9 Internal Audit & Control

The management of risks, internal control, integrity and compliance is an integral part of business process management within BSC, embedded into its business objectives setting process, operations at HOK and field offices, and is continuously strengthened and improved during FY10

9.1 Overview

The primary responsibilities of the Banking Services Corporation is to perform the functions of the bankers to the governments, banks, state bank, ensuring adequate supplies of the good quality currency notes and coins across Pakistan, besides implementation of various policies of the SBP relating to development finance. It also administers various schemes of the government involving payment to the exporters. The very nature of these jobs requires putting in place systems, manuals, operating instructions that are to be complied with by all those involved in execution of these activities, at any stage of above activities with zero tolerance limits. Although the internal monitoring units exist across BSC offices and at HOK, whose job is to undertake pre audit of these activities, however the BSC also has a fully functional Internal Audit Department (IAD) at HOK with Audit Hubs[1] at its Karachi and Lahore offices. These audit hubs were created during FY09 by merging 17 Internal Audit Units previously housed at field offices and one at BSC HOK. These audit hubs were made fully functional during FY10 and have started carrying out periodical audit of SBPBSC Offices as per their monthly audit program to high light irregularities and improve efficiency of business operations.

The Audit Sub-committee of Board of Directors of the BSC has persistently focused on strengthening BSC`s internal controls, risk management and IT audit. As per their guidance the IAD has also been entrusted to identify various risks to the organization. For the purpose it evaluate compliance to the system of internal controls to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies for accounting and financial controls. For discharging its responsibilities the IAD carry out a systematic methodology for analyzing business processes, procedures and activities with the goal of highlighting organizational problems and putting their recommendations. One of the prime objective of IAD is to examine and evaluate whether the Bank's framework of risk management, internal control and corporate governance processes are adequate and functioning properly and carried out throughout the year. All findings of the IAD along with its recommendations are made part of their periodic audit report besides reports prepared by them after conducting special investigation of a particular activity.

For smooth operations of the IAD activities, the department prepares its Annual Audit Plan containing audit goals and schedule of audit of SBPBSC Offices and Departments.

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[1] Audit Hubs has been created at Karachi and Lahore offices on 6th November, 2008

The Committee of the Board of SBPBSC on Audit formally approves the audit plan. After conducting audit of the offices of SBPBSC Offices and Departments at HOK it prepares the Audit Report along with the Executive Summary of Audit Observations comprising High/Medium risk observations detected during the audit which are submitted to the Managing Director, SBPBSC, for review. Concurrently, the same is forwarded to the Executive Director, Internal Audit & Compliance Department, SBP, for perusal and onward submission to the Governor, State Bank of Pakistan. Further for strengthening the enforcement & compliance functions, in respect of audit observation a Compliance Officer has been assigned to each Audit Team, who ensures compliance of the Audit Reports by the offices/departments besides ensuring timely resolution of issues highlighted in Executive Summary of Audit Observations keeping in view the observation of the Managing Director recorded thereon. Compliance Reports submitted by the Offices and Departments are being processed in IAD and submitted to the Managing Director of SBPBSC. The audit observations containing medium and high impact are submitted to the Audit Committee of the Board, which normally meets at least once in a quarter for reviewing the findings of the audit and implementation of Audit Plan.

9.2 Annual Audit & Compliance

Box 9.1		
Areas of Operation		**Suggestion/ Recommendation of Audit**
Banking	Payment of Cheques of Government Department	Schedules meant for Government payments may be redesigned to make it in conformity with respective cheques by providing complete information of cheque including beneficiary's account number, bank & branch name in the Pay to Column of the schedule if the same information is recorded in the pay to column of the instrument besides beneficiary's name.
	Review of Telegraphic Transfer	Practice of transferring funds of Banks under Remittance Facility Scheme through T.T. Purchase at the offices does not appear to be in line with the instructions as contained in B.D. Manual and circular issued from time to time; therefore, it should be discontinued.
	Cheques & Bank Drafts/ Government Drafts- destruction of	After implementation of Globus/Oracle the procedure of processing of cancelled/misprint Payment Orders, Cheques and Bank/Government Drafts should be reviewed.
Prize Bonds	National Prize Bonds – Frauds & Forgeries	Some offices make endorsement on thephoto copy of Rs.200/- winning National Prize Bonds presented for the direct payment of prize money but they do not make any Endorsement on Photo Copies of other prize bond being not retained. Procedure may be revised.
	Maintenance Stock Register of Defaced / Cancelled Prize Bonds (PB-11 & 17)	Column of system generated reports viz. PB-11 & PB-17 are not in accordance with the columns of manually prepared reports as various columns and important information with regard to 'Progressive Total', Date of defacement, Number of pieces destroyed and balance of defaced bonds in stock etc. are not available in system generated reports. Therefore, the above columns may be inserted in the System generated report by ISTD.
	Destruction of Retain New Prize Bonds	New denomination retained Prize Bonds containing winning prize money of Rs.10,000/- and above may be destroyed in accordance with the procedure applicable in respect of old denomination retained Prize Bonds after retaining these bonds for a further period of one Year beyond six years retention period.
Treasury (Cash)	Examination of Chest / Sub Chest Branches	Reporting of affairs of the chest branches with reference to the quality and usage of chest balances needs a major improvement.
	Deposit of Chest Bonded Balances with SBP BSC Field Offices	In view of inflation and incurring cost, sorting charges may be reviewed in respect of surplus balances deposited by commercial banks if that were not found properly sorted out in the lots of re-issuable and non-issuable bank notes

During FY10 three financial and operational audit teams headed by Junior Joint Directors (OG-4) carried out audit of 4 departments and all 16 office of BSC across the country. Audit reports were issued to the respective head of Departments and Chief Manager of field offices for their information and ensuring regularization of irregularities highlighted in the reports. These reports also highlighted the efficiency levels of operating processes and level of effectiveness of internal controls at the respective departments/ offices, identified control weaknesses and suggested corrective actions. Out of 1,016 audit observations of different nature viz; high medium and low, 964 were complied during the year under review. Compliance reports submitted by the offices and departments were processed in IAD and submitted to the Managing Director of BSC for perusal. On the basis of audit observations, changes/ improvements have been made in the following areas of operations of BSC offices Box 9.1.

9.3 Information Technology Audit

Internal audit for IT system was introduced in BSC in 2005 and though efforts were continued during FY10 to strengthen it further and improving its effectiveness, its overall role is being evolved. The IT internal auditors focus specifically on risks within the IT environment with a main purpose to explore enhanced use of existing technology in identifying and helping to mitigate emerging risks, develop creative solutions to complex challenges, and encourage new practices to enhance both business and IT functions. One IT Auditor invariably participated in the annual audit at the BSC offices and at its departments concurrently with the financial and operational audit teams. The observations of the IT Auditors are usually referred to the Information System and Technology Department (ISTD) SBP for their comments which enabled them to take corrective measures to eliminate/minimise the weaknesses. From now onward they will also be shared with the business side to better understand the impact of any irregularity and undertake corrective action for the same.

During FY10, IT Audit Division of IAD carried out audit of the IT System of 16 field offices and 4 departments of BSC to identify the risk and control weaknesses in the software viz; Globus Banking Solution, Oracle ERP & HRIS applications etc rolled out at BSC.

9.4 Performance of Internal Audit Hubs

As already stated that the IAD has undergone a major restructuring during the last year when set up of IAD was consolidated into two Audit Hubs, one each at Karachi and Lahore offices through merger of 17 IAUs at BSC offices and HOK. Audit Hub at Karachi has been allocated departments of HOK and BSC offices at Karachi, North Nazimabad, Karachi, Hyderabad, Sukkur, Quetta, Bahawalpur, and Multan offices, while the Hub at Lahore has been entrusted with the responsibility to undertake periodical audit, enforcement and other functions as assigned to them from time to time in respect of BSC offices at Islamabad Lahore, Gujranwala, D.I. Khan Sialkot, Peshawar, Rawalpindi, Muzaffarabad and Faisalabad. These Hubs, headed by the Joint Directors (OG-5) with functional & administrative reporting to the Director IAD, also assist the Audit Teams during Annual Audit of the departments/ field offices of BSC.

Table 9.1: Performance of Audit Hubs during FY10

S. No.	BSC Offices	Frequency of Audit (No. of times)	No. of irregularities pointed out			
			High	Medium	Low	Total
1	Karachi	1	8	13	2	23
2	N. N. Karachi	3	20	39	3	62
3	Hyderabad,	2	13	42	2	57
4	Sukkur,	2	15	23	1	39
5	Quetta,	1	16	14	1	31
6	Bahawalpur	1	7	12	3	22
7	Multan	1	10	17	1	28
8	Lahore	4	43	50	14	107
9	Faisalabad	5	22	50	5	77
10	Gujranwala	5	26	40	10	76
11	Sialkot	3	12	29	6	47
12	Rawalpindi	4	33	42	7	82
13	Islamabad	3	20	30	-	50
14	Muzaffarabad	4	17	36	3	56
15	Peshawar	5	21	64	8	93
16	D.I. Khan	5	16	46	13	75
	Total	**49**	**299**	**547**	**79**	**925**

The newly established Audit Hubs participated equally in streamlining the audit process across all BSC offices besides providing assistance in improving internal monitoring, expand efficacy of internal controls and undertaking surprise audit activities.

During FY10, Audit Hubs carried out 49 audit program of the BSC Departments at HOK and offices across the country as per monthly audit programs and during the process raised a total of 925 observations, out of which 890 were complied during the year under review Table 9.1.

9.5 Contribution of Audit Committee in achieving Corporate Governance

The Committee of the Board of SBPBSC on Audit is the key institution for providing guidance for improving and ensuring corporate governance in the BSC. During the year FY10, three (3) meetings of Committee of the Board on Audit have been held. During these sessions the committee has gone through the Audit Reports viz; finding and recommendations of Internal Audit Teams of IAD, and provided its guidance and issued instructions for implementations. The performance of Internal Audit Department of BSC remained under continues monitoring of the Committee throughout the year under review. The Director 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 Audit Committee. Following were the main agenda items discussed in these meetings:

- Quarterly Progress report on Audit Briefs of Offices / Departments.
- Business Plan of Internal Audit Department for the year 2009-10.
- Management Letter issued by the External Auditors on the financial statements of BSC.

9.6 Capacity building of Internal Auditors

The IAD has always given special emphasis on training and skill development of its work force and arranged several training programs for the staff. Different training modules in line with the latest audit techniques have been developed and training is being imparted to them on regular basis. Opportunities were also provided to the employees to attend

the workshops/ seminars held within or outside the bank premises. During FY10 different training and skill development programs were provided to 120 participants of

Internal Audit Department to enhance their capacity to perform audit function in a better way, as also utilize their skill to solve the problems and achieve the desired objectives in a sustainable manner Table 9.2.

Table 9.2: Training & Skill Development Programs arranged for Internal Auditors during FY10		
S #	Training Module	No. of Participants
1	Audit Command Language (ACL)	5
2	IFRS / IAS	6
3	Information System Audit	5
4	Internal Auditing – Policy & Procedure	4
5	Audit Report Writing	23
6	Internal Personal Skill for Auditors	20
7	Audit Report Writing on MS Word	9
8	Advanced Excel & Project 2007	1
9	COSO frame work	1
10	Understanding Statement of Affairs	10
11	Soft Skill	28
12	Others	8
	Total	**120**