

10 Internal Audit & Control

Assessment and mitigation of risks, continuous monitoring of internal controls and a proactive approach to business process rationalization in accordance with the changing business dynamics as deeply implanted in the vision of SBP-BSC's top management. During FY11 these ideals were largely pursued by the Internal Audit Department(IAD) of SBP-BSC, who like yester years continued to provide its help in identifying risks to objectives of the BSC 's management by pinpointing activities that require business process re-engienrring to minimize risk.

10.1 Overview

BSC has a fully functional Internal Audit Department (IAD) at Head Office Karachi (HOK) with Audit Hubs¹ at its Karachi and Lahore offices. Goals of Internal Audit Department are to analyze the internal controls and operational performance of SBP-BSC viz-a-viz its internal control operational policy and instructions issued by HOK. The IAD also offers its recommendations to align the operational performance of various units at offices and department of HOK to identify and gauge the overall risk profile of the organization.

IAD's work is governed by the Committee of the Board of SBPBSC on Audit which has empowered the department to identify various risks associated with operational activities within the organization. For this purpose, IAD evaluates compliance to the system of internal controls, verifies the accuracy and reliability of accounting data, assesses operational efficiency, and ensures adherence to prescribed managerial policies for accounting and financial controls along with formulation of recommendations to further strengthen them. Findings of IAD are not just compliance driven but are also playing a crucial role in business process modifications and procedure transformation in accordance with the associated risk appraisals carried out by it.

A short to medium terms road map has also been formulated to further strengthen the department by revisiting the audit processes, emphasizing upon skill development activities through self learning and focused trainings, realigning the department to the changing business environment of BSC and ultimately developing it into a value adding arm of BSC.

A risk based Annual Audit Plan is prepared by the department for proactive scheduling of audit initiatives which is approved by the Committee of the Board of SBPBSC on Audit. After conducting audit of SBPBSC Offices and Departments at HOK, IAD prepares the Audit Report which is discussed in the exit meeting with management of the concerned department / office elaborating therein the perspectives of observations and immediate way out for early resolution of the underlying risks. Subsequently the report along with the Auditor's Brief comprising major observations detected during the audit is submitted to the Managing Director, SBPBSC for review and ensuring that corrective actions are taken thereon. Concurrently, the report is also forwarded to the

¹ Audit Hubs were created at Karachi and Lahore Offices on 6th November, 2008

Executive Director, Internal Audit & Compliance Department, SBP for onward submission to the Governor, State Bank of Pakistan. Further, department has also strengthened its enforcement & compliance function in order to ensure that audit findings are promptly addressed. A Compliance Officer assigned to each Audit Team develops liaison with BSC Offices/Departments of HOK for compliance as well as quick disposal of issues highlighted in Executive Summary of Audit Observations keeping in view the minutes of Managing Director recorded thereon.

10.2 Annual Audit & Compliance

During FY11 three financial and operational audit teams headed by Junior Joint Directors/Joint Directors (OG-4/OG-5) carried out audit of some departments at HOK and 16 Field Offices of BSC. Audit reports were issued to the respective Chief Managers of Field Offices for their information and ensuring rectification of irregularities highlighted in the reports and compliance of recommendations as well. The department has also initiated increased utilization of its IT expertise in evaluation of operations of offices by excavating irregularities through system-based data extraction, while process-centric observations with significant considerations given to possible risks associated therewith also remained prime focus. Highlighting efficiency & accuracy level of business transactions, evaluating the effectiveness of internal controls, identification of risk & control weaknesses along with suggesting corrective actions are integral part of Audit Reports. These audit observations along with recommendations played a vital role to bring a number of changes/ improvements in various core operations of BSC.

10.3 Information Technology Audit

Information Technology (IT) Audit is primarily focused on evaluating the core banking solution in Globus and Oracle ERP for non implementation or weaknesses in internal controls which are or could be applied through these systems. Additionally, IT audit reviews and evaluates:

- Physical IT infrastructure for environmental and physical controls
- Hardware for apparent weaknesses
- Network connectivity for latency weaknesses and
- Business Continuity Planning for adequacy from both IT and business perspective

Apart from the above core functions, IT audit continuously provides support to operational audit teams through dedicated attachment of one IT auditor with the operational auditors during annual audit of BSC Offices. IT auditors have also developed business related expertise over the course of time and hence are assisting in the process by auditing areas like Internal Bank Security, Engineering, General Services and Banking, etc. from time to time. IT auditors, with the coordination of ISTD-SBP, have carried out a lot of improvements in IT related transactions and also enabled users to minimize/eliminate the weaknesses.

In FY11, IT Audit Division conducted audit of IT System of 15 Field Offices with 304 observations and proposed recommendations thereon.

10.4 Performance of Internal Audit Hubs

The Audit Hubs at Karachi and Lahore were established in the year 2008. Each Audit Hub is headed by a Joint Director (OG-5) who is administratively and functionally reporting to the Head IAD. The Audit Hubs generally conduct brief but frequent audit engagements of three days and evaluate the control environment and processes of the Field Offices to ascertain effectiveness and accuracy of business transactions. The quick frequency of the audit engagements help make prompt rectification of outstanding issues in high risk areas. During the year a major review of working of the Audit Hubs was carried out with an aim to improve its effectiveness particularly with respect to efficient reporting and systematic analysis of its activities & functions. Audit Hub at Karachi has been allocated seven BSC offices which include Karachi, North Nazimabad, Hyderabad, Sukkur, Quetta, Bahawalpur, and Multan, while the Hub at Lahore has been assigned nine BSC offices i.e. Islamabad, Lahore, Gujranwala, D.I. Khan, Sialkot, Peshawar, Rawalpindi, Muzaffarabad and Faisalabad.

The Audit Hubs have added value during the year by adopting systematic and disciplined approach towards evaluating operational and financial controls at the BSC Offices across the country.

During FY11, Audit Hubs conducted 60 country-wide audit drills of BSC Field Offices as per monthly audit programs and during the process raised a total of 1,184 observations.

10.5 Contribution of Audit Committee in achieving Corporate Governance

Committee of the Board of SBP/BSC on Audit is assisted by the Internal Audit Department so as to discharge its responsibilities pertaining to achieving acceptable corporate governance standards. The committee ensures that role of IAD is elaborated on an organization-wide governance basis so that the department enjoys sufficient authority to conduct risk-driven analysis of controls related to the entire organization during audit engagements, excavate material control weaknesses, monitor compliance against prevailing policies and recommend risk-centric process transformations to strengthen the existing framework of checks and balances.

The performance of IAD itself as a department was also under consistent monitoring of Audit Committee. The Head IAD as a Secretary of the Committee submitted the Executive Summary of Audit Observations comprising of significant findings observed during the course of audit of the Departments/ Field Offices to the committee. Two audit committee meetings were held during the year under focus and following were the main agenda items discussed in these meetings:

- Quarterly Progress reports on Audit Briefs of Offices/Departments.
- Approval of Business Plan for the year 2010-11.
- Sanction of Management Letter of 30th June, 2009 issued by the External Auditors.

10.6 Capacity building of Internal Auditors

Training is considered to be the cornerstone of IAD's policy to facilitate the internal auditors to endow themselves with the necessary skill base to add value to BSC's control environment. As many as 50 internal auditors were trained in different areas in order to enhance their skills and knowledge to serve the department in a better way. In addition to local trainings, two officials of the department were sent on foreign training on "Internal

Auditing”. Details of trainings coordinated in FY11 to IAD officers are mentioned in Table 10.1.

Three-prong strategy has been recently communicated by the senior leadership of IAD in order to adopt coaching on consistent basis. Firstly in-house training modules are being delivered by area experts in addition to signing a collaborative attachments framework with the Karachi and Lahore Field Offices. The method is very efficient as a collaborative learning mechanism is under operation with virtually no cost at all. Secondly, trainings are being imparted under the umbrella of NIBAF and other local institutions as per departmental need. Finally, exposure in high value professional training modules of international commendation will also be provided to the IAD workforce.

Table 10.1: Capacity Building of Internal Auditors FY11

Training Module	No. of Participants
1 Information System Audit	8
2 Cy Management & Operations	7
3 Values and shared behavior	5
4 Internal Auditing – Process & Procedure	5
5 Foreign exchange operations and practices	4
6 National Prize bond scheme	4
7 Audit Command Language (ACL)	3
8 Understanding Statement of Affairs	3
9 Conducting enquiry and preparing report	3
10 EFS – Operation & Procedure	2
11 Conducting disciplinary enquiry	2
12 Customer Services	1
13 Trade document & regulatory regime in PK	1
14 Branch Fraud Investigation & Reporting	1
15 Internal Audit Workshop	1
Total	50

10.7 Future Plans

To move forward with the broad organizational changes linked with future management initiatives, IAD has designed following future plans.

a) Revisiting the structure of Audit Report and improve audit process for its effectiveness and prompt compliance of audit observations.

- Concise & Issue oriented format and redefining parameters/ determinants of High/ Medium/ Low priority audit observations.
- Developing the audit rating as well as enforcement/ compliance rating of offices/ department.
- Skill development activities through self learning and focused trainings. Carry out TNA internally / Identify Skill gap.
- Identify the internal & external area experts & formation of specialized groups in different areas of auditing.
- Develop and revisit the audit checklist & Audit Tool Kit.
- Update the Audit Manuals.

Future Plans

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- Skill development activities through self learning and focused trainings.
- Realigning the department to the changing business environment of BSC.
- Developing IAD into a value adding arm of BSC.

- b) Realigning the department to the changing business environment of BSC.
 - Strengthening the enforcement/compliance function through formalization of Quality Review and Enforcement Division.
 - Gradual introduction of Off-site monitoring function.
 - Redefining the Audit Hubs' scope.
- c) Developing IAD into a value adding arm of BSC.
 - Developing and Revisiting risk registers of the departments/offices.
 - Support management in carrying out investigative assignments.
 - Data extraction from Globus/ Oracle and analyses through Audit Command Language (ACL).