositors. Board should ensure the establishment of independent audit and compliance culture within the Bank. The overall responsibility of establishing broad business strategy, significant policies and overseeing effective system taken by management to arrest/investigate significant internal control and compliance risks of the Bank rests with the Board of Directors.

As per directives of Bangladesh Bank, Sonali Bank Limited has formed Audit Committee, Risk Management Committee and Executive Committee of the Board to ensure effective & efficient control and compliance structure within the bank to mitigate the associated risks.

1.3.2 Role and Responsibility of the Audit Committee:

In compliance with Bangladesh Bank guidelines and Bangladesh Securities and Exchange Commission (BSEC) notification on Corporate Governance, the Audit Committee (AC) of the Board of Sonali Bank Limited (SBL) has been formed by the Board of Directors to provide independent oversight of the Bank's financial reporting, non-financial corporate disclosures, internal control and compliance system, compliance of required laws, rules and regulations etc. The major objectives of the Audit Committee regarding Internal Control and Compliance oversights are:

- To review the financial reporting process, system of internal control and compliance, approach to manage risk, audit process, findings of central bank comprehensive audit and the bank's process for monitoring compliance under relevant laws, rules and regulations and its own code of business conduct.
- To assist the Board in fulfillment of its oversight responsibilities including achievement of the vision, mission, strategies, goals, objectives and overall business plans set by the Board for effective functioning of the Bank.

1.3.3 Role and Responsibility of the Board Risk Management Committee:

The Board of Sonali Bank Limited (SBL) has formed Risk Management Committee to provide independent oversight of the Bank's risk management pattern, internal control system and compliance, compliance of required laws, rules and regulations etc. The major objectives of the Risk Management Committee regarding Internal Control and Compliance oversights are:

- Formulation and implementation of appropriate strategies for ICC risk assessment and its control. The committee will review the risk management process to ensure effective preservation and control measures.
- The responsibility of Risk Management Committee is to ensure an adequate organizational structure for managing ICC risk within the bank.
- ICC risk management policy & guidelines of the bank should be reviewed annually by the committee.
- Risk Management Committee will monitor proper implementation of ICC risk management policies. They will monitor whether proper steps have been taken to mitigate ICC risk.

1.3.4 Role and Responsibility of the MD & CEO:

The MD & CEO of the bank shall be responsible for the overall management and operation of the Bank. He shall ensure the existence of efficient, effective and independent ICC structure within the bank. He shall ensure compliance of the Bank Company Act, 1991 (Amended up to 2013) and other relevant laws and regulations in discharging routine functions of the bank. He shall report to Board Committees and Board any deviation of compliance regarding required laws, regulations and rules. The MD & CEO also shall report to Bangladesh Bank any violation of the Bank Company Act, 1991 (Amended up to 2013) or of other laws/regulations.

1.3.5 Responsibility of the Management:

Bank has a Management Committee (MANCOM) comprising of Senior Executives for implementation of policies approved by the Board. MANCOM will develop processes that identify measure, monitor and control risks; maintain organizational structure that clearly assigns responsibility, authority and disseminate information; ensure that delegated responsibilities are effectively carried out; set appropriate internal control policies and monitor the adequacy and effectiveness of the same and certify on yearly basis to the Board as to the effectiveness of internal control system and compliance status thereof.

1.3.6 Risk Recognition and Assessment:

Bank should ensure that the material risks that could adversely affect the achievement of the Bank's goals are being recognized and continually assessed. This should cover all risks exposure of the Bank (i.e. credit risk, market risk, interest rate risk, liquidity risk, legal risk and reputation risk). Internal control system needs to be reviewed and revised from time to time in order to address any new and previously uncontrolled risks appropriately.

1.3.7 Control Activities and Segregation of Duties:

Control activities are an integral part of the daily activities of the Bank which ensure that an appropriate control structure is set up with control activities defined at every business level, such as top level reviews, appropriate activity controls for different departments or divisions, physical controls, checking for compliance with exposure limits and follow-up of non-compliance, a system of approvals and authorities, and a system of verification and reconciliation.

In the Bank there must have proper segregation of duties and responsibilities. Areas of potential conflicts of interest should be identified, monitored and minimized.

1.3.8 Management Reporting System:

For effective internal control, Bank should ensure that all the internal and external information should be reported for decision making process. Internal information which should cover all the significant activities of the Bank viz. financial, operational and compliance and also include those that capture, store and use data in electronic form. The information should be reliable, timely, accessible and the channels of communication must ensure that all staff fully understand and adhere to the policies and procedures affecting their duties and responsibilities and other relevant information is reaching the appropriate personnel.

1.3.9 Monitoring Activities and Correcting Deficiencies:

The overall effectiveness of the Bank's internal controls should be monitored on an ongoing basis. Monitoring of key risks should be done daily and periodic evaluations are carried out by the internal auditors. There should have been an effective and comprehensive internal audit and inspection system within the internal control system of the bank that would be carried out by the operationally independent, appropriately trained and competent staff. The Head of Internal Control & Compliance (ICC) should report directly to the Board Audit Committee, as per instruction of Bank Company Act, 1991 (Amended up to 2013). He also report to Board of Directors through Audit Committee, if required, based on the gravity of the observation and findings. All material deficiencies should be promptly reported and timely addressed. Head of ICC should directly report to Audit Committee of the Board as a functional reporting line and indirectly reports to CEO & MD for administrative issues.

1.3.10 Role of External Auditors in Evaluating Internal Control System:

External auditors examine the records and transactions to evaluate those and to furnish unbiased recommendation on the strength and weakness of the internal control system of the Bank which should be promptly reported and timely addressed by the management of the Bank.

1.3.11 Regulatory Compliance:

The bank needs to comply with the existing laws as well as rules and regulations of Bangladesh Bank and other regulatory bodies such as National Board of Revenue, Securities and Exchange Commission, Registrar of Joint Stock Companies, Ministry of Finance and Bank's own policies, circulars and guidelines.

1.3.12 Establishment of Compliance Culture:

An efficient compliance culture is to be established by the Board of Directors and the Senior Management within the banking organization so that personnel at all levels understand the importance of internal control.

1.3.13 Way to establish Compliance Culture:

1. The Board of Directors and the Senior Management may establish a 'Code of Ethics' that all level of personnel must sign and adhere to.
2. The Board of Directors will recommend and the Senior Management should establish a compliance culture within the banking organization that emphasizes and demonstrates the importance of internal control to all levels of personnel.
3. Strong Compliance culture throughout the organization is to be encouraged to comply with laws, policies, procedures and regulations. Even an individual at the lowest level should be empowered to speak up without the fear is she/he identifies any non-compliant issues.
4. In order to establish a compliance culture the board of directors and senior management may promote a high ethical and integrity standard.
5. In reinforcing ethical values, the bank should avoid policies and practices that provide inadvertent incentive to employees which may encourage them to undertake unethical/inappropriate activities. Examples of such policies and practices include undue emphasis on performance targets or operational results, particularly short term ones that ignore long term risks and compensation schemes that excessively depend on short term performance.

1.4 Process Guidelines:

Bank should have policy guidelines in order to ensure an effective control over its process in various fields i.e. credit, human resources, finance and accounts, treasury, audit, customer service etc. It has been suggested that there should be policy guidelines/manuals for each Department's function which may be as follows:

- a) Credit Policy Manual/Guidelines.
- b) Operations Manual
- c) Finance & Accounting Manual
- d) Treasury Manual
- e) Human Resource Policy/ Manual
- f) Internal Control Manual
- g) Compliance manual
- h) Audit & Inspection Manual

1.4.1. Internal Control Process:

For smooth operations of Bank's Internal Control function/mechanism 1) Departmental Control Function Check List (DCFCL -daily, weekly, monthly and quarterly) 2) Loan Documentation Check List (LDCL) 3) Quarterly Operations Report (QOR) & 4) Foreign Exchange Documentation Check List(FEDCL) should be prepared and maintained by branch and reviewed properly by the controlling office.

1.4.2 Departmental Control Function Check List (DCFCL):

Departmental Control Function Check List (DCFCL -daily, weekly, monthly and quarterly) should be prepared and duly signed by the concerned person and reviewed by the designated person as per circular and preserve it properly for further audit/review by internal auditor, controlling office, Bangladesh Bank Inspection Team, etc.

1.4.3 Loan Documentation Check List (LDCL):

The Loan Documentation Check List (LDCL) covers the matter relating to security documentation in respect of sanctioning and draw-down credit facilities to ensure that prescribed documentation formalities have been observed and required securities have been obtained as per sanction terms and conditions to safeguard Bank's legal protection and to avoid credit risk in the exposure.

The Loan Documentation Check List (LDCL) should be prepared and duly signed by the concerned person and reviewed by the designated person and filed as per circular. Moreover, copy should be forwarded to controlling office/head office for further checking as per requirement of circular. It should also be preserved by the respective office properly for further audit/review by internal auditor, controlling office, Bangladesh Bank Inspection Team, etc.

1.4.4 Quarterly Operations Report (QOR):

- a) The guidelines/procedures relate to reporting of operational functions of each branch.
- b) Quarterly operations report will be prepared in duplicate by each branch in the prescribed format and to be despatched to the Head of Control & Monitoring Division by 10th of the following month.
- c) The items which are not applicable for individual branch or division should be marked as N/A and no signature is required against the items marked as N/A.

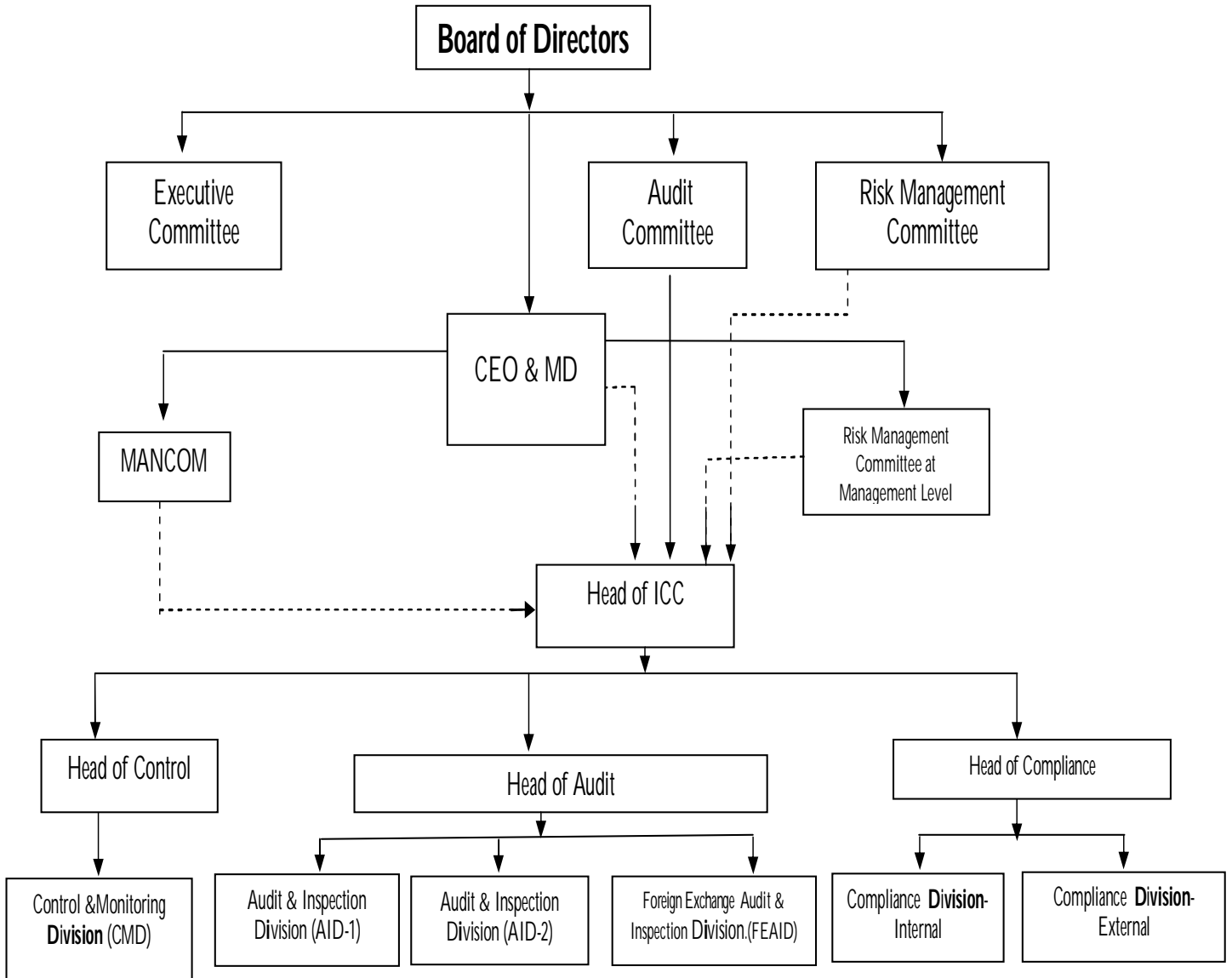
1.4.5 Foreign Exchange Documentation Check List (FEDCL):

Foreign Exchange Documentations Check List deals with the mechanism of opening of L/C, retirement of import documents, disposal of remittances in foreign currencies, reporting of transactions to the regulators. It should be prepared and maintained by the branch properly for further course of action.

1.5 Internal Control and Compliance Structure of a Bank as per Bank Company Act, 1991 (Amended up to 2013) and Bangladesh Bank Guidelines:

As per Bank Company Act, 1991 (Amended up to 2013) and Bangladesh Bank guidelines and circulars, the internal control and compliance system of a bank will comprehensively reflect the overall internal monitoring system, internal audit and inspection functioning and compliance structure of the bank. In line with requirement of section 15(C) of the Bank Company Act, 1991 (Amended up to 2013) and Bangladesh Bank circulars, the internal audit and inspection system of the bank should be fully independent and should discharge their duties without any sorts of intervention of the management. As per that instruction, the proposed Internal Control and Compliance Structure of a bank should be of following pattern:

Organizational Structure of ICC



At this stage Head of ICC will be at least General Manager level executive & Divisional Head will be at least DGM level executive. The responsibility of head of Control, head of audit and head of compliance will remain with head of ICC.

To ensure effective ICC system for Sonali Bank Limited, if deemed appropriate, DMD level executive may be posted as Head of ICC and GM level executive as head of control, audit and compliance in course of time.

1.5.1 Head of Internal Control & Compliance (ICC) of the Bank

Internal Control and compliance means the whole system of control (control means total monitoring, internal audit & inspection and compliance), financial and otherwise, established by management in order to carry on the business of the Bank in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records.

Head of Internal Control & Compliance (ICC) ensures that Bank should have effective and efficient control environment in operation as well as Bank complies with laws, rules, regulations and regulatory requirements while conducting its business. He will also maintain liaison with the regulators and notify other units regarding regulatory changes.

He will look after the overall activities of Control and Compliance (i.e. controlling/monitoring, internal audit & inspection and compliance) of the Bank. The head of ICC will be fully independent and isolated from bank's other day to day business operations and he should directly report to Audit Committee of the Board and maintain indirect reporting line with CEO & MD, MANCOM and Board Risk Management Committee. Head of ICC will be responsible to establish a sound control and compliance culture within the bank. He should discharge his duties and responsibilities without any intervention of the bank management. However, if head of ICC thinks appropriate, he should produce a memo to the Chairman of Audit Committee as well as to CEO & MD at the same time regarding serious irregularities/non-compliances.

1.5.2 Head of Audit

Head of Audit is responsible to ensure effective and efficient functioning of audit division i.e. he is responsible to establish a true audit culture within the bank under the direct supervision and follow up of the head of the ICC. He should be responsible for overall monitoring and supervision of the total activities of all the divisions under his jurisdiction division (i.e. Audit & Insp. Dept.-1, Audit & Insp. Dept.-2 and Foreign Exchange Audit & Insp. Dept.). The head of ICC and head of AID should be free, fair and independent not only in state of mind but also be free, fair and independent in state of appearance. To carry on smooth internal audit and inspection functioning, each year the Head of Audit and Inspection Division will set out an audit plan for the year to be approved by the Audit Committee of the Board of Directors through head of ICC. This would be a **high level risk-based audit plan** where priority will be given to sensitive areas. **Risk based branch grading policy should be formulated to measure the risk associated with each branch before designing the annual audit plan for regular audit to address the maximum risk adherent with overall control and compliance activities of the Bank.** The deficiencies identified during the audit should be notified to the branch and significant audit findings should be reported to the Chairman of the Audit Committee as well as to CEO & MD at the same time based on the gravity of impacts of those findings so that the CEO & MD can take immediate action to address the audit findings, if required in consultation with the Chairman of the Audit Committee. At the end of each quarter, the head of audit Division will prepare a summary report on the audit findings and corrective actions taken which should be forwarded to the Audit Committee of the Board through the head of ICC.

1.5.3 Head of Control

Head of Control is responsible for proper functioning of Control & Monitoring division i.e. is responsible to establish and to maintain a true and sound control environment and effective compliance culture within the bank under the direct supervision of the head of the ICC. He will be responsible to establish a robust control and compliance environment within the Bank. He will also be

responsible for overall monitoring and supervision of the overall activities of the division. To carry out smooth internal control and monitoring functioning, each year the Head of Control and Monitoring Division will formulate a comprehensive work plan for the year and produce it to Audit Committee of the Board of Directors through head of ICC.

This would be a high level risk based planning where priority will be attached to more sensitive areas. He should employ the close monitoring on strict compliance of all sorts of audit findings (both internal and external) in time. He will also employ high concentration on standardization and continuous development of overall control environment of the bank. He should follow up whether the head of compliance division notifies the deficiencies to the branch that identified during the audit along with instructions and recommendations suggested by the audit people/Audit Committee. He should produce the quarterly compliance status and major observations to the Audit Committee based on the gravity of impacts of those findings. At the end of each quarter, the head of Control will prepare a summary report on compliance and control status and forward to the Audit Committee of the Board through the head of ICC.

The Head of Control will be responsible to establish effective control environment within the bank. He will continuously evaluate the total control process of the bank. He should review Quarterly Operations Report submitted by the branch including exceptions report, if any. The Head of Control will instruct/advise the Branch to rectify the irregularities in the operations report and the exceptions and inform that to the higher authority. If deemed necessary, the Head of Control will request Audit & Inspection Division through the Head of ICC to carry out an audit & inspection on the specific area as mentioned in the report. He will also report the matter to the Audit Committee of the Board for necessary guideline relating to action and rectification depending on the gravity of the deviation. This Division will arrange appropriate training for employees so that employees are aware of the regulations that are necessary to accomplish their jobs.

"Loan Documentation Checklist" has been prescribed by Bangladesh Bank. That checklist shall be revised time to time and shall be complied by each Branch as per ICC circular provided by Bangladesh Bank. The Division will pursue the Branch for strict compliance of the sanction terms. He will submit a report to the head of ICC on the type/nature of discrepancies appeared in that checklist as revealed to him.

This division, in addition to the above, will carry on inspection routinely and surprise manner. Based on output of risk matrix calculation, this division will determine the frequency level of visit and sample size of inspection. The frequency and sample volume of these checks are given in the table below:

Risk Rating	Frequency	Sample Volume
High	Quarterly	25%
Medium	Half Yearly	12%
Low	Yearly	10%

1.5.4 Head of Compliance

The Head of Compliance will be responsible to monitor and to follow up all the observations of internal audit division as well as observations of external audits. The Head of Compliance will incorporate regulatory requirements in the work process to ensure full compliance. The Head of Compliance-External will be responsible for collecting regulatory guidelines, maintaining proper records and distributing these among all concerned and ensuring that the guidelines received from the regulatory authority are properly disseminated along with clarification, if any, received from the regulatory authority or internal policy

guidelines. The Compliance Division-Internal will take over all the compliance issues of all sorts of observations of internal audit and inspection activities and Compliance Division-External will take over all the compliance issues of all sorts of observations of external audits like BB, Statutory audits, Commercial audits and others.

The Compliance Division-external will be the focal point of contact when regulatory inspection is conducted on the operation of the Bank and ensure taking timely corrective measures as soon as the inspection report is received and must ensure that serious lapses identified by the regulatory authority are brought to the notice of Audit Committee of the Board along with the Senior Management. It will work as a focal point of all sorts of external communication issues regarding compliance.

1.6 Reporting

- a) The Head of CMD, AID and CD will directly report to head of ICC and based on the severity of the findings, head of ICC will decide whether it is to be disposed from his/her end or will produce to Audit Committee of the Board or Board of Directors.
- b) The head of Control & Monitoring Division may develop/design a reporting structure for his division depending upon the size and complexity of deviation and non compliance by the branches/offices/departments of any irregularity/lapse in the operations. However, he will follow a standard reporting structure to perform his assignment appropriately.
- c) Under the direct supervision and follow up of the head of monitoring division, the monitoring people will conduct a surprise inspection. If the Head of ICC approves, and prepare a report on individual inspection and submit to head of CMD within 15 days (except for items that need immediate remedy) and forward the same to the branch for rectification.
- d) Having no high risk items as well as having up to 5 medium risk items, the head of division will report to the head of ICC for his necessary action.
- e) More than 3 high-risk items identified in the violation of set norms the report will be given to the head of ICC for his necessary action and also to the Audit Committee of the Board.
- f) The Head of Control will prepare a quarterly report on the overall position of the Bank's control status and submit to the head of ICC and Board Audit Committee for onward submission to the Board of Directors, if necessary.
- g) The overall objective of reporting is to ensure that appropriate actions are taken timely by the concerned management so that issues and irregularities are addressed immediately and the reported risk exposures are minimized/eradicated.

1.6.1 Departmental Control Function Checklist (DCFCL) to be Maintained by the Branch, Treasury Division and Treasury Back Office.

Branch will strictly follow the compliance of DCFCL on daily, weekly, monthly and quarterly basis duly signed as per designed DCFCL and maintains in the Branch for inspection purpose. Treasury Division and its Back Office at Head Office will also introduce DCFCL in order to ensure that the prescribed controls are being observed and laid down procedures are not overlooked.

1.6.2 Quarterly Operations Report (QOR):

Branch will submit Quarterly Operations Report for each quarter ended as on March 31, June 30, September 30 and December 31 of every year as per prescribed format to Head of Control and Monitoring Division for their review and follow-up within 10 (ten) days of the end of the quarter (i.e. 10th April, 10th July and 10th October and 10th January).

1.6.3 Certificate of Documentation (Loan Documentation Check List):

While sending Certificate of Documentation (LDCL) to Audit and Inspection Division & Credit Division, Branch shall also send one copy of "Certificate of Documentation (Checklist)" to Head of Control for their review.

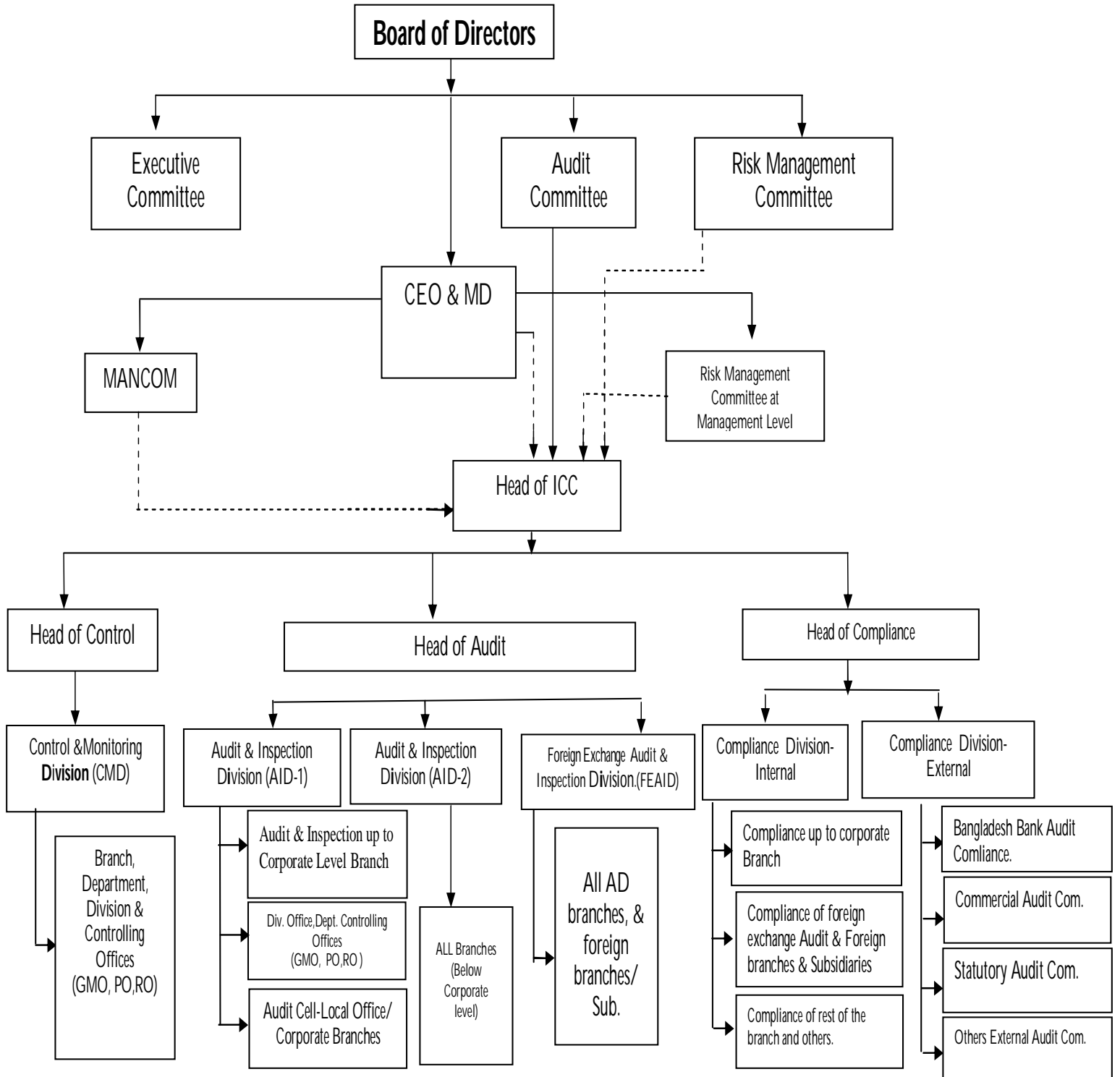
CHAPTER- 2

2. Implementation Aspect: Internal Control and Compliance Policy of Sonali Bank Limited

2.1 ICC Details Structure of Sonali Bank Limited:

As per Section 15 (B) & (C) of the Bank Company Act, 1991 (Amended up to 2013), Board of the Directors will be responsible to ensure that management has established and implemented sound risk management policy and internal control & compliance policy within the banking operation. Board should establish an effective and efficient internal control and compliance unit within the bank so that independent Audit & Insp. Division works freely and independently without any sorts of intervention of the management and directly reports to the Board Audit Committee. To comply this instruction as well as to implement the guidelines circulated through BRPD Circular No-11 dated 27 October 2013, DOS Circular No-02 dated 15 February 2012 and Bank should restructure its organogram and redesign the ICC structure in the following shape:

ICC Details Structure of Sonali Bank Limited



At this stage Head of ICC will be at least General Manager level executive & Divisional Head will be at least DGM level executive. The responsibility of head of Control, head of audit and head of compliance will remain with head of ICC.

To ensure effective ICC system for Sonali Bank Limited, if think appropriate DMD level executive may be posted as Head of ICC and GM level executive as head of control, audit and compliance in course of time.

As per Bank Company Act, 1991 (Amended up to 2013) and BRPD Circular-11 dated 27 October 2013, for effective and efficient Internal Control and Compliance system within the Bank, both the Board of Directors and Management of the Bank have crucial role to play.

2.2 Board of Directors : Oversight

The responsibility of the Board of Directors is to ensure the establishment of sound and effective internal control system and compliance culture within the bank by the management to confirm the safety and security of total loans and investments of the Bank as well as to protect the interest of depositors. The Board shall perform such responsibilities by establishing sound and effective policies giving necessary directions and overseeing the functioning of the bank. In the Bank Company Act, 1991 (Amended up to 2013) the newly included Section 15(kha) & (ga) give responsibility to the Board of Directors for establishing policies for the bank company, for risk management, internal controls, internal audit, and compliance and for ensuring their implementation. They should ensure the establishment of independent audit and effective compliance culture within the Bank. The overall responsibility of establishing broad business strategy, significant policies and understanding significant internal control and compliance risks of the Bank rests with the Board of Directors.

- Board should recommend the necessary steps to establish an effective and efficient internal control system and compliance culture within the bank to ensure the existence of sound control environment and robust compliance culture.
- Through the establishment of 'Audit Committee' the Board of Directors should monitor the effectiveness of internal control system of the Bank and ensure that appropriate compliance of regulators' instructions, rules and guidelines are in place.
- Establishment of fully independent audit & insp. mechanism so that they carry on independent audit functioning without any intervention of the Bank Management to monitor the effectiveness of the organization and procedural control and directly report to the Board Audit Committee.
- Approving a control and compliance risk management policy that provides the senior management with clear guidelines and procedures for managing control and compliance risk.
- Establishing a management structure capable of implementing the bank's control and compliance risk management process.
- Periodical review of the bank's control and compliance risk management policy to ensure the implementation of proper guidance for effectively managing the institution's overall control and compliance risk.
- Review the quarterly control and compliance status report on observations of Internal Auditors, External Auditors, Bangladesh Bank and other regulatory authorities that will be produced to the Board by the Compliance Division through Audit Committee.
- Have periodic review meetings with the senior management to discuss the effectiveness of the internal control system of the Bank and ensure that the management has taken appropriate actions as per the recommendations of the internal and external auditors.
- Board should review the Internal Control and Compliance Policy annually to make it more worthy.

2.3 Board Audit Committee : Oversight

In compliance with Bangladesh Bank guidelines and Bangladesh Securities and Exchange Commission (BSEC) notification on Corporate Governance, the Audit Committee (AC) of the Board of Sonali Bank Limited (SBL) has been formed by the Board of Directors to ensure the independent oversight of the Bank's financial reporting, non-financial corporate disclosures, internal control and compliance system, compliance of required rules and regulations etc. The major objectives of the Audit Committee regarding Internal Control and Compliance oversight are:

- To review the financial reporting process, system of internal control and compliance, approach to manage risk, audit process, findings of central bank comprehensive audit and the bank's process for monitoring compliance under relevant laws and regulations and its own code of business conduct.
- To assist the Board in fulfilling its oversight responsibilities including achievement of the vision, mission, strategies, goals and objectives and overall business plans set by the Board for effective functioning of the bank.

2.3.1 Role and Responsibilities of Audit Committee

The role of Audit Committee of SBL has been framed by considering the provision of BRPD Circular No-11, dated 27 October 2013, DOS Circular No-02, dated 15 February 2012 and new corporate governance notification issued by BSEC dated 07 August 2012 and other best practice corporate governance guidelines and standards. Some important roles and responsibilities of Audit Committee are highlighted below:

(a) Internal Control

- Evaluate whether management is adhering to the appropriate compliance culture by communicating the importance of internal control and risk management to ensure that all employees have clear understanding of their respective roles and responsibilities.
- Review the arrangements made by the management for developing and maintaining a suitable management information system (MIS)
- Review whether internal control strategies recommended by the internal and external auditors are being implemented timely by the management.
- Review the existing risk management policy and procedures for ensuring an effective internal check and control system.
- Review the corrective measures taken by the management as regards the reports relating to fraud and forgery, deficiency in internal control or other similar issues detected by internal and external auditors and inspectors of the regulators and inform such to the Board on a regular basis.
- The head of internal control and compliance will directly report to the Audit Committee of the Board and in matters requiring immediate operational decisions and action also to the CEO & MD.

(b) Audit & Inspection.

- Evaluate whether audit & inspection functioning is fully separated and independent from the bank management or not.
- Review the activities and organizational structure of the audit & inspection functioning and ensure that no unjustified restrictions or limitations are made to perform the independent audit & inspection functioning.
- Review and assess the annual audit & inspection plan.
- Review the efficacy and effectiveness of audit & inspection functions.
- Review the findings and recommendations made by the internal auditors for removing the deficiencies, if any detected are duly acted upon by the management in running the affairs of the bank.
- Meet periodically with the head of ICC where head of Control, head of Audit and head of Compliance review their performance.

(c) External Audit

- Review and make recommendations to the Board to be put to shareholders for approval at the AGM in relation to the appointment/ re-appointment and removal of the bank's Audit firm.
- Meet regularly with the external auditors, including once at the planning stage, before commencement of the audit, and one or more times during the finalization of audit report.
- Review the findings and recommendations made by the external auditors to resolve the irregularities, if any, detected by them.

(d) Compliance with existing laws and regulations

- Review the compliance status of the Bank
- Review whether the laws and regulations introduced by the regulatory authorities (Central Bank, BSEC and other regulatory bodies) and internal circulars /instructions/policies and regulations approved by the Board and Management are properly complied.

(e) Others

Review the quarterly compliance status on observations of Internal Auditors, External Auditors, Bangladesh Bank and other regulatory authorities that will be produced by Compliance Division to the Audit Committee and accordingly quarterly compliance status report of the Bank will be produced to the Board by the Audit Committee. Board Audit Committee should review the Internal Control and Compliance Policy annually and suggest recommendations to keep it updated and to make it more fruitful.

2.4 Board Risk Management Committee : Oversight

The Board Risk Management Committee is required to play an effective role in mitigating impending risks arising out from strategies and policies formulated by the Board and to carry out the responsibilities efficiently, Board Risk Management Committee shall take the responsibilities to identify and to assess several risk factors like credit risks, foreign exchange risks, internal control and compliance risks, money laundering risks, information and communication risks, management risks, interest risks, liquidity risks, etc. Future it will scrutinize whether appropriate risk management measures are being put in place and applied and whether adequate capital and provision is being maintained against the risks identified.

2.4.1 Role of Risk Management Committee

The major roles of Risk management Committee regarding Internal Control System and Compliance are as follows:

- Formulation and monitoring the implementation of appropriate strategies for risk assessment and its control. Board will ensure that the Risk Management Committee will monitor risk management policies & methods and amend it if necessary. The committee will review the risk management process to ensure effective and control measures are in enforced.
- The responsibility of Risk Management Committee is to ensure an adequate organizational structure for managing risk within the bank. The Risk Management Committee will supervise formation of separate management level committees and monitor their activities for the compliance of instructions of lending risk, foreign exchange transaction risk, internal control & compliance risk, money laundering risk, information & communication risk including other risk related guidelines.
- Risk management policies & guidelines of the bank should be reviewed annually by the committee. The committee will propose amendments if necessary and send it to the Board of Doctors for their approval. Besides, other limits including lending limit should be reviewed at least once and should be amended, if necessary.
- Risk Management Committee will monitor proper implementation of overall risk management policies. They will monitor whether proper steps have been taken to mitigate all risks including lending risk, market risk, and management risk.

2.5 Duties and Responsibilities of the MD & CEO Regarding ICC

The MD & CEO of the bank shall discharge the responsibilities and effect the authorities regarding ICC of the bank as follows:

- The MD & CEO shall ensure the existence of efficient, effective and independent ICC structure within the bank.
- The MD & CEO shall ensure compliance of the Bank Company Act, 1991 (Amended up to 2013) and other relevant laws and regulations in discharging routine functions of the bank.
- At the time of presenting any memorandum in the Board Meeting or Board Committee Meeting , the MD & CEO must point out if there any deviation from the Bank Company Act, 1991 (Amended up to 2013) and other relevant laws and regulations.
- The MD & CEO shall report to Bangladesh Bank any violation of the Bank Company Act, 1991 (Amended up to 2013) or of other laws/regulations.
- If ICC reports to CEO & MD any matters requiring immediate operational decision and action, he will take necessary steps for the interest of the Bank.

2.6 Responsibilities of the Senior Management (MANCOM)

In setting out a strong internal control and compliance framework within the Bank, the role of Managing Director is very important. He/she will establish a 'Management Committee' (MANCOM), which will be responsible for the overall management of the Bank.

- The MANCOM will establish an effective organizational structure for control and compliance risk management and be in regular contact with employees who are directly responsible for conducting control and compliance risk management.
- The MANCOM will implement the control and compliance risk management system approved by the Board.
- With governance & guidance from the Board of Directors, the MANCOM will put in place policies and procedures to identify, measure, monitor and control these risks.
- The MANCOM will put in place an internal control structure in the banking organization, which will assign clear responsibility, authority and reporting relationship.
- The MANCOM will monitor the adequacy and effectiveness of the internal control system based on the bank's established policy & procedure.
- The MANCOM will ensure that all employees are working in order to protect the Bank's reputation.
- The MANCOM will ensure that sufficient skilled manpower and technical resources are devoted for control and compliance risk management system. They should also ensure that the right man is in right place at the right time.
- The MANCOM will ensure the existence of ongoing control and compliance for all business lines, particularly, when introducing new banking products or new market areas.
- The MANCOM will review the overall effectiveness of the control system of the organization on a yearly basis and provide a certification to the Board of Directors on the effectiveness of Internal Control policy, practice and procedure.

2.7 Role of Head of Internal Control & Compliance (ICC)

The major responsibilities of head of ICC is to ensure that Bank should have effective and efficient control environment in operation as well as Bank complies with rules, regulations and regulatory requirements while conducting its business. He will look after the overall activities of Control and Compliance (i.e. monitoring, audit & insp. and compliance) of the bank.

The main responsibilities of the Head of Internal Control & Compliance (ICC) are risk identification of various activities of a bank and to address that appropriately. It verifies whether the control policies and procedures are being complied with. Head of ICC continually recognizes and assesses all of the material risks that could adversely affect the achievement of the Bank's goals. The risk assessment by internal control focuses more on compliance with regulatory requirements, social, ethical and environmental risks that affect the banking industry.

The head of ICC is responsible for all the audit and inspection as well as compliance and control related activities of the Bank which include compliance with laws and regulation, audits and inspection, monitoring activities and risk assessment. The head of ICC will be fully independent and isolated from bank's other day to day operations and he should directly report to Audit Committee of the Board. He should discharge his duties and responsibilities without any intervention of the bank management. This unit must also have an administrative reporting line (indirect reporting line) with the CEO & MD. In

addition to that, he will also maintain indirect reporting line with MANCOM and Board Risk Management Committee for better risk purpose of the Bank.

As a head of Internal Control and Compliance (ICC) of the Bank, he is responsible for the activities that are performed under Audit and Inspection Division, Control and Monitoring Division as well as Compliance Division of the Bank. In addition to above mentioned responsibilities, he is also responsible for the following:

- ⇒ To supervise and monitor the activities of Control and Monitoring Division, Audit and Inspection Division (activities of AID-1, AID-2 and FEAIID) and Compliance Division (Compliance-internal & Compliance-external) of the Bank.
- ⇒ He will supervise the preparation of risk based annual audit work plan, getting approval from the Audit Committee of the Board. Also supervise the setting of annual target relates to monitoring and compliance functioning of the Bank.
- ⇒ He will be responsible to establish an effective control environment and true compliance structure within the Bank.
- ⇒ To execute the approved yearly audit plan, he should keep close monitoring on activities of audit and inspection division of the Bank.
- ⇒ Review the executive summary along with audit and inspection reports that are placed to him by the head of audit and inspection division. Based on the severity of audit findings, he may forward such to the Audit Committee of the Board if found justified.
- ⇒ Keep close monitoring on functioning of monitoring and compliance division.
- ⇒ He will be responsible to design risk based annual audit plan to address the risky area of the Bank with consultation and proper coordination with other divisional heads. Then the plan should be placed before Audit Committee of the Board for final approval. He will also be responsible to monitor and supervise all sorts of policy related activities of Audit and Inspection Division and Monitoring and Compliance Division of the Bank.
- ⇒ He will sign the Board Memo that will place to the Audit Committee of the Board and the Board of the Directors. He will attend in Board Audit Committee meetings and Board of the Directors meeting to answer any query raised by any honorable member of the Audit Committee of the Board and Board of Directors regarding ICC of the Bank (if required).
- ⇒ He should approve and produce the quarterly performance reports, quarterly audit and inspection summary reports, quarterly control and monitoring summary reports and quarterly compliance status reports to the Board Audit Committee. He will also provide these reports to the Board Risk Management Committee, if necessary.
- ⇒ He should recommend appropriate training for the ICC personnel of the Bank and recommend need based training proposal to the Bank's Training institute.
- ⇒ He should maintain direct reporting line (functional reporting line) with Audit Committee of the Board and Board of Directors. He should also maintain indirect reporting line (administrative reporting line) with CEO & MD, MANCOM, Departmental Risk Management Committee and Board Risk Management Committee. For any serious lapses, where immediate reporting is demanded, the Head of ICC will produce a memo to the Chairman of the Audit Committee as well as copy to CEO & MD immediately.
- ⇒ He will carry out all sorts of activities instructed by Audit Committee of the Board and Board of Directors of the Bank and the other appropriate authority.

CHAPTER-3

3. Internal Control and Monitoring Policy

3.1 Overview

Banking is a diversified and complex financial activity which is no longer limited within the geographic boundary of a country. Since its activities involve high risk, the issue of effective internal control system, corporate governance, transparency, accountability has become significant issues to ensure smooth performance of the banking industry throughout the world. In many banks internal control is identified with internal audit and inspection, though the scope of internal control is not limited to audit work. It is an integral part of the daily activities of a bank, which on its own merit identifies the risks associated with the process and adopts a measure to mitigate the same. Internal audit & inspection on the other hand is a part of internal control system which reinforces the control system through regular review.

According to an IMF publication, Internal Control refers to the mechanism in place on permanent basis to control the activities in an organization, both at the central and a department/ divisional level. A key component of effective internal control is the operation of a solid accounting and information system.

In Bangladesh, an analysis on the performance of the banks has pointed out that an effective internal control system could have contributed significantly in improving the performance of the commercial banks if the control culture is brought in through policy guidelines and structural changes at these banks.

Recent developments in the financial sector have proved that good risk management and corporate governance are crucial to the strength and success of banking business. An effective internal control system is an integral part of risk management framework.

A properly designed and strictly enforced system of internal control helps to protect the Bank's assets and profitability from operational losses, frauds and forgeries, as well as helps to comply the required laws and regulations and creates value for stakeholders.

3.2 Definition and Purpose

Internal control denotes a set of tools directed towards the achievement of organizational overall objectives. It helps an organization in maintaining its operational soundness, achieving performance and profitability targets, and preventing loss of resources. It can also help in ensuring reliable financial reporting and compliance with relevant laws and regulations. Many organizations try to define internal control in different ways. One of the widely accepted definitions is given by the COSO (The Committee of Sponsoring Organizations of the Treadway Commission) which defines Internal Control(IC) as " a process effected by the entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objective, the effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations ". It is worth-mentioning here that the Guideline on Internal Control and Compliance by Bangladesh Bank (BB) defines IC in almost the same way as that by the COSO.

Internal control is the process, effected by a company's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with applicable laws, regulations and internal policies.

Internal controls are the policies and procedures established and implemented alone or in concerned with other policies or procedures, to manage and control a particular risk of business activity or combination of risks or business activities to which the company is exposed or in which it is engaged.

At a glance internal control covers-

<p><u>PURPOSE-1</u> To promote orderly, economical, efficient, and effective operations and to produce quality products and services consistent with the organization's mission.</p>	<p><u>DEFINITION</u> Internal controls or an internal control system are the integration of the activities, plans, attitudes, policies and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve it's objectives and missions.</p>	<p><u>PURPOSE-3</u> To ensure adherence to laws, regulations, contracts and management directives.</p>
<p><u>PURPOSE-2</u> To safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud.</p>		<p><u>PURPOSE-4</u> To develop and maintain reliable financial and management data and accurately present that data in timely reports.</p>

If an organization addresses each of these four purposes in developing its internal control system, the organization will most likely achieve its objectives and mission. Failure to adequately address any one of these purposes may put the organization at risk.

In recent years, many groups and organizations have published standards and guidelines on internal control and defined it in various ways. Each of those definitions has captured the basic concept of internal control using different words. The definitions are similar in recognizing internal control's extensive scope, its relationship to achievement of an organization's mission and its dependence on people in the organization.

An internal control system should provide reasonable assurance that an organization will accomplish its objectives; the concept of reasonable assurance recognizes that the cost of an internal control activity should not exceed the benefit derived there from.

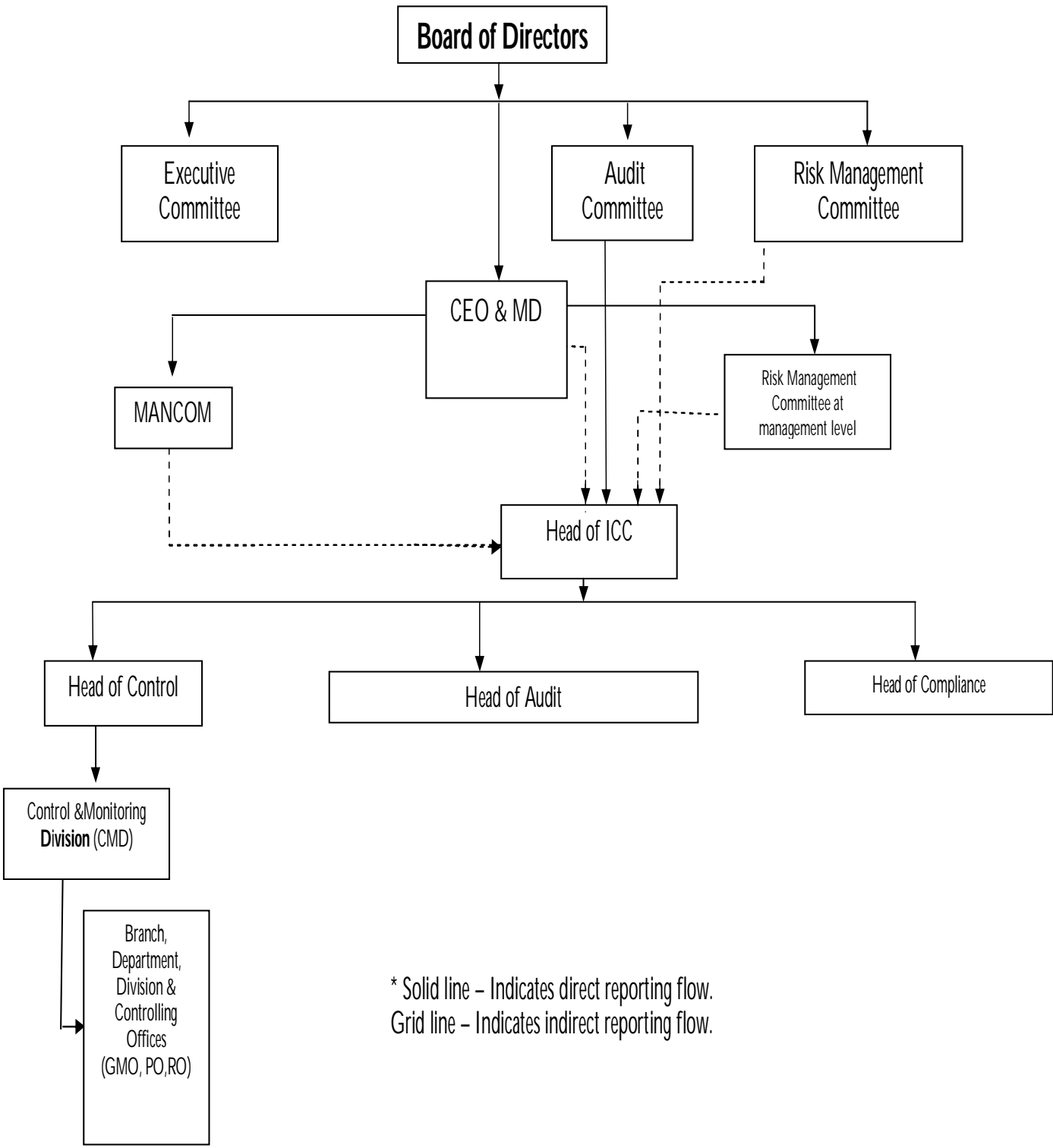
3.3 Mission

Control and Monitoring Division (CMD) takes proactive approach to assist the Bank's Board of Directors and senior management in carrying out their management control responsibilities while striving to provide reasonable assurance that the mission and objectives of Sonali Bank Limited are met efficiently and effectively.

3.4 Organizational Structure of Control & Monitoring Functioning of Sonali Bank Limited:

In line with BRPD Circular No. 17 dated 07-10-2003 & BRPD Circular -11, dated 27-10-2013, Sonali Bank Limited should restructure the total monitoring function through CMD as under:

Organizational Structure of Control & Monitoring Division



* Solid line – Indicates direct reporting flow.
 Grid line – Indicates indirect reporting flow.

Before deploying Head of Control, the Head of ICC will perform that function

3.5 Objective of Control and Monitoring Division (CMD)

The primary objective of control and monitoring system in a bank is to help the bank perform better with appropriate use of its resources. Through control and monitoring system, bank identifies its weaknesses and takes appropriate measures to overcome the same. The main objectives of CMD are as follows:

- (i) Ensure efficiency and effectiveness of activities (performance objectives).
- (ii) Ensure reliability, completeness and timelines of financial and management information (information objectives).
- (iii) Ensure compliance with applicable laws and regulations (Compliance objectives).

3.6 Purpose and Scope

The purpose of Control & Monitoring Division is to offer a proactive approach of reducing risk to provide reasonable assurance that the Bank's goals and objectives will be achieved. The system includes organizational design, written policies and procedures, actual operating practices and controls to protect assets and all personnel.

CMD will assist the Bank's senior management in establishing systems which discourage the occurrences of errors or irregularities, and to identify within a reasonable time frame, errors or irregularities that may occur. It is the responsibility of the Division to prepare appropriate reports and comments to include identified deficiencies during the course of their assessment of the Bank area in question.

CMD assists in the development of financial and operational Internal control systems, including administrative information systems, to assist in reducing risk so that the Bank's;

- * Financial assets and information are safeguarded,
- * Information is accurate and reliable,
- * Bangladesh Bank and other related policies, procedures, laws and regulations are followed; and
- * Resources are employed efficiently and economically.

3.7 Control & Monitoring Environment

The control & monitoring environment is the framework under which internal controls are developed, implemented and monitored. It consists of the mechanisms and arrangements that ensure internal and external risks to which the Bank is exposed are identified; appropriate and effective internal controls are developed and implemented for sound and prudent management of these risks; reliable and comprehensive system are to be put in place for appropriate monitoring of the effectiveness of these controls. The Bank needs to have in place an appropriate and effective internal control environment to ensure that the Bank is managed and controlled in a sound and prudent manner. The factors which together comprise the control environment are:

- 1 A Board of Directors along with Audit Committee and Risk Management Committee that is actively concerned with sound corporate governance and that understands and diligently discharges its responsibilities by ensuring that the Bank is appropriately and effectively managed and controlled;

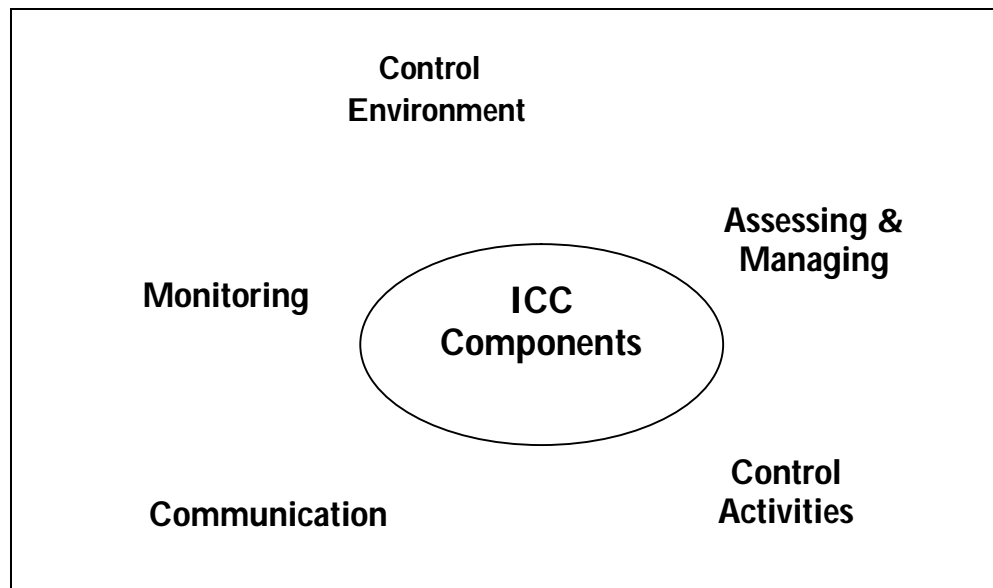
- 2 A management that actively manages and operates the Bank in a sound and prudent manner.
- 3 Organization and procedural controls supported by an effective management information system for sound and prudent management of the Bank's exposure to risk; and
- 4 An independent audit mechanism to monitor the effectiveness of the organization and procedural controls.

3.8 Components of Internal Control System

Typically, management's internal control system has components which direct attention to various areas and functions within the Bank. Among these components are:

1. Control Environment.
2. Communication,
3. Assessing and Managing Risk,
4. Control Activities, and
5. Monitoring.

Diagram: ICC and its Components



3.8.1 Control Environment

Control environment is the attitude towards internal control and control consciousness established and maintained by the management and the employees of an organization. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. The organization's delegation structure and accountability relationships are key factors in the control environment.

3.8.2 Communication

Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Within an organization, information should be communicated to management and other employees who need it in a form and within a time frame that

helps them to carry out their responsibilities. Communication also takes place with outside parties such as customers, suppliers and regulators.

3.8.3 Assessing & Managing Risk

Risks are events that threaten the accomplishment of objectives. They ultimately impact an organization's ability to accomplish its mission. Risk assessment is the process of identifying, valuating and determining how to manage these events. At every level within an organization there are both internal and external risks that could prevent the accomplishment of established objectives. Ideally, management should seek to prevent and/ or control these risks.

Sometimes management cannot prevent the risk from occurring. In such cases, management should decide whether to accept the risk, reduce the risks to acceptable levels or avoid the risk.

To have reasonable assurance that the Bank will achieve its objectives, senior management should ensure each risk is assessed and managed properly.

3.8.4 Control Activities

Control activities are tools- both manual and automated - that help prevent or reduces the risks that can impede accomplishment of the Bank's objectives and mission. Management should establish control activities for effective and efficient accomplishment of the Bank's objectives and mission.

3.8.5 Monitoring

Monitoring is the review of the Bank's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of Bank objectives. For monitoring to be most effective, all employees need to understand the Bank's mission, objectives, responsibilities and risk tolerance levels. All the components are important to the success of a Bank. However, the control environment is especially significant. This component is the foundation on which the other components are dependable. If this foundation is not effective and strong, the rest of the system will not be as effective as it should be in ensuring that the Bank accomplishes its mission.

The internal control system is intertwined with the Bank's operating activities, and is most effective when controls are built into the Bank's infrastructure becoming part of the very essence of the organization.

An effective internal control structure can actually be part of the competitive advantage of the organization.

3.9 Policy Guidelines of Internal Control

3.9.1 Risk Recognition and Assessment

- An effective internal control system continually recognizes and assesses all of the material risks that could adversary affect the achievement of the bank's goals.
- Effective risk assessment must identify and consider both internal & external factors. Internal factors include complexity of the organization structure, the nature of the Bank's activities, the quality of personnel, organizational changes and also employee turnover. External factors

include fluctuating economic changes in the industry, socio-political realities and technological advances.

- Risk assessment by internal control system differs from the business risk management process which typically focuses more on the review of business strategies developed to maximize the risk/reward trade-off within the different areas of the bank. The risk assessment by internal control focuses more on compliance with regulatory requirement, social, ethical and environmental risks those affect the banking industry.

3.9.2 Process Guidelines

Bank should have policy guidelines in order to ensure an effective control over its process in various fields i.e. credit, human resources, finance and accounts, treasury, audit, customer service etc. The Bank should have updated policy guidelines/manuals for each Division's function which may be as follows:

- a) Credit Policy Manual/Guidelines.
- b) Operations Manual
- c) Finance & Accounting Manual
- d) Treasury Manual
- e) Human Resource Policy/ Manual
- f) Internal Control & Compliance Policy/Manual
- g) Loan Review Policy
- h) Assets Liabilities Management Policy,
- i) Liquidity Management Policy
- j) Various Risk Management Policy/Guidelines.
- k) IT security Policy/ Guide line
- l) CBS operation manual

3.9.3 Control Activities and Segregation of Duties

Effective internal control system requires that an appropriate control structure is set up with control activities defined at every business level, i.e. top level review; appropriate activity controls for different division or divisions; physical controls; checks for compliance with exposure limits and follow-up on non-compliance; a system for approvals and authorization and system of verification and reconciliation.

Control activities involve two steps:

- a) The establishment of control polices and
- b) Verification that the control policies and procedures are being complied with.

Senior management should ensure that adequate control activities are an integral part of the daily functions of all relevant personnel; this enables quick response to changing condition and avoids unnecessary costs. Controls activities are most effective when they are viewed by management and all other personnel as an integral part of daily activities rather than an addition to it.

One of the most important aspects of internal control system requites that appropriate segregation of duties and personnel are not assigned conflicting responsibilities.

Furthermore, the employees must also be provided with necessary authority which will enforce segregation of duties with proper check and balance.

For employees to carry out their responsibilities properly each employee should have appropriate job description.

Areas of potential conflicts of interest should be identified, minimized and subjected to careful independent monitoring.

3.9.4 Responsibilities of Control and Monitoring Division

The Head of Control and Monitoring Division has the responsibility for coordinating the internal control activities of the Bank. The Monitoring Division's responsibilities are to help:

- * Establish a system of internal control culture;
- * Make available management policies and guidelines for all employees;
- * Establish a system of internal control review;

Briefly, the major responsibilities of Control and Monitoring Division include:-

- * Design, develop, and implement a system of internal control and accountability;
- * Development of performance measurement and monitoring techniques;
- * Develop and maintain an ongoing Self-Assessment of Anti-Fraud Internal Controls continuous improvement program;
- * Assessing degree of regulatory compliance in financial and operational process to ensure that these will provide reliable safeguards of the Bank's assets.
- * Working in partnership with management to ensure policies and procedures are effective and efficient, and suggesting policies and procedures where appropriate;
- * Serving as a resource to the Board of Directors, Board Audit Committee, Board Risk Management Committee, Board Executive Committee, the CEO & MD and senior management in identifying the need for and characteristics of adequate systems of control;
- * Responsible to prepare Bank's Health Check Report on a regular interval,
- * Manage and participate in major systems development initiatives to ensure appropriate internal controls and accountability considerations are included in the efforts
- * Review new systems and designs for efficiency of internal control features,
- * Review process and streamlining improvement to ensure the inclusion of appropriate Embedded controls.

However, the establishment of the CMD does not in any way diminish the responsibility of managers to oversee internal control of their operations.

Further, it is important to note that the duties and responsibilities of the head of CMD should be separated from those of the internal auditors. As explained above, the head of CMD coordinates the internal control program for the Bank. He or she establishes procedures, guidelines and requirements that employees should follow to ensure the system of internal control is functioning properly.

The internal auditor is responsible for evaluating the effectiveness of this system and should be independent of the processes he or she audits. Therefore, the same individual cannot simultaneously fulfill responsibilities for both the head of monitoring and internal auditor and effectively maintain the necessary independence.

3.9.5 Management Information System (MIS)

For effective control and monitoring of compliance risk, a robust management information system (MIS) should be in place. MIS should enable the bank to identify and measure its compliance risk on a timely manner and generate data and reports for use by the board and management.

The effectiveness of risk monitoring depends on the ability to identify and measure all risk factors, and must be supported by appropriate, accurate and timely MIS with analysis and decision making. Therefore, management must develop and upgrade its information system to identify and measure risks in an accurate and timely manner. The MIS should be consistent with the complexity and diversity of the bank's business operations.

The bank should establish a database of its legal documents. This database should contain at least: type of legal documents (contracts, memorandum of understanding, etc.), period of document validation, and responsible division for document enforcement.

3.9.6 Internal Control & Monitoring Charter

Internal control is a process, effected by an entity's Board of Directors, Management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in three categories:

- * Effectiveness and efficiency of operations
- * Reliability of financial reporting, and
- * Compliance with applicable laws and regulations

Internal control can be judged as effective in each of these categories if the Board of Directors and management have reasonable assurance that:

- * They understand the extent to which the entity's operational objectives are being achieved.
- * Published financial statements are being prepared reliably.
- * Applicable laws and regulations are being complied with.

Monitoring Unit assists in the development of financial and operational Internal control systems, including administrative information systems, to assist in reducing risk so that the Bank's financial assets and information are safeguarded, information is accurate and reliable, Bangladesh Bank and other related policies, procedures, laws and regulations are followed; and resources are employed efficiently and economically. Monitoring Unit is responsible for the verification of all internal control functions within the Bank.

3.9.7 Control Perception: Employee's Perceptions of Internal Control

Very often, employees believe internal control is the responsibility of the organization's internal control officer or the auditors who periodically review their activities. Employees may view internal control this way because they hear about internal control only during or shortly after an audit. The auditor routinely reviews the organization's system of internal control to evaluate its financial statements and related transactions. If the auditor finds significant errors in those statements or transactions he or she would cite a failure in the internal control system.

However, it is the organization's Management, not the internal control officers (ICO's), who are responsible for establishing the system and for preventing such breakdowns from occurring.

Managers generally have the authority to influence, to some degree, the integrity of the components of the internal control system. Managers make decisions, policies and plans, and create the work atmosphere, which influences all the components. Therefore, managers are often held accountable for any failures of the system.

3.9.8 Critical Control Function

The Bank's Board, Audit Committee, Risk Management Committee, Head of ICC, CEO & MD and senior management committee (MANCOM) must ensure that appropriate internal controls are in place. All employees are ultimately responsible for operating and maintaining an efficient internal control system at their respective levels.

However, the head of CMD should acquire/gain a thorough understanding of all areas of risk and ensure that the necessary controls are in place to mitigate them.

3.9.9 Evaluation

An important part of internal control system is meant to detect errors/discrepancies in the internal control system; to minimize deviations from policies, procedures and laws; and to recommend improvements.

Evaluation is a multi-party process undertaken by Internal Auditors, External Auditors and Bangladesh Bank who use different techniques keeping in mind the objectives of their respective evaluations.

The Evaluation process in all cases should ensure the following control are in place and are working effectively;

i. Organizational Controls

- * Board/Board Committee level authorities are clearly determined.
- * Regular reporting to Board/Board Committee of business performance and all key areas of risk;

ii. Management Controls

- * Clear delegation of management responsibilities and authorities;
- * Clear delineation between front- middle- back office functions, such that independence of Check is not compromised;
- * Formal policies and limit structures for all types of business and risk;
- * Regular monitoring of risk levels by management;
- * New business services/ products are properly reviewed before adoption;
- * Fully documented procedures (e.g.: proper manuals, job descriptions, etc.) for all day-to-day processes;
- * Staffing levels and capabilities are adequate.

iii. Key Operating Controls:

- * All job responsibilities are clearly defined;
- * All transactions are properly authorized, documented, booked and settled;
- * Payments require dual authorities;
- * Clear segregation of duties over confirmation, payment and nostro functions;
- * Independent Profit/ Loss (P & L) valuation checks in place;
- * Regular reconciliation of books and records;
- * Client's moneys are properly segregated;
- * Valuation statements are sent to clients regularly (where applicable);
- * IT systems are stable and secure;
- * Change management procedures are effective;
- * Business continuity plans are in place.

iv. Regulatory issues

- * Statutory reports are completed accurately and on time;
- * Regulatory limits are complied with;
- * Formal client identification-Know Your Customer (KYC) and
- * Due diligence checks performed on all new customers.

v. Other

It is important also to recognize that the Bank must exercise effective control over standard functions such as fixed assets, personnel and payroll, suspense accounting and physical security.

Policies, Procedures and Controls:

To strengthen the overall internal control and compliance (ICC) functioning of the bank, the head of control and monitoring division will also ensure the following issues at a regular interval as deemed appropriate:

1. Central Bank

The Branch / office was last audited by the Central Bank on

We confirm that adequate corrective action have been initiated to remove the deficiencies other than the following papers of their Audit Report.

Audit Para number	Original Target Date of Rectification.	Revised Target Date

2. Internal Control (Local):

The Branches/Office operational functions were also last audited by the internal control on We confirm that adequate corrective actions have been initiated to remove the deficiencies other than the following paras of the report.

Audit Para number	Original Target Date of Rectification.	Revised Target Date

3. Regulatory Compliance:

We confirm that regulatory requirements in Bangladesh as outlined by Bangladesh Bank / other Govt. Ministry have been complied with except the following :

SL.No.	Compliance Risk	Legislation	Remarks

4. Customer Service Standards:

The Customer Services standards of branches/divisions have been checked and documented as per guidelines from HO. The shortfalls detected during the last quarter will be removed within the target set.

5. Computer Access:

We confirm that administrator passwords are held in dual custody.

6. Closed Circuit Television (CCTV): (This clause will be used for (CCTV holders only).

We confirm that operation and recording of day's activities in CCTV installed in the branch and ATM's where applicable and have been checked regularly.

7. Departmental Control Functions Checklists:

The DCFCLs were completed and documented as per Head Office guidelines by the concerned department, which have been verified by the concerned officials.

8. Internal Checks:

We ensure that all internal checks as per Head Office guidelines are performed properly.

9. Fraud Forgeries:

During our audit, any sorts of fraud forgeries are not noticed to our knowledge.

10. Complaints:

We confirm that complaint letters received from customers were dealt with in terms of Head Office guidelines. All complaints in the form of statement including pending complaints of previous quarter have been forwarded to Head Office Internal Control team for review.

11. Returns:

We confirm that returns to Head Office / Regional Office/ Bangladesh Bank including those under calendar of returns have been submitted within the schedule dates except the following:

Title of Return	Due Date	Reasons for Delay	Section

12. Fixed Assets:

We confirm that :-

Quarterly as on December, March, June and September all items of fixed assets deployed to the branch have been verified with the departmental inventories.

- a) The entries passed through profit & loss in respect of sales of fixed assets have been addressed properly.

Protection of valuables:

- a) Change of keys :-

We confirm that the key register is being maintained as per prescribed procedure.

- b) Safe Custody:-

We confirm that safe custody items are being maintained under dual custody and the last complete independent physical verification of safe custody items as per Head Office instruction complied properly.

- c) Safe Custody Lockers: - Confirm that Annual internal checks are conducted as per rule.

Custodian-1

Custodian-2

- d) Test Keys :-

Test Keys/Code books are being maintained as per requirements.

- e) Signature Booklets :-

All Signature Booklets of branches and correspondent banks are being maintained as per rule.

- f) Cash/TCS/SPS etc. :-

Cash / TCS / Prize bonds / foreign currencies / Sanchay Patra/Wage Earners Development Bonds are being dealt as per rule.

- g) Vault Security and Vault Management etc. :-

Varified the security management and other security aspects as per latest bank circulars and vault management are carried on as per rule. These issues should be reported by respective control office/ branch at a regular interval to the head of ICC.

3.9.10 Testing Factors

- * Internal Control and Monitoring Division (CMD) shall focus on process control effectiveness and enhancement but not only for error detection and correction.
- * The CMD shall be responsible for evaluating process effectiveness and influencing enhancement but not directly responsible for the performance, of audit rating of this process.
- * Tasks assigned to CMD must be consistent with its responsibilities.

- * The CMD head shall not have any financial or maintenance access, except for maintaining/creating user profiles.
- * Internal CMD shall receive quarterly report from the Audit & Insp. Division regarding major issues noticed and reported to the Audit Committee, Managing Director and senior Management.

3.9.11 Internal Control Process

Control & Monitoring Division carries on site sampling random basis identity and removes the leakage of ICC. Field Control also ensure the proper compliance of DCFCL/LDC/ QOR etc. either as surprise visit or as part of regular monitoring purpose.

I) Departmental Control Function Checklist (DCFCL)

- a) The guideline procedure deals with matters relating to review/ verifications of departmental function to ensure that prescribed procedures are being following by each department.
- b) All departments are required to check that prescribed controls are being observed and laid down procedures are not overlooked & relaxed.
- c) Departmental Managers, Line Managers, Branch Manager will review the DCFCL to ensure that control functions are performed and documented in the control sheets at the prescribed frequencies i.e. Daily, Weekly. Monthly and Quarterly.
- d) The DCFCL Checklist should be retained with the branch/departments for future inspection by Internal Control and senior Management.

II) Loan Documentation Checklist (LDCL)

The Checklist deals with matters relating to security documentation for sanctioning and draw- down credit facilities to ensure that prescribed documentation is being obtained to safeguard bank's legal charges.

III) Quarterly Operations Report Appendix

- a) This guideline/ procedures relates to reporting of operational functions of each branch /centre under the following heads on the enclosed format:
 - i) Policies, Procedures and Controls
 - ii) Protection of Valuables
 - iii) Proofs/Verifications and Internal Checks
 - iv) Personnel and Supervision
 - v) Premises Management and
 - vi) Confirmation on Regulatory Compliance
- b) A quarterly report will be prepared in duplicate by each branch/ centre in the prescribed format; one copy is to be dispatched to the Line Management and another copy to Internal Control Team by 10th of the following month i.e. 10th April, July, October, and January each year.
- c) The items which are not applicable for individual Branch or Department should be market as N/A and no signature is required against the items market as N/A.
- d) Any deviation in the quarterly operations report must be reported in a separate exception report.
- e) All concerned are advised to adhere to the requirements as outlined in each of the above head for review by the Line Management quarterly and by Internal Control /Audit as and when they visit the branch /centre.

3.10 Risk Analysis of Control Functions

Individual items in the DCFCL need to be assigned a risk rating in terms of the following dimensions:

- a) Impact: Before taking into account the mitigation (i.e. Insurance) what is the impact of the lapse/ omission.
- b) Probability: After taking into account of the mitigation what is the likelihood of the event occurring.

Following matrix can be used to measure the level of risk of the audit findings. Where appropriate, additional details e.g. financial values can be added. The key principle is that the Bank should be able to differentiate between different levels of risk in their area of activities and then ensure appropriate controls are established.

Score should be plotted on the following table to determine a category of high, medium and low.

Probability	3	High	High	High
	2	Medium	Medium	High
	1	Low	Medium	High
		1	2	3
	Impact			

Table: Risk Assessment Matrix

To arrive at the decision of what constitutes a high, medium or low risk the following template can be used:

Risk Score	Probability: (After taking into account of risk mitigation)	Impact: (Before taking into account of risk mitigation)
3	<ul style="list-style-type: none"> * High probability or almost certainty * High/ frequently recurring * Governed by widely anticipated external factors/ frequency of management review not established * New area of risk with no policy & procedure to deal with the matter * Probability uncertain * Complex, requires specialized skills to mitigate 	<ul style="list-style-type: none"> * Catastrophic/ major impact on the bank * Potential loss in excess of BDT 1 Million * Serious regulatory implications (Revocation of license, imprisonment) /sanctions. * Potential / actual damage to reputation * Major corporate governance failure
2	<ul style="list-style-type: none"> * Evidence of increasing trends * Management reviews largely to manage exceptions * Policies exist but compliance is complex * External factors have medium bearing on ability to follow established standards * Processes require moderate degree of supervision 	<ul style="list-style-type: none"> * Significant impact on the bank * Potential loss in excess of BDT 1,00,000 * Possibility of fines/penalties from regulators * Medium financial loss with some potential for recovery * Medium level of reputation risk * Exposure due to control weakness
1	<ul style="list-style-type: none"> * Unlikely * Isolated incident /Not likely to be repeated * Frequent management review well documented * Clear policy exists 	<ul style="list-style-type: none"> * Potential or actual loss less than BDT 1,00,000 * Low impact on business or reputation * Exposure on regulatory sanctions low * Customer service issues are within expected levels

<ul style="list-style-type: none"> * External factors have low impact on ability to follow established standards * Process simple 	<ul style="list-style-type: none"> * Impact on local business unit level.
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Bank will follow a **separate Branch Risk Based Grading Policy to measure the risk involved** with individual branch and overall bank as a whole. This activity will be conducted by Monitoring Department and supply the data to Audit Division on a yearly basis. Accordingly, the **AID-1 will design the annual Risk Based Audit Plan for the bank to conduct the annual audit functioning.**

3.11 Monitoring & Follow-up

- The Control and Monitoring Division will review the Quarterly Operations Report and Exceptions Report (if any) in addition to the line management. The CMD will instruct the branch to rectify the exception and report the same. If deemed necessary the CMD will instruct the Audit & Inspection Division (AID) to carry out an inspection on the specific deviation.
- Depending upon the gravity of the deviation the head of CMD will report the matter to the Head of ICC and to the Audit Committee of the Board for necessary action and rectification.
- A copy of the Loan Documentation Checklist (LDCL) would be sent by branch/RO/PO/GMO to the CMD, who will review the same. On quarterly basis the CMD will submit a report to the Audit Committee mentioning the discrepancies in credit documentation.
- In addition to the above the CMD will send out the report to Audit & Insp. Division routinely and at a specific date when they conduct surprise check to branches/departments to carry out sample checks on the items mentioned in the DCFL. The frequency and sample volume of these checks are given in the template below:

Risk Rating	Frequency	Sample Volume
High	Quarterly	25%
Medium	Half Yearly	12%
Low	Yearly	10%

3.12 Reporting

The following reporting structure would be used as a benchmark for the banks:

- The CMD will work as a watch dog of total ensuring establishment of sound control environment in the bank and overall ICC implementation functioning.
- As a part of on site monitoring, the CMD will prepare a comprehensive annual plan to review the controlling environment of the branch/department and take approval from the Audit Committee. Then after conducting on site visit on control issues, a report on individual inspection program should be produced to head of ICC through head of Control and its disposal should come from the Head of ICC and within 15 days (except for items that needs to be escalated immediately) the report should be submit to the branch/ business unit for rectification with a copy to line management.
- Up to no high-risk items and less than 5 medium risk items will be reported to the head of ICC by the head of Control.
- More than 3 high-risk items identified in breach will trigger the report to be given to the head of ICC .

- However any losses amounting to more than BDT 10 million will be directly reported to the Audit Committee of the Board through head of ICC and for quick administrative operational action, it shall be addressed to CEO & MD without delay.
- CMD will prepare an annual report on the health of the Bank to be submitted to the head of ICC and the Audit Committee of the Board for onward submission to the Board of Directors/Bangladesh Bank as may be required.
- CMD will prepare and submit Self-Assessment of Anti-Fraud Internal Controls report to the head of ICC as well as to Bangladesh Bank as may be required.
- CMD will also prepare quarterly summary report on site review findings and quarterly summary report of Quarterly Operations Report (QOR) to be submitted to the head of ICC and the Audit Committee of the Board on a regular basis by the Head of CMD. The head of ICC should share this report with Board Risk Management Committee if Audit Committee suggests for better risk management purpose of the Bank, or if the Board Risk Management Committee desires as such.

CHAPTER-4

4. Audit & Inspection Policy

4.1. Overview

Audit & Inspection Divisions will conduct both internal audit and inspection functioning of the Bank. An internal auditor/inspector (hereinafter referred to as auditor) of the Bank conducts audit/inspection on the business affairs of the Bank based on different instructions, rules, regulations, guidelines and procedures laid down in different circulars and circular letters provided by regulators and by the Bank from time to time and other Manuals viz. Credit manual, General Banking Manual, Foreign Exchange Manual, different Risk Management Manuals etc. that have been adopted by the Bank. Therefore, an auditor is to be well conversant with all these rules and procedures and keep himself aware of development in commercial and economic fields at home and abroad, which may have bearing on banking activities. Besides, auditor must keep him very well conversant with relevant legal provisions relating to different types of banking business. In particular, he must be thoroughly familiar with provisions and requirements of the followings, as applicable, to his field of work.

The Bank Company Act, 1991 (Amended up to 2013)

The Companies Act- 1994, and its subsequent amendments.

The Negotiable Instruments Act- 1881.

Bangladesh Bank's Circulars & Guidelines, Guidelines & Instructions endorsed by Banking Division of Ministry of Finance.

Various laws, Rules and Regulations, Policies and procedures regarding bank's operational activities.

All types of circulars, instructions, directives, policies and guidelines issued by the Bank.

Latest MOU with BB,

Annual closing instructions issued by Head Office of the Bank.

Government's instructions, especially for deduction of taxes/levies etc. involving Government revenue.

Objective clauses of Memorandum & Articles of Association of the Bank.

Bank's own circulars and directives etc.

4.2 Internal Audit: Its Relationship with External Audit and Internal Control:

4.2.1. Internal Audit

An internal audit is a review of operations and records, sometimes continuous, undertaken within a business by specially assigned staff. The scope and objectives of the internal audit vary widely in different business and may, particularly in large organizations like Sonali Bank Limited extend to many aspects which are not directly of an accounting in nature. On accounting matters the main objective of an internal audit is to assure management that the internal check and the accounting systems are effective in design and operation. In practice, the internal auditor may often be required to report also on whether the system of accounting and the internal check are economical. Internal audit & insp. is a part of the whole system of internal control, but is not an integral part of the internal check or the accounting system. Two eventual features of an internal audit & insp. are that it should be operated independently and in no circumstances anyone should divest the responsibilities placed upon him.

4.2.2 Relationship With Statutory Audit

On accounting matters, internal auditor and statutory auditor operate largely in the same field and they have common interest in ascertaining that there is:

- a) an effective system of Internal control and check to prevent or detect errors and fraud and that it is operating satisfactorily.
- b) an adequate accounting system to provide necessary information for preparing true and fair financial statements.

Although these two forms of audit have a common interest in important matters mentioned in the preceding paragraph, there are some fundamental differences:-

- a) **Scope:** Extent of work undertaken by internal auditor is determined by management whereas that of statutory auditor arises from responsibilities placed on him by statute,
- b) **Approach:** Internal auditor's approach is to ensure that the banking operation and accounting system is efficient, so that information presented to management throughout the period are accurate and disclose material facts. Statutory auditor's approach, however, is governed by his duty to satisfy himself that accounts to be presented to shareholders show a true and fair view of the profit or loss for the financial period and of the state of the company's affairs at the end of that period.
- c) **Responsibility:** Internal auditor's responsibility is to the management and board whereas statutory auditor is responsible directly to the shareholders. It follows that internal auditor being an employee of the company, does not have the independence status which the statutory auditor possesses.

Notwithstanding these important differences, work of both the internal auditor and the statutory auditor on accounting matters is carried out largely by similar means, such as:

- a) examination of system of internal check, for both soundness in principles and effectiveness in operation.
- b) examination and checking of accounting records and statements.
- c) verification of assets and liabilities, and
- d) Observation, enquiry, making of statistical comparisons and such other measures as may be judged necessary.

4.2.3 Internal Check, Internal Audit and Internal Control

The expressions 'internal audit', 'internal check' and 'internal control' have been used indiscriminately and they are differentiated from each other as under:

4.2.4 Internal Check:

It means a system under which the work is allocated amongst various persons in such a manner that the work of one person is automatically checked by another and thus possibilities of fraud or error or irregularity are minimized, if not completely eliminated.

The term "Internal Check" mentioned above means checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is checked independently or is complementary to the work of another, the object being prevention or early detection of errors and fraud. It includes matters such as delegation and allocation of authority and division of work, method of recording transactions and use of independently ascertained totals against which a large number of individual items can be proved. Internal control comprises the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data and promote operational efficiency in all levels. It extends beyond financial and accounting matters and custody of company assets. Such functions as work study, operations research and production quality control, for example, may be an integral part of the system although not falling within the sphere of finance and accounting.

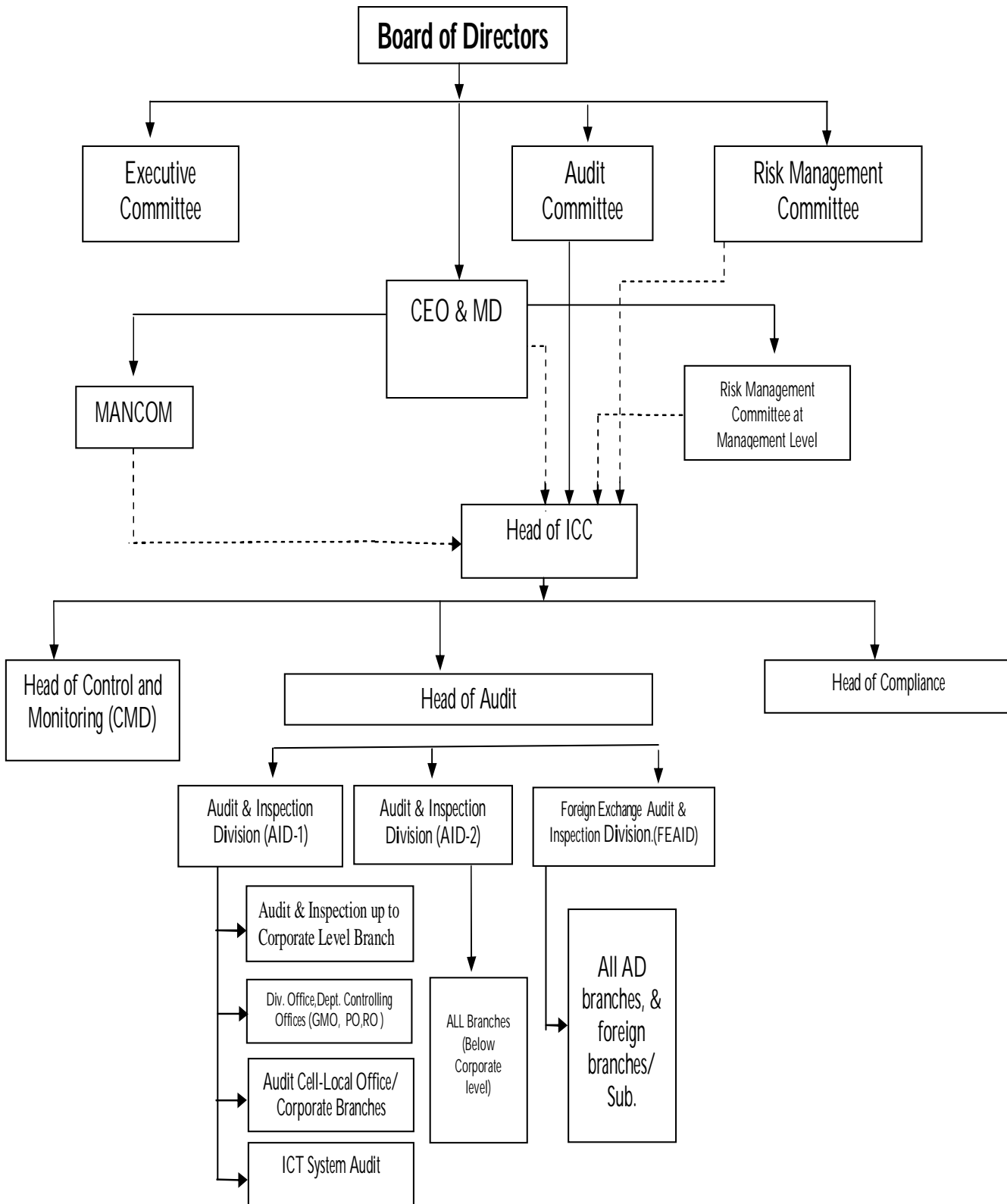
4.2.5 Internal Control:

Internal control is meant not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records.

4.3 Organogram of Internal Audit & Insp. Functioning of the Bank

Bank should have a separate and independent Audit & Inspection Mechanism. Under ICC currently there may have three separate divisions i.e. Audit & Insp. Division-1, Audit & Insp. Division-2 and Foreign Exchange Audit & Insp. Division. All these divisions are individually headed by each individual. Audit & Insp. Division-1 (AID-1) performs internal audit & insp. activities of all the Bank branches covering at least corporate level, controlling offices (GMOs, POs, ROs), Head office Departments and Divisions, General Banking and general loan functioning of AD branches etc. and also ensure the safe and secure ICT system of the Bank through performing ICT system audit. It will also work on policy issues of Audit and Inspection Divisions. It will monitor and supervise the issue of the concurrent audit also. Audit & Insp. Division-2 (AID-2) performs internal audit & insp. activities for rest of the branches of the Bank except AD branches. Foreign Exchange Audit and Inspection Division performs audit and inspection activities on foreign exchange functioning of all the Authorized Dealer Branches of the Bank. Also, the head of ICC may restructure/ rearrange the divisions as deemed appropriate with the approval of the management. Field level inspection will be conducted by respective GMO/PO/RO offices as their own jurisdiction (based on controlling needs) and supply their reports to compliance division. Independent audit and inspection functioning of the bank should be staffed by an appropriate number of personnel that is sufficiently independent and having the quality as desired and prescribed by regulatory authority in latest MoU, to perform the duties objectively. It should be adequately resourced and should have unrestricted access to the Bank's record as well as ultimate recourse to the CEO & MD and/on Audit Committee of the Board of Directors, as the case may be.

Structure of Audit & Insp. Division



Before deploying Head of Audit, the Head of ICC will perform that function

4.4 Objectives of Audit & Insp. Divisions

The main objects of Audit & Insp. divisions are to enforce true and effective risk based audit culture within the Bank to ensure safeguard of depositors' and shareholders' interest within the regulatory framework prescribed by different regulators and by the Board and Management of the Bank. In brief, the core object of internal audit & insp. Divisions are the elucidation of system of internal control & internal check as well as accounting system for detecting or preventing errors and fraud. The objectives of Audit & Insp. divisions of the Bank may be looked at from different angles – general and specific. The general objectives are:-

- i) To check and verify whether the books of accounts i.e., the daily affairs, the Balance Sheet and Profit & Loss A/C are properly drawn up in accordance with the Banking Companies Act.
- ii) To detect and prevent errors and lapses.
- iii) To detect and prevent frauds and forgeries.
- iv) The detection and prevention of errors or mistakes.
- v) The prevention and detection of loss to the client by reason of fraud or misrepresentation resulting in the accounts being false or incomplete.
- vi) Verification of assets and liabilities.
- vii) Observation, inquiry, making of statistical comparisons and such other measures as may be judged necessary.
- viii) Understand, analyze and interpret wide range of information and data.
- ix) Carry on system review as provided by Bank's internal circulars, Bangladesh Bank circulars, Public notices and Book of instructions/manual etc. and
- x) Identify the areas of inefficiency, cost reduction, productivity improvement, and security of assets, weaknesses & leakages.
- xi) To ensure safe and secured IT system in operation and ascertain shortcomings thereof.
- xii) Ensuring authenticated and time-bound Management Information System.
- xiii) Evaluate the quality and quantity of audit and inspection that conducted by GMO/PO/RO while conducting audit and inspection on that branch by Head office audit team and also pass appropriate comments on findings and compliance audit of controlling office.

Considering the general objectives, the specific objectives of audit Divisions of the Bank may be highlighted as: -

- i. To ensure that operations of the Bank are conducted within the framework of principles, procedures and instructions laid down in different operational Manuals and Circulars issued by the Bank and Bangladesh Bank from time to time, Bank Company Act, 1991 (Amended up to 2013) and Govt. policies etc.
- ii. To establish and carry on an independent and objective internal audit & insp. process that adequately monitors internal control systems, tests and reviews information systems and documents test findings and corrective actions.
- iii. To ensure an effective risk assessment process, that is to identify and evaluate the magnitude of the Bank's risk and the quality of its controls over those risks.

- iv. To address the control and compliance risk of the Bank, a risk based audit schedule and scope should be specified so that it focuses on the areas of greatest risk and sets priorities for audit work.
- v. To establish and ensure a process that includes verification and review of management actions addressing material weakness; and a process that requires the Board or Audit Committee to review the internal audit & insp. systems' effectiveness to include review of management responses.
- vi. To take initiatives to keep the Bank, their personnel and their customers free from risk as far as possible.
- vii. To provide proper guidance to the human resources of the Bank to perform their duties well.
- viii. To provide guidance and train up the personnel of the Bank on the basis of common errors and lapses that are committed by them in their day to day operations.
- ix. To suggest adoption of new policy to cope with novel situation and for efficient business operations.
- x. To provide detailed information regarding business affairs of the Bank enabling the Management to chalk out future course of business plan for the Bank.
- xi. To provide the management with the information whether there is any deviation from the set principles, policies, and objectives.

4.4.1 Major Roles and Functions of Audit & Insp. Divisions:

Internal auditing and inspection 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.

Major roles and responsibilities of internal audit & insp. function should be as follows:

- Evaluates and provides reasonable assurance that risk management, control, and governance systems are functioning as intended and will enable the organization's objectives and goals to be met
- Reports risk management issues and internal control deficiencies identified directly to the audit committee and provides recommendations for improving the organization's operations, in terms of both efficient and effective performance. It should also be placed to the Board Risk Management Committee as deemed appropriate.
- Evaluates information security and associated risk exposures
- Evaluates regulatory compliance status.
- Evaluates the organization's readiness in case of business interruption
- Maintains open communication with management and the audit committee
- Teams with other internal and external resources as appropriate.
- Engages in continuous education and staff development.
- Provides support to the company's anti-fraud programs.

4.4.2 Roles & Responsibilities of Head of Audit & Inspection Divisions

Head of Audit is responsible to establish a true and fair audit & inspection culture within the bank under the proper guidelines and follow up of the head of the ICC. He should be responsible for monitoring and supervision of the overall activities of all the division under the control of this Unit (i.e. Audit & Insp. Div.-1, Audit & Insp. Div.-2 and Foreign Exchange Audit and Inspection Division). The head of ICC and head of Audit of the Bank should be free, fair and independent not only in state of mind but also be free, fair and independent in state of appearance. For smooth functioning of Banks' internal audit and inspection, each year the Head of ICC and head of Audit will set out an audit plan for the year to be approved by the Audit Committee of the Board of Directors through head of ICC. This would be a high level risk-based audit plan where priority will be provided to sensitive areas. Risk based branch grading policy should be formulated to measure the risk associated with each branch before designing the annual audit plan for regular audit to address the maximum risk adherent with overall control and compliance activities of the Bank. The deficiencies identified during the audit should be notified to the respective Branch/office and significant audit findings should be reported to the Audit Committee based on the gravity of impacts of those findings. At the end of each quarter, the head of audit will prepare a summary report on the audit findings and corrective actions taken which should be forwarded to the Audit Committee of the Board through the head of ICC.

As head of Audit, he is responsible for all the activities that are performed by his controlling divisions (AID-1, AID-2 and FEAIID). In addition to above mentioned responsibilities, he is also responsible for at least the followings:

- ⇒ To supervise and monitor all the activities of Audit and Inspection division (activities of AID-1, AID-2 and FEAIID) including designing of audit plan, produce such to Audit Committee through the head of ICC, implementation of approved audit plans and its proper follow up.
- ⇒ To execute the approved yearly audit plan, he should employ close monitoring on activities of all the divisions as well as field work of the auditors to ensure that auditors are carrying out their responsibilities within the defined code of conduct and ethics. Head of each division will chalk out a separate audit schedule in such a manner so that the execution of the annual audit plan can be ensured and Head of Audit should employ close monitoring and follow up on those activities.
- ⇒ As a Head of Audit, supervise the guidance and leading activities of head of the divisions through ensuring close monitoring on all the divisional activities as well as employ required attention to supervise all sorts of audit and inspection activities of the Bank over the country that are conducted by the auditors of these divisions.
- ⇒ Review all sorts of executive summary as well as audit and inspection reports that placed to him by the head of each division and approved those accordingly. Based on the gravity of audit findings, he may forward such to the head of ICC and place such to the Audit Committee of the Board subject to approval of the head of ICC.
- ⇒ Employ close monitoring on conducting special audit, re-audit, investigation, fix-up liabilities of the bank employee(s) involved in the irregularities, fraud, crime etc. as and when proposed by the honorable Board/Audit Committee of the Board(ACBOD)/CEO & MD.
- ⇒ He is responsible to monitor & follow up along with carrying out all sorts of administrative functioning of the division.

- ⇒ He is responsible to design risk based annual audit plan to address the risky area of the Bank with consultation and proper coordination with the divisional heads and place the plan to the Audit Committee of the Board for final approval through the head of ICC. He is also responsible to monitor and supervise all sorts of policy related activities of Audit and Inspection Divisions of the Bank.
- ⇒ In light with approved annual audit plan, he will approve all sorts of audit and inspection program of the divisions produced before him for final approval.
- ⇒ To supervise and monitor the **arrangement & conducting all sorts of Co-Ordination Meeting** both in Divisional/Principal/Regional Offices level and others as deemed appropriate. He may also preside the coordination meeting if deemed appropriate.
- ⇒ He will review the Board Memo and place that to the Audit Committee and the Board through head of ICC. He will also attend all the Board Audit Committee meeting to answer any query that raised by the honorable member of the Audit Committee of the Board.
- ⇒ All sorts of policy related activities like designing and formulation of audit manual, policy, guidelines, and directives etc. regarding Banks' audit and inspection should be conducted by the Audit and Inspection Divisions and as a head of Audit, he is responsible to lead, monitor and supervise such activities appropriately.
- ⇒ He is responsible to carry out all sorts of administrative activities and make decisions regarding day to day functioning of the division as per approved power allow to him and should consult with the head of ICC, where necessary.
- ⇒ To conduct Enquiry/Investigation on any kind of fraud, forgery, defalcation, malpractice or any other serious irregularities as he deemed fit or advised by Board Audit Committee. Also lead in conducting of investigation of any breach of a rule or law for which some governing or regulatory authorities or forces may ultimately prescribe a punishment.
- ⇒ To conduct special audit/inspection/ investigation/surprise visit for special purpose as deemed appropriate subject to approval of the head of ICC. He also should submit report to the head of ICC after such activities.
- ⇒ He should prepare a quarterly performance report and quarterly audit and inspection summary reports and that place to the Board Audit Committee through the head of ICC. He also should produce that quarterly summary report to Board Risk Management Committee through the head of ICC.
- ⇒ He should take pragmatic steps to ensure the safety and security of total ICT system of the Bank.
- ⇒ Take initiatives to keep the auditors updated. He should recommends appropriate training and send need based training proposal to the Bank's Training institute in consultation with head of ICC.
- ⇒ Head of audit should take active role to make communication regarding internal audit and inspection of the Bank subject to approval of the competent authority. He should maintain direct reporting line (functional reporting line) with Audit Committee of the Board through the ICC, He should also maintain indirect reporting line (administrative reporting line) with CEO & MD, MANCOM, Departmental Risk management Committee and Board Risk Management Committee through head of ICC.
- ⇒ All sorts of activities that instruct by bank management through office order/circulars/directives or in any form of communications that management deemed appropriate for the interest of the Bank.
- ⇒ Special Assignment or to perform any other duties as instructed by the Higher Management/Board etc.

4.4.3 Roles & Responsibilities of the Audit and Inspection Division-1 (AID-1)

As a divisional head of Audit and Inspection Division-1, he is responsible for all the activities that are performed from his division under the head of Audit, especially, he is responsible to establish a true and effective audit and inspection culture within the Bank, In addition to that, he is especially responsible for at least the following:

1. To supervise and monitor the activities of Audit and Inspection division-1 including designing of audit plan, implementation of approved audit plans and its proper follow up. To execute the approved yearly audit plan, divisional head will form numbers of audit teams that he may deem appropriate and issue office order to the teams in consultation with head of audit to conduct regular audit and inspection of the Local Office, all branches up to corporate level (**excluding foreign exchange operations part of AD branches**) controlling offices (GMOs/POs/ROs), Departments and Division of HO etc. Head of the Division will chalk out a separate audit Schedule in such a manner so that the execution of the annual audit plan can be ensured.
2. As a divisional head, guide and lead all the audit teams, ensuring close monitoring of all the divisional activities as well as employ required attention to supervise all sorts of audit and inspection activities of the Bank over the country conducted by the auditors of this division.
3. Review all sorts of audit and inspection reports along with executive summary that may be placed to him by the subordinates and pass appropriate comments/specific recommendations /proposals to be placed before the head of Audit. He will also ensure the sending of all audit and inspection reports to compliance division without delay as approved by the competent authority. Also conduct correspondences with respective branches/offices as deemed appropriate.
4. He should be responsible to check and verify the safety & security of total ICT system of the Bank. For the purpose, he should arrange regular ICT system audit through his Division.
5. Conduct special audit, re-audit, investigation, fix-up liabilities of the bank employee(s) involved in the irregularities, fraud, crime etc. as and when instructed by the honorable Board/Audit Committee of the Board(ACBOD) /CEO & MD, head of ICC and head of Audit.
6. Head of Audit is responsible to monitor & follow up along with carrying on all sorts of administrative functioning of the Internal Audit Cell/ Concurrent Audit of Local Office & all other branches of the Bank up to Corporate level (if any).
7. He is responsible to prepare audit plan of Audit and Inspection Divisions of the Bank with consultation and proper coordination among other divisional heads. He is also responsible to conduct all sorts of policy related activities of Audit and Inspection Divisions of the Bank.
8. In light with annual approved audit plan, he will approve all sorts of audit and inspection program of his division subject to approval of the head of the division.
9. To arrange & conduct all sorts of Co-ordination Meeting both in divisional/Principal/ Regional/ office level and others as deemed appropriate subject to prior approval of the competent authority.
10. He will direct, supervise, review and monitor all the activities related to drafting and preparing of the Board Memo and place before the head of audit and inspection division that should be placed to Audit Committee and to the Board.
11. All sorts of policy related activities like designing and formulation of audit manual, policy, guidelines, and directives etc regarding audit and inspection functioning of the Bank should be conducted from the Audit and Inspection Division-1 and as a head of this division, he should be responsible to lead, monitor and supervise such activities appropriately.

12. He should be responsible to carry on all sorts of administrative activities and decisions regarding day to day functioning of the division as per approved power given to him and he should consult and take approval from the head of the division where necessary.
13. To act as the Head of Fraud & Crime Prevention Unit of AID-1.
14. Conducting of Enquiry/Investigation regarding any kinds of fraud, forgery, defalcation, malpractice or any other serious irregularities.
15. Conducting an investigation of any breach of a rule or law for which some governing or regulatory authorities or forces may ultimately prescribe a punishment.
16. Conducting of special audit/inspection/ investigation/surprise visit for any purpose instructed by the honorable Board and Audit Committee of the Board, Board Risk Management Committee, CEO & MD, MANCOM, RMC, head of ICC and head of Audit to Audit and Inspection Division and preparation of report on the conducted investigations/audits /investigations/surprise visits and submitting the same to the competent authority.
17. Prepare a quarterly performance report and quarterly audit and inspection summary reports and place them to the head of Audit for ultimately producing the same to the Board Audit Committee through the head of ICC.
18. Take initiatives to keep the auditors updated. He should ensure that his division preserves all the relevant circulars and other guidelines and policies for future reference and to conduct effective audit. He should also recommend appropriate training for overall audit people and send need based training proposal to the Bank's Training Institute in consultation with head of other audit divisions.
19. Head of audit and inspection division-1 should take the role as a focal point to make all sorts of external communication regarding internal audit and inspection of the Bank subject to approval of the competent authority.
20. Perform all sorts of activities that are assigned by bank management through office orders/circulars/directives or in any forms for the sake of the Bank interest.
21. He should ensure that his division preserves all the relevant circulars and other guidelines and policies for future reference and to conduct effective audit. He should also recommend appropriate training and send need based training proposal for audit people of the bank in consultation with head of other audit divisions to the Bank's Training institute through head of Audit and ICC.
22. Special Assignment or to perform any other duties as instructed by the higher Management.

4.4.4 Roles & Responsibilities of the Audit and Inspection Division-2 (AID-2)

As a divisional head of Audit and Inspection Division-2, he is responsible for all the activities that are performed from his division under the head of Audit, he is responsible to establish a true and effective audit and inspection culture within the Bank. In addition to that, he is especially responsible for at least the following:

1. To supervise and monitor the activities of Audit and Inspection division-2, conducting and managing audit and inspection functioning of all branches below corporate level branch including designing of audit plan with consultation of AID-1 and implementation of approved audit plan with its proper follow up.
2. As a divisional head, guide and lead all the audit teams, ensuring close monitoring of all the divisional activities as well as employ required attention to supervise all sorts of audit and inspection activities that conduct on all branches below corporate levels of the Bank all over Bangladesh as per yearly Audit Plan.

3. Review all sorts of audit and inspection reports along with executive summary placed to him by the subordinates and pass appropriate comments/specific recommendations/proposals to be placed before the head of the division. He will also ensure the sending of all audit and inspection reports to compliance division (internal) without delay as approved by the competent authority. Also conduct correspondences with respective branches/offices as deemed appropriate.
4. He will cooperate head of AID-1 to prepare audit plan of Audit and Inspection Division of the Bank with consultation and proper coordination among other divisional heads. He is also responsible to conduct all sorts of policy related activities of Audit and Inspection Division of the Bank.
5. In light with annual approved audit plan, he will approve all sorts of audit and inspection program of his division subject to approval of the head of the division.
6. To assist in arranging & conducting all sorts of Co-ordination Meeting both in divisional/area office level and others as deemed appropriate subject to prior approval of the competent authority.
7. He will direct, supervise, review and monitor all the activities relate to draft and prepare the Board Memo and place before the head of audit and inspection division that should be placed to Audit Committee and to the Board.
8. He actively assists in AID-1 in carrying out all sorts of policy related activities like as designing and formulation of audit manual, policy, guidelines, and directives etc regarding audit and inspection functioning of the Bank .
9. He should responsible to carry out all sorts of administrative activities and decisions regarding day to day functioning of the division as per approved delegation of business power allow to him and he should consult and take approval from the head of Audit where necessary.
10. He has to act as the Head of Fraud & Crime Prevention Unit of AID-2 Conduct special audit, re-audit, investigation, fix-up liabilities of the bank employee(s) involved in the irregularities, fraud, crime etc. as and when instructed by the honorable Board/ACBOD/CEO & MD head of ICC and head of audit.
11. Conducting of Enquiry/Investigation regarding any kinds of fraud, forgery, defalcation, malpractice or any other serious irregularities.
12. Conducting of investigation on any breach of a rule or law for which some governing or regulatory authorities or forces may ultimately prescribe a punishment.
13. Conducting of special audit/inspection/ investigation/surprise visit for any purpose instructed by the honorable Board and Audit Committee of the Board, Board Risk Management Committee, CEO & MD, MANCOM, head of ICC and head of Audit to Audit and Inspection Division-2 and preparation of report on captioned the conducted investigations/ audits/investigations/surprise visits and submit the same to the competent authority.
14. Prepare a quarterly performance report and quarterly audit and inspection summary reports and place them to the head of audit for ultimately produce to the Board Audit Committee through the head of ICC.
15. Take initiatives to keep the auditors updated. He should ensure that his division preserves all the relevant circulars and other guidelines and policy for future reference and to conduct effective audit. He should assist head of AID-1 in recommending appropriate training and designing need based training proposal to the Bank's Training Institute in consultation with head of the division.
16. Head of audit and inspection division-2 should make all sorts of external communication regarding internal audit and inspection of his division subject to approval of the competent authority.

17. Perform all sorts of activities that are assigned by bank management through office order/circulars/directives or in any forms for the sake of the Bank interest.
18. Special Assignment or to perform any other duties as instructed by the Higher Management.

4.4.5 Roles & Responsibilities of the Foreign Exchange Audit and Inspection Division

Foreign Exchange Audit and Inspection Division should be reformed as a separate division under the Head of Audit to conduct audit exclusively on foreign trade and foreign exchange activities in Bank's AD (Authorized Dealer) branches and foreign units. As a divisional head of Foreign Exchange Audit and Inspection Division (FEAID), he is responsible for all the activities that are performed from his division, especially, he is responsible to establish a true and effective foreign exchange audit and inspection culture within the Bank. In addition to that, he is especially responsible for at least the followings:

The important roles and responsibilities of the head of (FEAID) are highlighted below :

- To supervise and monitor the activities of Foreign Exchange Audit & Inspection Div. including designing of audit plan with head of AID-1, implementation of approved audit plan and its proper follow up. To execute the approved yearly audit plan, divisional head will form numbers of audit team deem appropriate and issue office order to the teams in consultation with head of audit and inspection division to conduct regular audit of the respective AD branches and others as required. The head of the division will chalk out a separate audit Schedule in such a manner so that the execution of the annual audit plan can be ensured.
- Review all sorts of audit and inspection reports along with executive summary that are placed to him by the subordinates and pass appropriate comments/specific recommendations/proposal before putting up to head of audit. He will also ensure sending of all audit and inspection reports to compliance division without delay as approved by the competent authority.
- Similarly Division has to conduct Short/Surprise/Item/System Audit time to time as per Audit Plan and forward the Audit Report with Executive Summary to the Compliance Division through proper channel.
- In case of gross irregularities, division has to put up the matter before the ACBOD (Audit Committee of the Board of Directors)/BRMD/BOD (Board of Directors) through the head of audit and ICC.
- Divisional head/Executives should time to time physically monitor the activities of the Audit teams while conducting audit preferably in the top graded branches as per Audit Plan.
- The Division Head will time to time also call meeting and have discussions with all officials on various aspects of audit procedures, share their experiences/views to understand the practical situation prevailing in the bank and provide guidelines/suggestions/instructions accordingly.
- He will direct, supervise, review and monitor all the activities relate to draft and prepare the Board Memo and place before the head of audit that should be placed to Audit Committee and to the Board.
- He will co-operate the head of AID-1 to prepare audit plan the Bank with consultation and proper coordination among other divisional heads. He is also responsible to conduct all sorts of policy related activities of Audit and Inspection Division of the Bank.
- He has to carry out all sorts of administrative activities and decisions regarding day to day operation of the division as per approved delegation of business power and he should consult and take approval from the head of the Audit where necessary.

- He is to act as the Head of Fraud & Crime Prevention Unit of FEAID.
- Conducting of Enquiry/Investigation on all kinds of fraud, forgery, defalcation, malpractice or any other serious irregularities.
- Conducting of investigation on any breach of a rule or law for which some governing or regulatory authorities or forces may ultimately prescribe punishment.
- He should meticulously monitor, whether the audit team properly reviews and reports on LC/foreign bill and local bill acceptance and endorsement policies, process dealing of LTR, IBP, LDBP, FDBP etc or rest.
- Conducting of special audit/inspection/ investigation/surprise visit for any purpose instructed by the Board and Audit Committee, Board Risk Management Committee, CEO & MD, MANCOM, Head of ICC to FEAID Audit and Inspection Division and preparation of report on the conducted investigations/audits/investigations/surprise visits and submit the same to the competent authority.
- Preparation of quarterly performance report and quarterly audit and inspection summary reports and place them to the head of audit for ultimately producing the same to the Board Audit Committee through the head of ICC.
- Take initiatives to keep the auditors updated. He should ensure that his division preserves all the relevant circulars and other guidelines and policies for future reference and to conduct effective audit. He should assist head of AID-1 in recommending appropriate training and designing need based training proposal to the Bank's Training Institute in consultation with head of Audit.
- He should make all sorts of external communication regarding internal audit and inspection related to his division subject to approval of the competent authority.
- Perform all sorts of activities that are assigned by bank management through office orders/circulars/directives or in any forms for the sake of the Bank interest.
- Special Assignment or to perform any other duties as instructed by the higher Management.

4.5 Audit & Insp. Philosophy:

It is a continuous review of operations and records undertaken within the business and it is normally done by specially assigned staff. It should operate independently and in no case should anyone divest the responsibilities placed upon him.

Thus it is apparent that internal control expression is used in a wide sense and includes internal check and internal audit as well.

The Institute of Internal Auditors, USA, has defined internal audit as under:

“Internal Auditing is an independent appraisal activity within an organization for the review of operations as a service to management. It is a Head of the Branch control which functions by measuring and evaluating the effectiveness of other controls.”

4.5.1 Basic Principles of Internal Audit

Basic principles under which guidelines the Internal Audit functioning should be carried on are highlighted below:

Principle-1: An effective internal audit function provides independent assurance to the board of directors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and process, thereby helping the board and senior management to protect the organization and its reputation.

- Principle-2: The Bank's internal audit functioning must be independent, which requires the internal audit function to have sufficient standing and authority within the bank thereby enabling internal auditors to carry out their assignments with objectivity.
- Principle-3: Professional competence, including the knowledge and experience of each internal auditor and of internal auditors collectively, is essential to the effectiveness of the Bank's internal audit function.
- Principle-4: Internal auditors must act with integrity.
- Principle-5: Bank should have an internal audit charter that articulates the purpose, standing and authority of the internal audit function within the Bank in a manner that promotes an effective internal audit functioning as described in Principle 1.
- Principle-6: Every activity (including outsourced activities) and every entity of the Bank should fall within the overall scope of the internal audit functioning.
- Principle-7: The scope of the internal audit function's/ activities should ensure adequate coverage of matters of regulatory interest within the audit plan.
- Principle-8: Bank should have a permanent internal audit functioning, which should be structured and consistent with specific principles.
- Principle-9: Bank's Board of Directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control system and, accordingly, the board should support the internal audit function in discharging its duties effectively.
- Principle-10: The audit committee, or its equivalent, should oversee the Bank's internal audit function.
- Principle-11: Head of audit should be responsible for ensuring that the division complies with sound internal auditing standards and with a relevant code of ethics.
- Principle-12: The internal audit function should be accountable to the Board Audit Committee on all matters related to the performance of its mandate as included in the internal audit charter.
- Principle-13: The internal audit and inspection functioning should independently assess the effectiveness and efficiency of the internal control, risk management and governance systems and processes created by the business units and support functions and provide assurance on these systems and processes.
- Principle-14: To facilitate a consistent approach to internal audit & inspection functioning within the Bank, the Board of Directors within a Banking Group or holding company structure should ensure that either:
- (i) The bank has its own internal audit and inspection functioning, which should be accountable to the Bank's Board and should report to the head of internal audit of the bank.
 - (ii) The banking group or holding company's internal audit function performs internal audit activities of sufficient scope at the bank to enable the board to satisfy its fiduciary and legal responsibilities.
- Principle-15: Regardless of whether internal audit and inspection activities are outsourced, the Board of Directors remains ultimately responsible for the internal audit and inspection functioning.

- Principle-16: Board Risk Management Committee and Audit Committee should have regular communication with the Bank's head of ICC to (i) discuss the risk areas identified by both parties, (ii) understand the risk mitigation measures taken by the bank, and (iii) monitor the bank's response to weaknesses identified.
- Principle-17: Bank's Board Audit Committee should regularly assess whether the internal audit and inspection functioning has sufficient standing and authority within the bank and operates according to sound principles.
- Principle-18: Bank's Board Audit Committee as well as Board Risk Management Committee should formally report all weaknesses they identify in the internal audit functioning to the Board of Directors and require remedial actions.
- Principle-19: Bank's Board Audit Committee should consider the impact of its assessment of the internal audit and inspection functioning on its evaluation of the Bank's risk profile and on its own supervisory work.
- Principle-20: The supervisory authority (Bank's Board Audit Committee as well as Board Risk Management Committee) should be prepared to take informal or formal supervisory actions requiring the Board and senior management to remedy any identified deficiencies related to the internal audit and inspection functioning within a specified timeframe and to provide the supervisor with periodic written progress reports.

4.6 Scope of Audit & Insp. Functioning

The scope and objectives of internal audit & insp. may vary from time to time based on nature of the audit & inspection and its purpose, size and structure of the branch and nature of activities that the branch carry on as well as based on association of risk and the requirements of the authority. Audit & Insp. Division of the Bank should conduct normally the following types of audit and inspection -

- ⇒ The Regular Audit,
- ⇒ The Special audit,
- ⇒ The Item Audit,
- ⇒ The Surprise Audit,
- ⇒ The Foreign Exchange Audit,
- ⇒ The System Audit
- ⇒ The Concurrent Audit,
- ⇒ The Policy Audit,
- ⇒ The Management Audit,
- ⇒ The Performance Audit,
- ⇒ The Compliance Audit,
- ⇒ The Special Audit on Fraud & Forgery
- ⇒ The Monitoring Audit
- ⇒ Inspection, Investigation and Determination of liabilities of responsible officers etc.

Normally, internal audit & insp. division operates in one or more of the following areas:

- (1) Review of accounting system and related internal controls. The establishment of an adequate accounting system and the related controls is the responsibility of management, which demands proper attention on a continuous basis. The internal audit & insp. function is often assigned specific responsibility by management for reviewing the accounting system and related internal controls, monitoring their operation and recommending improvements thereto.
- (2) Examination of financial and operating information. This may include review of the means used to identify measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.
- (3) Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organization. Generally, the external auditor is interested in the results of such audit work only when it has an important bearing on the reliability of the financial record.

4.7 General Duties of an Internal Auditor

The internal auditor should be skillful and experienced having background of internal audit & insp. training supplemented by refreshers' courses from time to time. He should be selected from those who have already worked at different desks of a Branch in order to ensure that he has requisite working experience of a Branch. It would be better if he has working experience in Head Office also.

It is indeed extremely difficult to provide a set of all-exhaustive instructions and guidelines on how an auditor will perform his duties. The Bank's operational Manual and the circulars of Head Office and those emanating from Bangladesh Bank will definitely form the main basis with reference to which the auditor's duties should be carried out. In a sense, and more importantly the quality of audit will much depend upon the intuition developed out of cultivated experience, which he will always bring to bear upon the problems and issues faced at the Branch during the course of his performance. He should always keep in view the objectivity of his assignment while completing the audit. However, some highlights are stated as follows.

4.7.1 General Duties

a) Review of Records

1. The auditor is to check that books of account, registers and circulars, applicable to a particular Branch, have been properly maintained. In regard to procedure, any variation from operational Manuals, circulars must be carefully examined.
2. During his stay at each Branch, he should frequently examine the Cash Book, General Ledger and daily correspondences in order to keep in touch with the current business of the Branch. He should also acquire, by a perusal of its different statements, reports and budgets and previous audit reports, a working knowledge of its recent history.

b) Review of Documentation System

3. The auditor must verify the circular files and ensure that these have been brought to the attention of the concerned officers and staff are being kept serially and properly and are regularly read by concerned officers and staff of the Branch.

c) Review of Loan Management

4. In respect of conduct of examination of loans and advances of all types, account wise lapses/violation/irregularities of terms and conditions are to be clearly mentioned in the report pinpointing officials responsible for the lapses. It is, however, no part of auditors' duty to recommend any punitive action against any official.

5. When the auditor detects any unauthorized extension of credit facilities or excess drawings over the limit or drawing power or detects any irregular entries, etc., he will address it to the Branch incumbent requesting him to realize/regularize the same on the spot. The auditor should reduce objections through spot rectification as far as possible. They should also mention if corrective/disciplinary action was already taken in order to avoid duplication of action but not to suggest any disciplinary/punitive action unless called for.

6. In respect of Cash Credit and loans against imported merchandise (LIM), the auditor should particularly pay attention to the condition of the godowns, performance of duties of godown staff, recovery of salary and allowances of godown staff from borrowers' accounts, systematic storage of commodities in general and stacking in particulars, insurance coverage and maintenance of relevant registers, such as Stock Register, Drawing Power Register, Delivery Order Register, Pledge Register, Key Register, Insurance Register, etc.

Besides, it should be checked to ensure that Godown Stock and Inspection Register is maintained for each godown for recording all inward and outward movements of stock and that stocks are verified physically.

7. The auditor will examine the cases of late payments of cheques to ascertain whether concealed overdrafts/loans were given. Detection of any such malpractices should be specially reported to the Head Office mentioning the names of delinquent officials.

8. The auditor will check to see whether or not any goods sold by auction/private negotiation were done strictly according to rules. The auditor should review whether the loans and advances disbursed/sanctioned within the allocated or approved budget or not.

d) Sharing the Audit Findings

9. The auditor will discuss the audit findings with the Head of the Branch before finalizing the report.

10. There may be non-compliance of the instructions laid down in Manuals and circulars or any of the books of account may not have been properly maintained. Such irregularity should be brought to the notice of the Head of the Branch for immediate regularization and also for his comments. In case of failure of the Head of the Branch to rectify such irregularities or to offer reasonable comments, the auditor will report the same to Head Office.

e) Special Reporting

11. Any matter which the auditor considers not advisable to discuss with the Head of the Branch before bringing to the notice of Head Office will be intimated to Head Office in a separate special report.

12. Should any irregularity of serious nature which smacks of ill motive be detected in course of audit, the matter should be examined in depth and a detailed special report on the findings without holding discussions for soliciting comments of Branch Head, mentioning names of officials involved, extent of

their respective involvement, modus operandi etc., should be dispatched urgently to the Head of Audit in his personal name. The concerned operational Division at Head Office should also be provided with a copy of the special report for information and initiation of corrective action. When the auditor cannot resolve problems himself, he should seek instructions from competent authority by phone or Fax.

f) Comply with Due Diligence

13. The audit team leader will make such use of services of his assistants as may be necessary but they themselves are responsible for the correctness of audit work and reporting of the cash, bills, securities, safe deposit articles, advance documents. His assistants may help, in Branch officers presence, in counting of cash balance and may be entrusted with checking of quantities and values in connection with advances. The assistants may check the balancing of the Current Accounts, Cash Credit Accounts, Saving Bank Accounts and Short Term Deposit Accounts, Accounts under Deposit Schemes and verify the outstanding in Suspense, Sundry Deposits, Drafts Payable, Payment Order, Fixed Deposit, Marginal Deposit, Call Deposit and overdue fixed Term Deposit Accounts. They may check items of stationery, mark off vouchers and acknowledgement and assist in examination of vouchers other than those on Suspense, Expenses control, Protested Bills and Stationery Accounts. They will also prepare the required returns and will render such other assistance to the team leader as may be required.

g) Reporting

14. All statements submitted by the Branch should be up to the last date of previous month and that date will be the date of audit report of the Branch. Audit report should contain subsequent position of all items under audit including a statement that cash balance, BSP, TCs, Prize Bonds and other items of cash values were duly checked. Audit report must be prepared, relevant issues discussed with Head of the Branch and then completed, considering his comments at the Branch level to which it relates. An auditor must be honest, i.e., he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes what he certifies is true. For intentional suppression of material facts, the auditor shall remain personally responsible and face proper consequences. An auditor should try his best to be rational and objective.

15. The team leader will state in audit report that all the checklists have been followed meticulously for conducting the audit.

16. The audit report should contain observations against each account regarding compliance, regularization and removal of irregularities before audit was started or during the course of audit at the instance of the auditor, the latest position of unauthorized and clean advances as reported in the previous internal audit & insp. Report, Bangladesh Bank inspection report and if disciplinary or punitive actions for irregularities were already taken.

17. The audit report should be clear, concise and free from ambiguity. It has to include all lapses, irregularities, deviation, violations and non-compliance whether of Manuals, circulars, terms and conditions of sanction letter, calculation of interest with specific recommendations, etc. and subsequent compliance, follow-up action taken by Branch management in order to set things right.

18. The team leader should prepare four copies of audit report according to the arrangements along with relative statements and other observations including audit synopsis of gross irregularities and submit as follows:

- a. One copy for the division
- b. One copy to respective Branch, and
- c. One copy to the Head of Compliance to follow up the compliance functioning.
- d. Team leader should keep one copy of the report for reference to working papers.

19. The auditor should check whether Head of the Branch/Authorized officer(s) verify and authenticate the Daily/Periodical Computer Transaction Report as instructed by Head Office.

g) Exit Meeting

20. At the end of the audit, the audit team should sit in an exit meeting with staff of respective branch/ office where the representative from controlling office must present. On that meeting the audit team should share the key audit findings/ lapses of ICC and recover the way to resolve these as well as to stop the recurrences.

h) The Control System

21. The audit team should review the total IT management scenario of the office/ branch in line with enforced/enacted IT management policy that approved by the Board.

22. Audit team should review the overall cash management and budgetary control system of the branch/ office and verify whether all cases are within the proper allocation/ approved budget or not.

I) Comments about Control Environment and Control Culture

23. The audit team should meticulously review the overall weaknesses/lapses of existing control environment and compliance culture of the branch/ office and provide appropriate recommendation to address such weaknesses.

j) Miscellaneous

24. In course of audit, the auditor will follow the Checklists furnished by head office and other controlling office time to time. These checklists indicate what the auditor is to do, as also what proper situations he is expected to observe in the Branch.

25. The auditor is not authorized to issue instructions to Head of the Branches on matters other than those relating to irregularities.

26. It is a very important part of the duties of the auditor to act as a sympathetic adviser to the officers/staff of the Branch he is auditing. Faults must, of course, be brought to light but report should be written with the recognition of difficulties and efforts of the officers/staff as well as its shortcomings. However, in no case he should allow himself to be diverted from the strict course of duty. He should at all times exercise the requisite tact.

27. The check must be thorough and efficient and nothing that may jeopardize the Bank's interest should escape the attention of the auditors.

28. The team leader will mention the date of starting the work, the date of completion and the date of submission of their report on the right hand top corner of the first page of the report.

4.7.2 Some Additional Duties

The auditor should physically verify assets in possession of the Branch except those kept under locker system, whether of Branch or of clients, with relevant documents and records and should likewise

check accuracy of liabilities, expenses and income from different sources. He should also compare periodic figures under audit with those of corresponding previous period(s) and check reasons of major variances. Internal auditor should take pragmatic initiatives to build up the the awareness program among branch employees.

4.8 Working Papers and Secrecy

The auditor should also index working papers related to each paragraph of report and preserve these papers and all audit evidences for future reference. His report, working papers and audit evidences are strictly for use of Bank management and therefore these or any part thereof should not be divulged to any other person without permission of management. In all situations, he should maintain utmost secrecy. Any negligence may cause damages to the Bank and, in turns, to members of the audit team, in the long run.

4.9 Qualities of an Auditor:

The internal auditors of the Bank should not only be independent in state of the mind but also be independent in state of the appearance. The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

The auditor should respect the confidentiality of information acquired in course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing.

The auditor requires specialized skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination, and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including relevant international and national pronouncements on accounting and auditing matters, and relevant regulations and statutory requirements.

In order to accomplish audit work properly, an auditor should have patience, competence, perseverance and integrity. He should be polite, tactful and vigilant. He must always be alert to apply reasonable care, skill and prudence required by circumstances prevalent to each issue or area under scrutiny. He must be neutral and not be guided by emotions or other external factors. He must be conscious of his independence though within the limits of his employment and bonafide instructions of senior management. The responsibility of the auditors is not only to point out the lapses/irregularities committed by the Branch but also to suggest measures as to how lapses/irregularities can be minimized. The Auditors should also suggest measures as to how overall performance of the Branch can be developed.

4.10 Policy to Conduct Risk Based Audit:

Bank should have **Risk Based Branch Selection Guidelines to design the risk based annual audit plan**. Based on Risk Based Branch Selection Guidelines, Control and monitoring Division of the Bank should grade the all branches of the bank and accordingly based on that grading status, the annual audit

plan for the Bank should be designed by Audit & Insp. Division-1 under the direct supervision of the head of audit as well as head of ICC and after getting approval from the Board Audit Committee, Audit & Insp. Divisions will start the execution of that approved audit plan.

4.11 Risk Based Annual Audit & Insp. Planning

The following factors shall be considered in designing the risk based effective audit plan for the Bank:-

- a) Risk grading status of all the branches of the Bank that is supplied by Monitoring Division at the early of each year based on Risk Based Branch Grading Policy of the Bank. The Risk Based Branch Grading Policy should cover a comprehensive risk assessment process of the whole Bank.
- b) Number of units/offices/Branches to be audited based on risk based branch selection guidelines that have been approved by Audit Committee of the Board..
- c) Available key manpower and team formation.
- d) Available resources and other logistic supports.
- e) Time period for programming.
- f) Frequency of audit.
- g) Monitoring capabilities of audit teams at a time when they conduct the audit.
- h) Review of the audit reports, suggested recommendations etc.

4.12 Audit & Inspection Procedure

- Each Year the Head of AID-1(with the help of head of other divisions) will set out an comprehensive audit plan for the year. This would be a high level plan which will be approved by the Audit Committee of the Board.
- This plan will be a risk based audit plan where sensitive areas will be covered with priority.
- Carry on the total audit functioning independently as per approved plan.
- Employ close monitoring on quality of the audit work. Maintain close follow up and communication with each team leader of the team to ensure their highest level sincerity and integrity.
- Nature and volume of work at the target office must be clearly understood by the audit people. Some pre-audit information may be useful in understanding the nature and volume of work. Proper selection of manpower presupposes 'proper' formation of teams for various types of audit assignments and is a precondition. Audit teams may be given target time which should be neither inadequate to cover important work nor so excessive to go into costly details.
- Before starting the audit function in any branch, each audit team does a sufficient groundwork and reviews the previous audit findings under the leadership of the team leader. The team leader also measures the control environment and identifies the area of risks on those branch activities before designing the strategy to conduct the audit functioning on a specific branch. Each audit team at first verifying cash and MIS data of the concern branch and then conduct introduction meeting with the respective officials/ manager.
- Designed report form may curtail time and awareness of and acquaintance with concepts of Management By Exception (MBE) would curtail cost of audit. On the eve of conducting an audit/inspection, the team should be equipped with all required formats, blank statements etc

to be subsequently filled- in by the office under audit and working papers containing account-wise information (mainly for Loans & Advances cases) so far available in Head Office in order to ensure quick disposal of report writing, efficient time management during audit/inspection and sequential programming of audit/inspection.

- Audit team should share their findings with branch manager and employ emphasis on maximum spot ratification. They also should employ emphasis on awareness of branch people on enforcing rules and regulation to stop the recurrence of same nature audit observation.
- The deficiencies identified during audit should be notified to the appropriate level and significant audit findings should be reported to the head of audit without delay. Based on gravity of finding, head of audit may place that to the Audit Committee of the Board through the head of ICC.
- At the end of each quarter, there should be a summary report on the audit findings and corrective actions taken which should be forwarded to the Audit Committee of the Board based on gravity of the impacts of finding.
- Based on the review of monitoring reports the audit team should also conduct surprise check on the branches where regular lapses and gaps are identified.
- Share the summary of finding with the head of the branch, if possible, before finalization of audit report.
- **Conduct exit meeting** with the branch people as well as relevant person from the controlling office before closing the audit program and exit the branch.

4.13 Important Guidance for the Internal Auditor:

The Internal Auditor Shall:

- a) Reach the Branch before cash is opened and produce the office order, i.e. letter of authority to the Head of the Branch and then conduct the cash verification.
- b) Check the attendance register & keep the record of time of entering the branch people in the office premises.
- c) Then conduct the verification of MIS data with respective statement of the affairs and judge the accuracy and authenticity of information.
- d) Conduct the **introductory meeting** about the purpose and strategy to complete the audit.
- e) Indent for stationery for using in audit work, if necessary.
- f) Check the duties allocation as per office orders
- g) Collect & check the Statement of affairs as of the preceding date of inspection with the general ledger & subsidiary ledger and then start the normal & strategic process of auditing.

4.14 Information Technology (IT) System Audit

IT Audit is one of the major control mechanisms for monitoring management activities in the Banking and Financial Institutions. ITS audit assures greater significance because a large number of critically strategic financial operations in the banking sector are wholly or partly being handled by computerized system. IT System audit should be conducted to:

- a) Ensure integrity, confidentiality and availability of information and resources.

- b) Ensure transparency, reliability, Security and efficiency
- c) Investigate possible incidents to ensure conformity with SBL IT policies.
- d) Check mismatch of exceptional transactions between manuals and the Computer Generated reports
- e) Monitor user or system activity where appropriate
- f) Overall inspections and evaluations of the System

Bank should have separate IT audit cell with sufficient IT people under the head of each division to conduct the IT audit.

4.14.1 System Auditor's Qualification

In Computerized environment, Information Technology System (ITS) audit is a very specialized task and very effective. Usually ITS implementation in Banking and Financial Institution is done by adopting a mix of different methodologies:

- In case of third parties, ITS audit requires to be conducted by trained auditor with skill and expertise required for the purpose.

Thus the System Auditor in the banking sector should have:

- a) Adequate knowledge of Information System and Banking Operations
- b) Specially trained with skill and expertise
- c) Attitude and ability to perform System audits

4.14.2 Audit Procedure for IT Audit

An auditor can audit the computerized Banking System in two ways:

A. Audit by generating report from Operating System.

A.1. Operating System generates its own audit reports. By the audit reports, auditors monitor the user activities and tasks.

B. Audit on screen or by generating report from Banking Software and crosscheck different reports.

B.1. Overdraft Limit: Assign the specific number of officers delegation duly documented by the authority.

- Authorized person
 - a) Should be Manager/Sub Manager
 - b) Should be Divisional Head
- System administrator should have zero limit.

B.2. Verify all interest Calculation Factors

Functions:

- a) Rate of Interest
- b) On Balance(Daily Product, Minimum Balance, Average Balance)
- c) Interest Application Schedule (Monthly, Quarterly, Half Yearly, Yearly, Annually, On Maturity)

B.3. Allocation of Operator Code and Authority :

- Take prints out from Banking Software for the existing Operator codes.
- Each personnel should hold only one operator code.
- Segregation of duties should be done with access permission of Operator code i.e. Client side, GL side, forex, cash etc.

- Guideline for creation of operator code.
System Administrator (super user)

Functions:

- a) User creates and assigns permission
- b) Can input transaction
- c) Daily data backup
- d) Look after the whole computer system
- e) Day-end, Day-start, Month-end etc.

Creation of other users:

- a) Should have an alternate System administrator.
 - b) Other user
- Preservation of authority/permission list duly signed by the authority.
To be checked by generating following reports from Banking Software.

B.4.1 Client side/Front Office

- a) Daily Transaction Audit trail
- b) Supplementary Summary
- c) Application Wise Detail Supplementary
- d) Overdraft Listing (by different type)
- e) Daily Position Summary/Detail Balance
- f) Loan and Advance Account Listing
- g) Account Statement Report
- h) Daily Exception Listing
- i) New Account Listing or log report
- j) Cheque Series Listing
- k) Summation Balance Report
- l) Closed Account Listing
- m) Dormant Account Listing

B.4.2 Bills (PO/DD/SDR/TT)

- a) PO/DD/TT/SDR Issued
- b) PO/DD/TT/SDR Cancelled
- c) PO/DD/TT/SDR Collection
- d) PO/DD/TT/SDR Stop Payment Listing
- e) PO/DD/TT/SDR Outstanding Report

B.4.3 General Ledger/Back Office

- a) Daily Transaction Audit Trail
- b) Clean Cash Report
- c) Supplementary
- d) Trial Balance Report

- e) Statement of Affairs Report
- f) Balance of Subsidiaries Report
- g) Income/Expenditure Report
- h) Sundry/Suspense Account Report
- i) GL Integration Parameter Report

B.4.4 Management

- a) User Profile Report
- b) Exceptional Advance Account Listing
- c) Lien Account Listing
- d) Defaulter Listing of CC Account
- e) Stop Payment on Cheque List
- f) Interest Report
- g) Interest Report of Classified Advances
- h) Excise Duty Report
- i) Excise Duty Exceptional Report
- j) Edit Report etc.

4.14.3 Software:

Auditors will cross-check one report with another corresponding report. The figures with correspondence should match with one another.

Following are the cross-checking basis:

- Branch will authorize a person to check the vouchers with detail transaction audit trail and online transaction reports daily to confirm correctness of input. Auditors will ensure the process.
- a) Daily Basis: The day to day transactions should be checked and compared with figures of daily affairs.
- b) Monthly Basis: Different type of accounts' Interest Provision Report (which will be generated in month and end process by the system) with Balance of Subsidiaries Interest Receivable/Paid Head.
- c) Quarterly Basis: Balance of Interest Receivable Head will be nil in Balance of Subsidiaries report for Quarterly Applicable interest Accounts.
- d) Yearly Basis
 - Balance of Interest Receivable/Paid Head except FDR Accounts will be **nil**.
 - Income Expenditure Heads balance will also be **nil**.

4.14.4 Others

Auditors will also ensure the following events:

a) IT Management

- IT Department should have an organogram for the IT Department
- Should have a job description for each individual within IT Department
- Should have a back-up plan for various levels of system support personnel
- Should have segregation of duties for sensitive IT tasks

b) Physical Security

- IT Room should be equipped with Power (UPS), Air conditioner, Fire control and Lock & Key.
- Environment consideration.
- Physical Access Control

c) Access Control

Access Control is a mechanism by which a system grants or revokes the right to access some data, or perform some action. Normally, a user must first Login to a system, using some Authentication system. Next, the Access Control mechanism controls what operations the user may or may not make by comparing the User ID to an Access Control database. Access Control system include:

- File permissions, such as create, read, edit or delete on file server
- Program permissions, such as the right to execute a program on an application server
- Data rights, such as the right to retrieve or update information in a database.

Every financial institution must have a good access control encompassing the above. The Servers and PCs of Head Office and Branches should be protected from any unauthorized use. Passwords are the most important aspect of Computer Security and are the frontline of protection for use of IT System:

- The Passwords for the use of IT System should be kept secret from others.
- One's Password must not be shared by others. Any deviation will be seriously dealt with.
- Password should be set by at least 6 characters of numeric and/or alphabet
- Password should be changed as per Bank approved ICT policy
- Protecting password mechanism/ system is a good practice to protect from any other unauthorized use.
- Whenever a user is created in the Server, the privileges should be kept recorded for further references
- Any change of Password and privileges should be notified to the network administrator
- Any unauthorized software installation in any PC is strictly prohibited. Any software installation other than the prescribed one shall require clearance from the IT, Head Office
- Employees are strictly prohibited from installing software on the Bank's computers, or copying or sharing bank owned software
- Workstations are configured with operating systems, that maps to local server and printers. Workstation configurations responsibility shall be done solely by the system's administrator
- Screen savers. Windows screen-savers with passwords should be used on workstations. The systems Administrator will provide procedures for screen savers.

Departmental Heads are responsible for maintaining additions, changes and deletions of users. All user maintenance should be done on the basis of written documentation.

d) Network Security

- Each user should have a unique user name and a valid password
- One person as administrator will be responsible for security of the network
- Enough physical security for the network equipment should be installed
- Network users should be familiar with its operation and security procedures

e) Data Encryption

- Data should be encrypted before sending to the WAN or Public Network

f) Virus Protection

- Anti-Virus software should be installed in each computer
- Anti-Virus software should be updated always with latest virus definition file

g) Anti Virus Audit:

A virus is a piece of self-replicating code; in other word, it is software, which is designed to copy itself. Boot sector viruses infect the boot sector of floppy disks and the partition sector or, in some cases, the boot sector of hard disks, when the PC is booted from an infected floppy disk. Executable file viruses infect program files, on local drives or network drives.

h) Identifying the Threat:

In order to implement an effective anti-virus strategy, it is essential to identify the sources of any possible virus infection the following should be considered and necessary pre-caution be taken.

- Transferable disks and CDs brought from outside unauthorised sources, disks from other organizations suppliers, marketing agencies, etc. bring with them the risk of virus infection. The movement of disks and CDs between different sites within a organization may also help to spread a virus.
- Desktop PCs used at home and laptop PCs are a potential source of virus infection. It is important to recognize that these PCs, which are not under the direct control of an organization's IT Department, may be more exposed to virus infection than those which are under the direct control of the organization.
- Use of the Internet is a further potential source of infection. Any file downloaded could contain a virus; either an executable file virus or a macro virus. Unprotected access to the Internet can provide a virus with a springboard within your organization.

i) BACKUP/RESTORE

- Daily backup should be kept on separate media
- Backup media should be sent off-site immediately after backup have been taken
- Backup log sheet should be maintained, checked and signed by the Authority

j) Backup/Restore Audit

Backup/Restore: Auditors should double check that the backup/restore processes are maintained in the Branch level properly and the backup cartridges are kept secured off-site.

- Backup of data & backup plan is maintained for better security and protection from any mishap. The backup procedure will be:
 - i. Daily
 - ii. Monthly
 - iii. Yearly / Year End
- Administrator must take daily backup carefully both in Hard disk & Form of other Soft Copy.

k) Management and legal issues

- Should have up to date service Contracts / Service Level Agreement.
- Legal Issue viz Computer Crime, Software Piracy, Computer Fraud, Hacking, Spreading Computer Viruses should be considered.

l) Insurance

- Adequate insurance covering the risk of Fire, RSD, Burglary, Earthquake, etc.

m) Disaster Recovery

- Backup should be stored offsite at a safe place
- Disaster Recovery exercise should be carried out at least once in a year.
- Disaster Recovery Planning and Maintenance process should be ensured

Basic plan: A general plan of system audits to be performed during the year. Information technology Division or Audit Division may perform the System Audit.

The system auditor must not, without good reason, divulge any secret he or she may come to know in the course of performing his or her job or use such secret for any undue purpose.

Note:

1. Auditor will follow the above Audit Policy in-conjunction with Information Communication policy of the Bank during Audit inspection of the System.
2. The Audit Policy may be changed time to time with the introduction of new version and/or changed system in the ICT, which will be communicated in due course.

4.15 Financial Crime Risk (FCR)

An internal auditor should also address the following areas to cover the Financial Crime Risk:

Support the division and the area management in managing the risk of financial crime i.e. risk of internal and external frauds, money laundering and serious breaches, this includes:

- * Providing expert advice on the implementation of Bank FCR policies.
- * Anticipating and disseminating information on emerging Financial crime Risks.
- * Working with other relevant risk functions to create comprehensive regime of FCR controls across the Banks branches.
- * Being involved in the independent investigation of all crime cases, this includes undertaking or managing investigations.
- * Direct access at any time to Business Heads, Area Managers.
- * Free access to all staff, all documents and records if considered necessary.
- * Authority to intervene in any transaction or conduct, where it is believed that a breach of legal or regulatory requirements has been identified.

4.16 Gradings of Audit Findings/Observations and its consequence:

The internal auditor should review and assess the facts and findings meticulously before drawing conclusion based on audit evidence that they obtained. Review and assessment involves forming an overall conclusion as to whether works are carried on in light with existing rules and regulations or not as well as the gravity of observation. Based on the consequence of findings, the audit team should categorized the findings i.e., whether the consequence of each findings that is attachment with the degree of a) high risk, b) Moderate risk, and c) Low risk. The audit report should contain a clear written observation with proper recommendations along with grading of each observation as per audit team.

- a) **Audit Observations Grading with high risk:** Audit observations that may relate with any sorts of fraud forgery irrespective of involvement amount should be categorized as high risky findings. In addition to that, other irregularities which are so serious in nature and consequence of which may welcome to serious punishment from regulatory aspects like as cancelling of license or imposing restriction to carry on specific functioning or imposing financial penalty, may categorize as observations of that category. Moreover, the findings of irregularities for which Bank will face certain loss more than taka 5.00 lac or probable loss more than taka 1.00 crore, should be categorized as high risk observation.
- b) **Audit Observations Grading with Moderate risk:** Audit observations that may relate with irregularities which are serious in nature and consequence of which may require show cause or explanation from regulatory aspects, may be categorized as observations of moderate risk category. In addition to that, the findings of irregularities which bank will face certain loss of taka up to 5.00 lac or probable causes of loss with the range of taka 10.00 lac to 1.00 crore, should be categorized as moderate risk observation.
- c) **Audit Observations Grading with Low risk:** Audit observations that may relate with irregularities which are not serious in nature and consequence of which may not require any show cause or explanation from regulatory aspects, may be categorized as observations of low risk category. In addition to that, the findings of irregularities which may not certain causes of loss but having a probable causes of loss less than taka 10.00 lac, may be categorized as low risk observation.

4.16.1 Fundamentals of Audit Report Writing:

The internal auditor should review and assess the facts and findings meticulously before drawing conclusion based on audit evidence that they obtained. Review and assessment involves forming an overall conclusion as to whether works are carried on in light with existing rules and regulations or not.. The audit report should contain a clear written observation with proper recommendations.

The following areas should be covered with while preparing an Audit Report:

- a) **Collection of information:** Events/information which will find place in the Report should be accurate and factual. Coverage of the report should be made on the basis of all sorts of evidence and information collected during the audit..
- b) **Logical ordering:** Sequencing the selected material in a logical order is the next important stage of the Audit Report.
- c) **Interpretation:** Interpretation of the information should be objective based and conveyed in simple language.

- d) **Presentation:** Audit Report is presented in the Bank's standard format covering each area of operation. A memorandum along with executive summary of findings along with the Audit Report be submitted indicating compliance and the rectification of the irregularities by the Branch officials and incumbent on the spot or afterwards.
- e) **Coverage :** A Comprehensive Audit Report on the Branches must cover at least the following :
- a. Highlights of major aspect of business of the Branch.
 - b. Functioning of IT Department
 - c. Functioning of Cash Department
 - d. Functioning of Deposit Department
 - e. Functioning of Bills and Remittance Department
 - f. Functioning of Credit Department
 - g. Functioning of Foreign Exchange Department
 - h. Functioning of General Services Department
 - i. Functioning of Human Resources Department
 - j. Functioning of Financial Administration Department and Fund Management.
 - k. Analysis of business trend as a whole.
 - l. Miscellaneous.

The Audit Report should be precise but the important observations must not be left out. The following tips may be helpful in writing an Audit Report:

- Observation should be direct, clear and concise.
- Report to be prepared as per banking norms and practice
- Objections pointed out in the report to be specific with category of risk.
- Repetition and irrelevant comments to be avoided.
- Responsibilities to be fixed up in case of serious irregularities.
- The report is to be objective and no personal aspersion should be made against any official.
- Report to be prepared Department wise and Function wise.

It may be noted that an Audit Report will yield better results to the controlling offices as well as the Bank Branches by way of correction of undesirable situations in the Branches and adopting rightful decisions by the management.

4.17 Reporting and Disposal of Audit Report

The Audit Report is to be submitted to head of audit through head of the respective division as early as possible after compilation of the same in the light of the policy and copy of the report is to be sent to the concerned Branch/Divisions and Compliance Division for necessary correction of the lapses/irregularities pointed out in the report. The report should **be submitted by team leader with executive summary and specific recommendations**. The supervisory executives will then review the reports and pass appropriate recommendation before placement to the head of the division. The head of division will review the reports with executive summary and previous comments/ recommendations and he has to recommend a specific course of action before producing the report to head of the Audit. Audit Reports should be disposed from the head of Audit and head of ICC and follow-up action will be taken by Compliance Division for compliance purpose. Based on the gravity of detected irregularities and its impacts, head of audit & insp. division and head of ICC will decide whether it should produced to Audit Committee of the Board or disposed from their own end. **Audit Reports consisting findings of any fraud or forgery, should be produced to ACBOD. In addition to that, having more than four high risk observations, should be produced to ACBOD.** Moreover, a quarterly summary report on overall functioning of audit & insp.

division should be produced to Audit Committee of the Board on a regular basis. The head of ICC should also share the report to Board Risk Management Committee if Audit Committee suggests for better risk management purpose of the Bank

4.18 Follow-up and Disposal of Audit Report:

Audit officer will detect irregularities through standard audit procedures. Detection is the first step towards rectification. While the Branch concerned is primarily responsible for rectification, controlling offices are responsible for supervision of rectification. Follow-up of compliance of Audit Report is therefore supervisory responsibility of controlling division. Controlling office must ensure that the compliance on the Audit observation is submitted to the controlling office within the time frame for review of the Management. Before initiating audit at a Branch, compliance of preceding Audit Report must be ensured. Follow-up actions must ensure that any inordinate delay in compliance of Audit Report does not occur.

4.19 Code of Conduct and General Discipline for Internal auditor

4.19.1 Internal Auditor: Code of Ethics

The Code of Ethics states the principles and expectations governing the behavior of individuals and organizations in the conduct of internal auditing. It describes the minimum requirements for conduct, and behavioral expectations rather than specific activities. A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about governance, risk management, and control.

4.19.2 Code of Ethics- Principles

Internal auditors are expected to apply and uphold the following principles:

- a) **Integrity:** The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.
- b) **Objectivity:** Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.
- c) **Confidentiality:** Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.
- d) **Competency:** Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

4.19.3 Code of Conduct: Rules

A. Integrity

Internal auditors:

- A.1. Shall perform their work with honesty, diligence, and responsibility.
- A.2. Shall observe the law and make disclosures expected by the law and the profession.
- A.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- A.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

B. Objectivity

Internal auditors:

- B.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- B.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- B.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.
- C. Confidentiality
Internal auditors:
 - C.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
 - C.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.
- D. Competency
Internal auditors:
 - D.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
 - D.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*.
 - D.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

4.19.4 General Discipline for Internal Auditor:

Every auditor shall-

- a) Observe, comply with and obey orders and directions, which may from time to time, be given by any person or persons under whose jurisdiction, superintendence or control he/she may be.
- b) Continue to remain in service as whole staff of the Bank and shall not remain absent or leave office without prior permission of the competent authority.
- c) Serve the Bank honestly, sincerely, diligently and with utmost dedication. He/She must sub-ordinate all personal interest to the interest of the Bank and use his/her utmost endeavor to promote the interest of the Bank. He/She shall serve the bank to the best of his/her skill & ability and in all respect conform to the rules and regulations of the Bank.
- d) Maintain strict secrecy of the affairs of the Bank and also the affairs of the customers accounts and shall not communicate directly or indirectly to press, public or to any other agencies any information or document which will come to his/her knowledge and possession either in the ordinary course of his/her official duty or otherwise unless otherwise directed by the competent authority.
- e) Show courtesy and attention to the senior and to the fellow colleagues.
- f) Comply with the various rules, regulations and policies framed by the Bank as well as by the Government & Regulating Authorities in discharging their duties and responsibilities.

- g) As and when desires to make a representation relating to service in the Bank, he/she shall address such representation to the competent authority through his/her immediate superior and as per enforced Service Rules.
- h) Absent him/her from duty, nor leave the station, without first obtaining the permission of the competent authority in writing. However in exceptional circumstances verbal permission may be obtained to be followed by written confirmation.

Moreover every auditor of the Bank should maintain decorum and decency with other employees and customers of the Bank during office hours and at other time. They do not also accept or permit any member of his/her family to accept any gift or subscriptions from the branch of the Bank

4.19.5 Auditors' Failures and its Subsequent Administrative Action:

If auditors fail to carry on their duties and responsibilities properly or disobey the code of ethics or make any sorts of compromise with audittee and hamper the quality of audit works, it should be considered as a serious offence and punishable actions should be recommended by Bank Management if those activities proved undoubtedly true through further investigation.

CHAPTER-5

5. Compliance Policy

5.1 Overview :

A bank is said to have strong compliance culture when throughout the organization employees are encouraged to comply with policies, procedures, applicable laws and regulations. Even an individual at the lowest echelon should be empowered to speak up without the fear of reprisal if she/he identifies something noncompliant. The board of directors and the top/senior management must establish a compliance culture within the banking organization that emphasizes and demonstrates to all levels of personnel the importance of internal control. In order to establish a compliance culture the board of directors and top/senior management must promote a high moral standard. In reinforcing ethical values the banking organization should avoid policies and practices that provide inadvertent incentive for inappropriate activities. Examples of such policies and practices include undue emphasis on performance targets or operational results, particularly short term ones that ignore long term risks and compensation schemes that overly depend on short term performance. The board of directors and the senior management should establish a 'Code of Ethics' that all levels of personnel must sign and adhere to. Bank should employ reasonable care to establish and maintain effective system and control for compliance with regulatory system and for countering the risk that the Bank may expose to carry on its activities. Considering the existing and upcoming nature, scale and complexity of its business, the bank has to establish a separate Compliance Division headed by head of Compliance. The organization and responsibilities of a Compliance Division should be documented. A Compliance function should be staffed by an appropriate number of personnel that is sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the Bank's record as well as ultimate recourse to the CEO & MD and/or Board of Directors, as the case may be.

5.2 Compliance Risk Management

Compliance risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility or incorrect interpretation of effective laws or regulations. Banks are exposed to compliance risk due to relations with a great number of stakeholders, e.g. shareholders, regulators, customers, counter parties, as well as tax authorities, local authorities and other authorized agencies.

Compliance risk arises from the necessity of the bank to conduct its businesses in conformity with the business and contractual legal principles applicable in each of the jurisdictions where the bank conducts its business, as well as, when there is a possibility that the institutions' failure to meet legal requirements may result in unenforceable contracts, litigation, or other adverse consequences.

Compliance risk can lead to license revocation, fines and penalties, payment of damages, deteriorating position in the market, reduced expansion potential, and lack of contract enforceability. Compliance risk can also lead to a diminished reputation, also known as Reputation risk, arising from an adverse perception of the image of the bank by customers, counter-parties, shareholders, or regulators. This affects the bank's ability to establish new relationship, introduce new services or products, or maintain existing service relationships. This risk may also expose the institution to administrative, civil and criminal liability, financial loss or a decline in its customer base.

Appropriate actions for the bank to take, in mitigating compliance risk, would include: reducing exposures of sources of compliance risk, an appropriate compliance risk management process and putting in place an effective compliance function in the institution.

The bank should identify sources of compliance risk. For instance, common sources of compliance risk are:

- a) Violation or noncompliance with laws and regulations and prescribed standards;
- b) Lack of or inadequate compliance with contractual obligations and other legal documentation;
- c) Inadequate identification of rights and responsibilities between the institution and its customers;
- d) Complaints by customers and other counterparties;
- e) Harming the interest of third parties;
- f) Litigation procedures, potential exposure (including cost of litigation) and nature of pending or threatened litigation;
- g) Involvement in money laundering, insider trading, violation of taxation rules, forgery and damage from computer hacking by the institution, its intermediaries or its customers; and/or
- h) Limited knowledge and postponed response by management to implement legal and reputation risk management.

5.3 Compliance Risk Definition

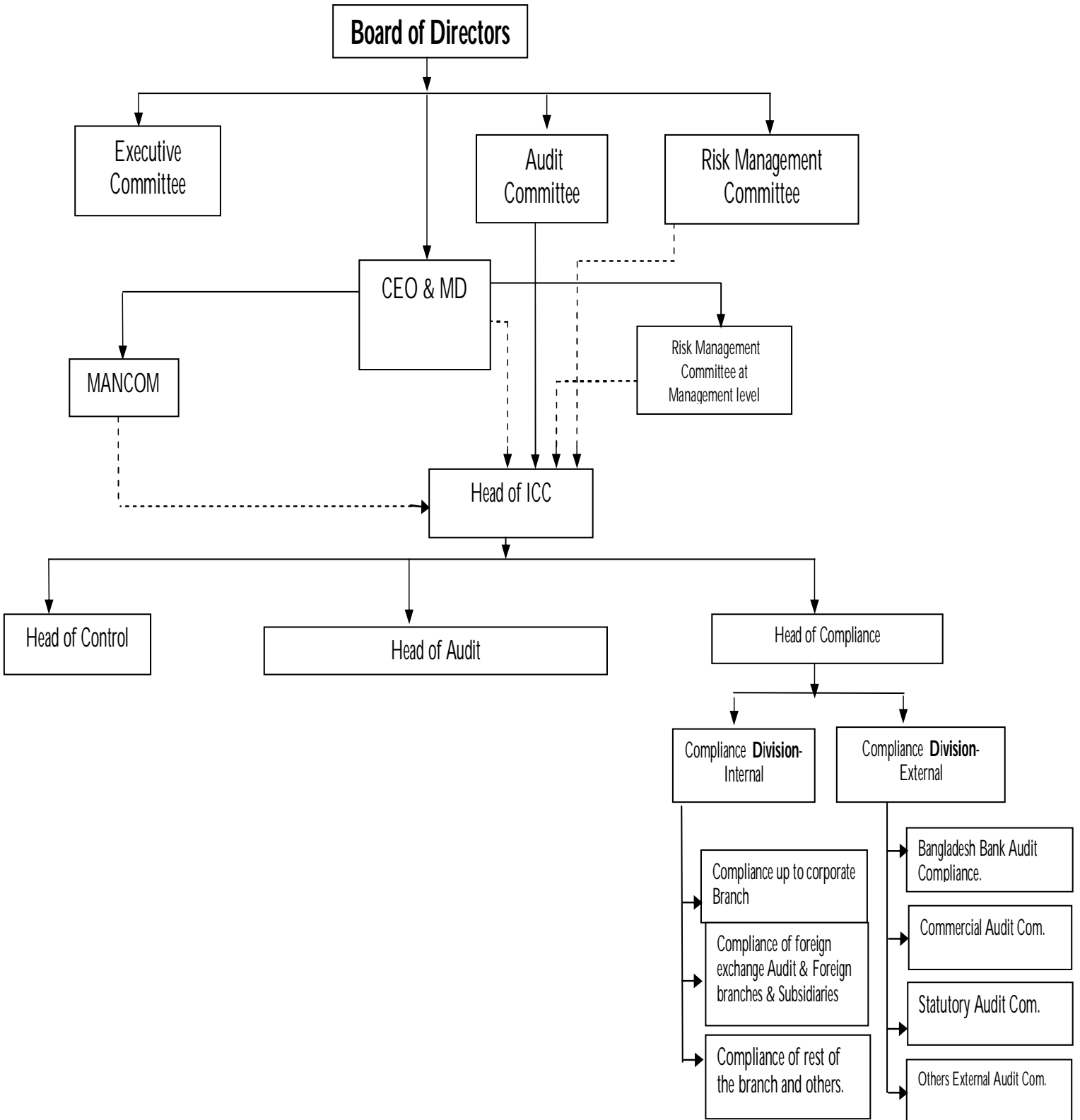
As part of Sonali Bank Limited's on-going efforts to address Bangladesh Bank and other regulators' supervisory issues, this Compliance Policy has been prepared to assist the Head of Compliance personnel managing the Bank's Compliance risk, which can be defined as:

"An independent function that identifies, assess, advises, monitors and reports on the banks Compliance risk, that is, the risk of legal regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice."

This policy has been framed based on the observance of two key principles:

- * First, the role and responsibilities of the Compliance function to be clearly defined: and
- * Second, the Compliance functions to be independent from the audit and control activities of the Bank, under responsibility of head of compliance:

Organizational Structure of Compliance Division



Before deploying Head of Compliance, the Head of ICC will perform that function

The Head of Compliance will be responsible for establishing sound compliance culture within the overall banking activities. Banks should have strong Compliance Division. Under the head of compliance, there should have two separate divisions for carrying on the total compliance activities of the Bank effectively and efficiently i.e. a) Compliance Division- Internal, and b) Compliance Division -External. The head of each division will report to the head of the Compliance and head of Compliance will report to head of ICC and Audit Committee of the Board of Directors.

5.3.1 Compliance Division -Internal:

Compliance Division-Internal will deal with compliance of objections raised by AID-1, AID-2, Foreign Exchange Audit Division, concurrent audit unit and all sorts of internal audit & insp. observations raised by any field offices (GMOs/POs/ROs)/departments/divisions/CEO & MD squad or any special teams that will be formed for any special purpose by the Bank. This division will employ close monitoring on compliance activities of all the bank branches. It will also be responsible for placement of internal audit & insp. objections settlement status of the Bank before the head of Compliance and head of Compliance will produce such to Audit Committee of Board of Directors on quarterly basis through the head of ICC.

5.3.2 Compliance Division-External:

Compliance Division-External will deal with compliance of objections/observations raised by the various external audits and Inspections team (i.e. Audit & Inspection by Bangladesh Bank, Commercial Audit, Statutory Audit by CA Firms, Audit of concerned Ministries and other regulatory authorities). This division will be responsible for placement of all external audit objections and its settlement status of the Bank before the head of Compliance and he will produce such to Audit Committee of Board of Directors on quarterly basis through the head of ICC. This division will be responsible for replying to the queries and furnish compliance status to concerned authorities with the prior approval of the head of ICC and CEO & MD where applicable. **This division will work as a focal point of external correspondence regarding compliance aspects of the Bank. It will also preserve, review and circulate all the circulars, instructions and guidelines, laws etc with collaboration with concerned division of the Bank and collect explanations/comments/opinion from concerned regulators, if any clarification is required by the implementing division(s).**

5.4 Policies, Procedures and Limits

Bank should put in place adequate policies and procedures for managing compliance risk. Compliance policy should explain the main processes by which compliance risk is to be identified and managed through all levels of the bank's organizational structure. The policy should also define the compliance function as an independent function, with specific roles and responsibilities of the compliance staff, and detailing the compliance officer's communication methods with the management and staff in the various business units.

Compliance risk management policy should be a part of the overall risk management policy of the bank, and should precisely determine all important processes and procedures in minimizing the institution's compliance risk exposure. The policy should be clearly formulated and put in writing. The policy must contain, at least, the following:

- a) Definition of compliance risk;
- b) Objectives of compliance risk management;
- c) Procedures for identifying, assessing, monitoring, controlling and managing compliance risk;

- d) Well defined authorities, responsibilities and information flows for compliance risk management at all management levels; and
- e) Clear statement of the institutions accepted tolerance for compliance risk exposure.

5.5 Identification, Measurement & Monitoring of Compliance Risk

An effective measurement and monitoring process is essential for adequately managing compliance risk. In order to understand its compliance risk profile a bank should identify the sources of compliance risk that it is exposed to and assess its vulnerability to these risks. If a new compliance risk is not recognized, the bank's legal experts may never thoroughly review the existing contracts. Thus, the bank should identify and assess the compliance risk inherent in all existing or new, rules, procedures, internal processes, activities, contracts and court cases.

The bank needs to define the appropriate approach to assessing each identified source of risks. There are various tools used for identifying and assessing compliance risk, such as:

- (a) Self-assessment:** A bank assesses its operations and activities against a list of potential risk vulnerabilities. This process is internally driven and often incorporates checklists to identify the strengths and weaknesses of the compliance risk environment.
- (b) Risk indicators:** Risk indicators are statistics or matrices that can provide insight into a bank's risk position. Such indicators may include the volume and/or frequency of law violations, frequency of complaints, number of initiated litigation procedures, payments of damages, fines and court expenses, unfavourable court verdicts or number of finalized court cases on a periodical basis, and frequency of actual or suspected fraud or money laundering activities. These indicators should provide good incentives, tying risk to capital to desirable improvement in the compliance function.
- (c) Risk mapping:** In this process, various divisions are outlined by risk types (for example credit division can be outlined by the risk of the lack of contract enforcement or incorrect interpretation of the agreements). This exercise can disclose areas of weakness and help to identify priorities for management action.

The bank should consider ways to measure compliance risk by using performance indicators, such as the increasing number of: customer complaints, corrective measures taken against the institution, or litigation procedures as a result of noncompliance with laws and regulations.

Compliance risk can also be measured by regular legal reviews on different bank's products and services, and their relevant documentation in order to ensure that all contracts are in conformity with laws and regulations. This review may take place on each transaction individually or may cover the legal adequacy of standardized documentation and procedures.

Banks are responsible for monitoring their compliance risk profiles on an on-going basis by reviewing defined compliance risk indicators in order to provide management with early warning. (.....)

Banks should have processes and procedures in place to control compliance risk. There should also be a constant review of the bank's progress towards meeting legal objectives, and checking for compliance with policies and procedures and defined duties and responsibilities.

5.6 Management Information System (MIS)

For effective monitoring of compliance risk, an efficacious and useful management information system (MIS) should be in place. MIS should enable the bank to identify and measure its compliance risk on a timely basis and generate data and reports for use by the board and management.

The bank should establish a database of its legal documents. This database should contain at least: type of legal documents (contracts, memorandum of understanding, etc.), period of document validation, and responsible division for document enforcement. The effectiveness of risk monitoring depends on the ability to identify and measure all risk factors, and must be supported by appropriate, accurate and timely MIS with analysis and decision making. Therefore, management must develop and upgrade its information system to identify and measure risks in an accurate and timely manner.

5.7 Objectives of Compliance Division

The objectives of Compliance divisions are:

- * To establish strong compliance culture within the Bank to mitigate the forthcoming risk.
- * To ensure systems and risk based compliance philosophy
- * To add value beyond the traditional Compliance role
- * To test and evaluate performance of controls through critical reviews for effectiveness, integrity of transaction processing and safeguarding the Banks interest.
- * To achieve Compliance evidence to frame a risk-based assessment and an early warning system to eliminate possible mishaps.
- * To ensure the safeguard of the assets of the Bank through establishing effective and efficient compliance culture.

5.8 Functions:

The Head of Compliance will be responsible for:

- * Compiling and monitoring an up-to-date reference for all applicable regulatory and supervisory requirements.
- * Ensuring that credit, investment, treasury, finance and other relevant banking Divisions have established appropriate procedures to effectively comply with the regulations and guidelines.
- * Inculcating overall awareness among staff concerning regulatory requirement and Compliance development.
- * Periodic reviews throughout the bank to evaluate specific as well as overall level of adherence to applicable regulations
- * Effective liaison with Bangladesh Bank, external and internal auditors and rectification of deviation from regulations as pointed out in their report.
- * Ensuring that the primary safeguarded against money laundering i.e. "Know Your Customer" concept is adhered to in all business areas.
- * Ensuring that all Compliance officers are up-to-date on current Compliance requirements and include training sessions on such topic.
- * Ensuring adherence and remain informed on regulatory requirements regarding the prevention and reporting of suspected money laundering transactions.
- * Ensuring that recommendations of Bangladesh Bank guidelines on the prevention of money laundering are complied with.
- * Ensuring correct and timely submission of periodic reports to regulatory and supervisory bodies.

- * Carrying out any other compliance related matter assigned by the head of ICC, CEO & MD and senior management.

5.9 The Role of Head of Compliance

- * To ensure that all regulatory requirements are met.
- * To develop and maintain a true compliance culture and a code of conduct throughout the Banks, in their day-to-day business activities.
- * To facilitate internal customers, whether business or operations, and assist senior management by ensuring that the bank operates in accordance with (a) all regulatory and legal requirements, and (b) standards of conduct, so as to protect and enhance the reputation of the Bank with its regulators and avoid significant financial loss.
- * To effectively enforce current Bangladesh Bank guidelines on Money Laundering (ML) and know Your Customer (KYC) procedures.
- * Acting as the senior Financial Crime Risk (FCR) representative for investigating financial crime cases and related control failures, as needed, in coordination with the Banks Audit & Insp.

5.10 Basic Compliance Methodology

- * The Head of the Compliance will ensure that procedures are in place to make staff members aware of requirements to comply with regulatory and supervisory guidelines and the instructions and policies that are issued by bank management time to time.
- * Compliance procedures are documented and performed to ensure that adherence to regulatory requirements are monitored and evaluated on a regular and systematic basis by Compliance Officer.

5.11 Role of External Auditors in Evaluating Compliance System of the Bank:

- External auditors by dint of their independence from the management of the bank can provide unbiased recommendation on the strength and weakness of the internal control and compliance system of the bank.
- They can examine the records, transactions of the bank and evaluate its accounting policy, disclosure policy and methods of financial estimation made by the Bank: This will allow the board and the management to have an independent overview on the overall control and compliance culture of the bank.

5.12 Regulatory Compliance

- Central Bank is the primary regulator, who governs the activities of banks. In addition Tax Authority, Registrar of joint Stock Companies, Finance Ministry etc. are regulatory bodies whose directives have significant impact on bank's business and day to day operations.
- The internal control and compliance system should always take into account the bank's internal processes to meet the regulatory requirement before conducting any operation.
- The internal control and compliance system of the bank must be designed in such a manner that the compliance with regulatory requirements is recognized in each activity of the bank. The bank must obtain regular information on regulatory changes and distribute among the concerned divisions, so that they can take necessary action to adapt to such changes.

- iv) The bank must develop an effective communication process which will allow smooth distribution of relevant regulations among different divisions and personnel which directly and indirectly helps to establish strong compliance culture.

5.13 Establishment of a Compliance Culture:

- i) Bank should have strong compliance culture when throughout the organizations employees are encouraged to comply with policies, procedures and regulations. Even an individual at the lowest echelon should be empowered to speak up without the fear of reprisal if she/he identifies something non-compliant.
- ii) The board of directors and the senior management must establish a compliance culture within the banking organization that emphasizes and demonstrates to all levels of personnel the importance of internal control.
- iii) In order to establish compliance culture the Board of Directors and Senior Management must promote high ethical and integrity standard.
- iv) In reinforcing ethical values the banking organization should avoid policies and practice that provide inadvertent incentive for inappropriate activities. Examples of such policies and practices include undue emphasis on performance targets or operational results, particularly short term ones that ignore long term risk and compliance schemes that overly depend on short term performance.
- v) The Board of Directors and the senior management may establish a 'Code of Ethics' that all levels of personnel must sign and adhere to.

5.14 Focus of Compliance

The key Compliance focus is based on the high risk potential areas. Therefore, all the branches and Head Office Divisions of Sonali Bank Limited are to be categorized according to the risk involved from the Compliance aspect. This risk categorization will be based on the following three factors.

* Penalty items by Bangladesh Bank

* Serious exceptions

* Others exceptions

5.15 Compliance Checking

The checking of Compliance in all high-risk potential areas of branches and Head Office Divisions will be primarily based on random sample and these can be accomplished through the help of internal auditor of the Audit & Insp. Division.

It is not within scope of the Compliance Policy to go into direct checking of any area as a mandatory requirement. Compliance verification will be accomplished through regular internal audit & insp. by the AID based on:

* Checking to be at random sample based

* According to potential high-risk areas

* Area-wise Unit/ Divisions in the branches or Head Office.

5.16 Compliance Division Charter

Responsibilities of Compliance Division within the Bank:

Compliance responsibilities shared by all Sonali Bank Limited's personnel as well as across various division of the Bank, most notably, are the following:

The Board of Directors, the CEO & MD, senior management, head of ICC and line managers have primary responsibility for Compliance throughout the Bank;

The Compliance Division identifies and assesses compliance risks, guides and educates personnel on compliance issues, performs monitoring and reporting role, in cooperation with the Legal Division, as needed; and

Audit & Insp. Division review the adequacy of controls established to ensure Compliance with Sonali Bank Limited policies, plans, procedures and business objectives, in accordance with the Internal Audit Charter.

5.17 The Activities of Compliance Division:

The Compliance Division should be independent from the business activities of the Bank and is under the responsibility of the head of Compliance. The head of Compliance should take pragmatic steps to ensure effective and efficient compliance culture within the Bank. Head of Compliance is to assist the ICC head of the Bank to ensure on a reasonable basis that the Bank-wide activities and its staff are conducted in conformity with applicable laws and regulations, the Bank's code of conduct and all relevant rules and policies, and generally with sound practices pertinent to those activities.

5.18 Specific Responsibilities of Compliance Division:

The Compliance Division shall have the following specific responsibilities.

- * On a pro-active basis, identify, document and assess compliance risks associated with the Bank's activities.
- * Assess the appropriateness of the Bank's compliance procedures and guidelines promptly, follow-up any identified deficiencies and where necessary, formulate proposals for amendments;
- * Request and have access to and communicate with any staff member within the Bank and to any records or files necessary to enable it to carry out its responsibilities;
- * In co-operation with other functioning division of the bank and relevant Bank business unit. (Internal Audit, Internal Control and Legal Services) and relevant Bank business units provide guidance and advice to staff on the appropriate implementation of the relevant laws, rules and standards through internal policies and procedures;
- * Assist the CEO & MD, senior management and line managers in educating staff on compliance issues, and act as a contact point within the Bank for compliance queries from staff members and other stake holders.
- * Monitor Compliance activities by performing sufficient and representative compliance risk assessment and testing this includes performing "spot-checks" to test compliance with polices and procedures, making inquiries into deficiencies and/or breaches and carrying out investigations.
- * The Head of Compliance shall report to the head of ICC on a regular basis on all compliance matters. The reports should refer to the compliance risk assessment and testing that has taken place during the reporting period, summaries any material deficiencies and/or breaches and

recommend measures to address them, and report on the corrective measures already taken. In addition to this regular reporting, the Head of Compliance shall report any deficiency or breach of which she/he becomes aware to the appropriate level of management in accordance with materiality criteria as established by the Bank's management.

5.19 Independence and Accountability

The Compliance Division should be independent from all business activities of the Bank and is responsible to the head of ICC. The Head of each Compliance Division reports directly to the head of Compliance and then head of Compliance will report to head of ICC. The management and staff of compliance division shall not be placed in a position where there is a possible conflict-of-interest between their compliance responsibilities and any other responsibilities they may have. The head of ICC shall meet with the CEO & MD on a regular basis for administrative purpose and as needed, with the Audit Committee, as and when required but at least once a quarter to discuss the matters of importance.

5.19.1 Authority

To carry out its mission effectively, the Compliance Division in the course of its activities shall be authorized to:

- ⇒ Enter all areas of the Bank and have access to any documents and records that it consider necessary for the performance of its responsibilities; and
- ⇒ Require all members of Management and staff to supply such information and explanations, as may be needed, within a reasonable period of time.

5.19.2 Standards

Compliance Division shall keep abreast of sound practices in its field and in particular take into account the recommendations and guidelines issued by Bangladesh Bank and other regulatory authorities as well as Bank's own rules and regulations.

5.19.3 Relationship with Other Divisions

In addition to the specific collaboration with the above mentioned divisions, on an "ongoing basis" efforts shall be made to ensure good coordination and close and continued cooperation between the Compliance Division and other Control Divisions of the Bank in particular the Internal Audit & Inspection functioning and other Control functioning. Duplication of activities should be minimized.

5.20 Compliance Risk Aspect

As part of Sonali Bank Limited, on-going efforts to address Bangladesh Bank supervisory issues, this Compliance Policy has been prepared to assist the Compliance Division – Compliance Division personnel Managing the Bank's Compliance risk, which can be defined as :

"As independent function that identifies, assess, advises, monitors and reports on the banks Compliance risk, that is, the risk of legal regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice."

The guidelines presented in this Compliance Policy set forth the re-alignment and restructuring of the Compliance Division activities and scope. This is based on the observance of two key principles:

- * First, the role and responsibilities of the Compliance function to be clearly defined: and
- * Second, the Compliance functions to be independent from the audit activities of the Bank, under the responsibility of head of compliance.

5.20.1 Risk Assessment

- * Risk Assessment for functions in area of responsibilities; ensure Compliance with Bank policy and procedures.
- * For functions under responsibilities, ensure Compliance with the Bank's Operational Risk policy and procedure.

5.20.2 Compliance Staff

- * Ensure functions in area of responsibilities operate in accordance with the Banks policies and standards.
- * Set the standards relating to adequacy/retention of internal and customer records in accordance with Bank's and local regulatory requirements.

5.21 Four Corner Stone's of Compliance

The basic components of compliance are depicted below:

A. BB & others regulatory Inspections

B. Internal Audit and Inspections



C. External Audit

D. Other Compliance

The four corner stones of compliance are presented graphically as above. These are also represented by the following activities:

- i) Bangladesh Bank and other regulatory audit Compliance
- ii) Internal Audit & Insp. Compliance
- iii) External Audit Compliance
- iv) Other compliance.

Additional areas of compliance will cover matters related to:

- i) Suspicious transactions
- ii) Frauds and forgeries cases
- iii) Overall Compliance certificates from Branches and Divisions.

5.22 Work Methodology of the Compliance Division

Under the head of Compliance total compliance functioning of the bank should be carried on under two broad umbrellas. i.e. 1.Compliance Division-Internal. 2. Compliance Division-External.

Compliance Division-Internal will conduct the compliance monitoring functions of all sorts of findings of the internal audit and inspections like as audit findings of the AID-1, AID-2 and FEAIID,

GMO, PO, RO offices. This division will consist three separate segments. These are a) Compliance on the internal audit findings on branches up to corporate level b) Compliance on the internal audit findings on branches below corporate level c) Compliance of the findings of foreign exchange Audit on AD branches, Foreign branches & other foreign units.

Compliance Division External will conduct the compliance monitoring functioning of all sorts of observations of the external audit and inspection like as audit observation of Bangladesh bank, Commercial audit, Statutory Audit etc. This divisions will consist of following segments. These are a. Bangladesh Bank audit Compliance B. Commercial Audit Compliance C. Statutory Audit Compliance, and Compliance of other external Audit observation.

All compliance officers have a pre-allocated task schedule for looking after the compliance related activities.

There are four distinct areas in which staff conducts compliance activities.

1) Compliance of findings of the Internal Audit & Inspection Divisions :

Compliance Divisions- Internal will deal in this area under the following sequence: -

- * Audit & Insp. Divisions conduct various types of audit and inspection activities of head office/controlling offices/ branch offices/ Subsidiaries and provide audit reports to the head of compliance, along with their recommendations for compliance purpose. Head of compliance will forward it to the head of compliance division internal.
- * After getting the audit report, the head of Compliance Division internal instructs the concerned compliance officer to follow-up such compliance with required correspondence.
- * In the case where this has been rectified, no further action needs to be taken by compliance officer.
- * In case where compliance has not been adhered to and/or not rectified, and if such has been detected by compliance officer the same is reported to the Head of the Division. Based on the gravity of the non-compliance head of the division should report it to head of ICC through head of compliance. If think appropriate head of ICC will report it to the CEO & MD as well as audit committee. For serious non-compliance rectification, a copy is to be sent to the internal audit & insp. division for documenting in the next scheduled audit.

2) Bangladesh Bank and Other Regulatory Audit

It is the functioning of the Compliance Division-External, maintaining the following sequence:

- * Bangladesh Bank notifies the CEO & MD/head of ICC/ Head of Compliance regarding the time frame for annual audit and inspection.
- * Pre-Inspection data is identified and solicited by them from the Bank by means of formal request.
- * The head of ICC may depute the head of Compliance Division for coordination purposes between the Bangladesh Bank and Sonali Bank Limited.
- * After Completion of audit on Bank by Bangladesh Bank, a draft report is handed to the Compliance Division-External for obtaining management comments.
- * Compliance Division-External gathers appropriate and plausible response from all the constituents of the audit and inspection.
- * The draft report with the management response is handed to Bangladesh Bank, within a specific period of time for finalization of report.

- * Compliance Division-External subsequently handles outstanding issues, with respective branches and Divisions.
- * Head of Compliance-External distributes the reports to divisional heads for their views and comments and settlements of outstanding issues.
- * They also produce it to audit committee and board as required. If required, this division also arrange in between triparties meeting among Bangladesh Bank audit team, Management and Board members of Sonali Bank Limited.
- * Follow-up is on-going for all units, branches and Divisions in respect of rectification status and reporting it to head of ICC/ CEO & MD/ audit committee/ Board has think appropriate.

3) External Audit/ Statutory Audit:

It is the functioning of the Compliance Division-External to comply the compliance of observations consisting in satutory audit related management reports, considering the following sequence:

- * Engagement process of CA firms will be dealt by Company Secretary/Procurement Division in cooperation with Central Accounts Division-1(CAD-1) as well as CAD-1 works as a focal point for coordination and conducting the total audit process.They also produce audit report to Audit Committee and to the Board in due process.
- * The subsequent management reports that produced by the CA firms, will be dealt by the Compliance Division-External. They produce that reports to the ACBOD and BoD for further course of action.
- * The Compliance Division-External follows up for the noted observations and deviations for rectification of the same.
- * The compliance division external will produce the compliance of observations to the audit committee and the board. They will also inform the audit committee the update of the compliance of observations of management report ongoing basis.
- * The Compliance Division is responsible for following up with the concerned unit to ensure that the noted rectification has been addressed.

4) Other compliance

- * All Compliance officers submit their reports to the concerned Head of Compliance Division who reviews that and will produce branch-wise consolidated report to the Head of Compliance and forwards to the CEO & MD through head of ICC showing both the rectified and un-rectified status of all exceptions and action taken.
- * Serious non-compliance observations are taken up separately with the concerned branch or Divisions. If the degree or repetitiveness of exceptions is high the head of compliance respective compliance division reports the same to the Board Audit Committee through head of compliance and head of ICC.
- * The Head of Compliance prepares a quarterly summary report of compliance status and produce to Board Audit Committee and BOD as required.

5.23 Other Activities

The head of compliance will be responsible to ensure that bank complies with all regulatory requirements while conducting its business. They will maintain liaison with the regulators at all level and notify the other divisions regarding regulatory changes. Head of Compliance Division-External will act as a focal point of all sorts of external communication regarding compliance issues.

(a) Frauds and Forgeries Statement:

All incidents of fraud and forgery, in principle, be recorded from the audit report and summary statement should be produced to the Head of Compliance. Such matters will be referred directly to the Head of Compliance, head of ICC and Board Audit Committee for further action. As per requirement of regulators, these statements should be provided by head of compliance subject to approval of head of ICC.

(b) Bangladesh Bank Audit:

The Annual Bangladesh Bank Audit functioning on Sonali Bank Limited. is to be coordinated from Compliance Division-External under the direct supervision of head of Compliance Division-External. The head of Compliance Division will work as a focal point of conducting BB audit and will play a vital role by helping to resolve the long outstanding issues relating to the respective branches and divisions e.g. Foreign exchange, Credits, and other operation-related violations.

(c) Compliance of Commercial Audit and other external audit: Compliance Division – External will be responsible for collection of compliance status of external audit/commercial audit observation from respective branch/division, summarize them and supply the status report to the concerned authority and ACBOD as well as BOD with the approval of Head of ICC and CEO & MD where applicable.

(d) Management reports from External Auditors:

It is the responsibility of the Compliance Division-External to FOLLOW-UP the External Auditors report to the management; the responses received Branches and Head Office Division.

The Head of Compliance-External will gather the relating responses, consolidate them and then forward them in a standardized format to the External audits and the Bangladesh Bank, as required.

(e) Centralized Circular Maintenance:

All internal instructions/circulars and policies and circulars received from Bangladesh Bank and others regulators will be maintained by the Compliance division-External exclusively and specifically for a quick platform of reference. The purpose for this is to further disseminate the essence instructions with appropriate interpretation/clarification/guidelines (from BB and outside association or agency along with those of our own Banks management) for the knowledge of and Compliance by all the constituents. Compliance Division.-External will preserve, review and circulate all the circulars/policies and guidelines among the various divisions/divisions of the Bank that are received from the regulators.

5.24 Guidance for Compliance Officers

It is the responsibility of all compliance officers to ensure that the following guidance norms be adhered to:

a) Collection of regular compliance status from the Branch:

b) Compliance Checking

Compliance officers are to ensure that the branch has complied with the objection raised by different internal/external auditor in their audit report i.e. the branch's response to the internal/Bangladesh Bank Reports shall be reviewed and checked to ensure the true compliance and rectification thereof.

c) Follow up of outstanding Exceptions

All Compliance officers are to ensure the timely receipt of follow-up feed-back of all outstanding exceptions of their branches within a stipulated time.

In case of any delays noted or failure to meet the target in this respect, Head of Compliance shall be informed immediately.

d) Focus of Compliance Checking

All Compliance officers shall focus on the following.

True and Timely Compliance:

All Compliance officers will, as part of their regular Compliance checking, ensure that the branches are following timely Compliance with the notified exceptions.

Repetition of Reported Exceptions:

All subsequent exceptions of a similar nature is to be viewed as a serious matter. The CEO & MD and senior Management of the Bank/Bangladesh Bank will take a serious view of the re-occurrence of a similar nature. All the compliance officers have to ensure that their respective branches do not show a trend of repeated exceptions of a similar nature. The focus of bank's compliance checking ought to be placed on ensuring that the branches show an improvement in the working of a particular area with respect to internal policies and procedures, Foreign Exchange and Prudential Regulations and overall internal controls environment.

If compliance officers observe that lapses of similar nature continues to occur in any area of operation, the typical pattern of such Re-occurrence shall be identified and be brought to the notice of the area Manager and the copies of the same to be marked to the Head of Compliance. Repetition of such exceptions may be subject of disciplinary action.

h) Timeframe for Submission of Compliance Repots

Compliance Officer (s) shall furnish their reports to the head of the division within seven (7) working days after receiving the Compliance report from the branch.

5.25 Checklist/Implementation

In compliance with requirement of managing core risk in banking, the senior management of the bank has published a checklist/guidebook in the name of "Internal Control & Compliance Risk" and provided the same down to the field level to comply with the Banks rules & regulatory guidelines from Bangladesh Bank for checking all sorts of risks. The Compliance Divisions will keep it up to date to maintain sound compliance culture within the Bank to address relevant risks.

5.26 Reporting:

The Head of Compliance Divisions shall report to the head of ICC on a regular basis on all compliance matters. The reports should refer to the compliance risk assessment and testing that has taken place during the reporting period, summaries any material deficiencies and/or breaches and recommend measures to address them and report on the corrective measures already taken. In addition to the regular reporting, the Head of Compliance Division shall report any deficiency or breach of which she/he becomes aware to the appropriate level of management in accordance with materiality criteria as established by the Bank's management.

There should be a centralized system of reporting all observations exceptions, their rectification status and the present and cumulative outstanding status of all observations/exceptions on significant issues etc.

The reporting position and summary of observations are outlined in the relevant format. All compliance officers must have a pre-allocated schedule for looking after the branches and the Head Office Departments for Compliance related activities in their respective regions.

For Compliance purposes all the reporting is routed through the Head of Compliance who after review, identification of significant issues, consolidates all the respective reports and submits it to the head of ICC through the head of compliance for onward submission to Audit Committee and BoD where applicable.

The Compliance Divisions should be independent from all business activities of the Bank and is responsible to the head of ICC. The Head of Compliance Divisions will report directly to the head of ICC through head of compliance. The head of Compliance should report to head of ICC and Audit Committee of the Board based on the gravity of compliance status. The head of ICC shall meet with the Audit Committee, as and when required but at least once a quarter to discuss matters of importance. The head of Compliance also submit a quarterly compliance status report to the Board Audit Committee regular basis through the head of ICC. The head of ICC should also share this report to Board Risk Management Committee if Audit Committee suggests for better risk management purpose of the Bank.

-----The End-----