

9 INTERNAL AUDIT AND CONTROLS

9.1 Overview

The scope of Internal Audit Department (IAD) in SBP-BSC is broad and involves in-depth and independent examination of internal controls to ensure efficacy of operations, reliability of financial reporting, deterring and investigating fraud, safeguarding assets, assessing risks and compliance with laws and regulations. IAD carries out inspection of each field office and department of head office atleast once in a year besides special audit / inspection of previous activities and complaints entrusted from time to time. It ensures effectiveness of existing policies, procedures and adherence to legal and regulatory requirements and that the corporate governance processes are adequate and functioning properly. In addition, IAD also gives suggestions and recommendations to higher management for improvement in internal controls and risk management systems.

IAD submits the detailed audit report along with audit brief comprising significant irregularities detected during the audit of an office or department to the Managing Director, SBP-BSC for review. Subsequently, the same is forwarded to Director, Internal Audit & Compliance Department SBP for perusal and onward submission to the Governor, State Bank of Pakistan.

The department consists of on-site inspection teams, IT audit division, enforcement division, off-site surveillance unit, development and strategic management unit, coordination unit besides 17 Internal Audit Units (IAUs) – one each at 16 field offices and one at HOK all reporting directly to the Director IAD. The IAUs at field offices are responsible to ensure enforcement of regularization / corrections of irregularities pointed out by IAD. Further, these IAUs also keep an eye on the working of the offices and conduct post audit.

9.2 On-site Inspection

IAD conducts on-site audit / inspection of field offices, departments of SBP-BSC Head Office and NIBAF as per approved annual Audit Plan. On the eve of each audit program of an office or department, an Inspection Team is specially constituted from existing officers of IAD. The Inspection Team is headed atleast by a Junior Joint Director who is

titled as Team Leader during the period of audit / inspection. In case of audit of an office or department the staff attached to IAU of that office / HOK also joins the Inspection Team as members. The responsibility of preparation and submission of audit report rests with the team leader.

During FY07, the Inspection Teams of IAD have conducted inspection of twelve field offices and three departments of HOK as per approved Audit Plan. The Inspection Teams made their observations in the light of control principles and risk management during on-site audit of departments / offices. In the closing meeting the Director Audit along with Team Leader discussed the significant irregularities with the respective Head of Department of HOK / Chief Manager of the field office in the light of prescribed instructions and provided guidance to the department / office in order to avoid recurrence of such irregularities in future. All the fifteen reports have been prepared / compiled and submitted to concerned quarters as per schedule.

9.3 IT Audit

Consequent upon implementation of automation processes in SBP-BSC it has become imperative to carry out IT audit along with the financial audit of the offices / departments as well. Accordingly, one of the IT Auditors of the IT Audit Division remains attached with each Inspection Team during audit of the office / department of SBP-BSC, who conducts IT Audit with respect to risk exposure and control issues in the Globus System, Oracle and HRIS. I.T. Audit Report is submitted to the concerned department / office separately. On the basis of the observations of IT Auditor, the IAD has made several recommendations for amendments in the systems and procedures during the year under review to make the system more effective, efficient and trust worthy.

9.4 Off-site Surveillance

IAD keeps a constant watch over the affairs of field offices and departments of HOK by off-site surveillance through its Internal Audit Units (IAUs) located at each of the 16 field offices as well as at HOK. During the year under review the IAUs reported a total number of 442 significant irregularities through their monthly returns of which 344 were observed to be major irregularities. IAD examined and evaluated the risk exposure in respect of these irregularities with a view to ensure adequacy and effectiveness of internal controls for mitigating risk, suggesting operational efficiency and adherence to relevant policies and procedures. On arriving at certain conclusion(s) in each case the IAD advised the respective office or department to take preventive and corrective measures so as to mitigate the risk and avoid recurrence of such irregularities in future. This undoubtedly helped the concerned office or department to focus on gray areas and prevent the repetition of such irregularities in future.

9.5 Enforcement of Rules and Regulations

The follow-up process introduced by IAD through its newly established enforcement division has made the audit activities purposeful. This process has enabled the IAD to ensure that their observations have been duly taken care of and the recommendations effectively implemented. During the year under review, the compliance status of a total number of 1,523 irregularities pointed out in the Audit Reports and 154 major issues which were accentuated in the Audit Briefs in respect of the offices and departments inspected, was analyzed and evaluated. Resultantly, the recurrence of irregularities was minimized to a considerable extent.

9.6 Establishment of Development & Strategic Management Unit

IAD has initiated restructuring of the department to streamline its processes during the year under review. The establishment of Development & Strategic Management Unit is one of the measures taken for smooth functioning of the department. Besides the main assignments like preparation of working papers for the meetings of sub-committee of the Board on Audit and business plan of the department, this unit is facilitating in achieving the departmental goals efficiently. During the period under review, the unit facilitated two meetings of the audit committee and prepared working papers for submission to them and followed the directives of the audit committee. The unit has also undertaken a skill gap analysis of the department and identified training needs of the employees to improve their knowledge and skill.

9.7 Performance of Internal Audit Units

There are 16 Internal Audit Units (IAUs) located at an equal number of field offices and one at HOK who conducted post audit of various units / division of respective office and the allocated department of HOK as per their monthly audit program. During the year under review the IAUs booked 8,020 irregularities in their AU-1 registers, of which 652 were found to be significant; particularly, in the area of Export Refinance where a sum of Rs.1,534,015/- was recovered as fine on account of shortfall in performance, misreporting in EE-1 & EF-1 statements and late submission of shipping documents etc. The IAUs also examined and evaluated the adequacy and effectiveness of internal controls relating to various activities and operations of the local management. As the IAUs conducted post audit of the respective office / department, the irregularities of similar nature are on decreasing trend particularly in the field offices as improvement in certain areas have been witnessed in their normal office working. Some of the improvements observed in the key areas at the field offices during FY07 are as under:

- Due to regular audit the recurrence of irregularities and violation of the instructions have been reduced considerably.
- Accounts Department issued various instructions while highlighting the gray areas

- Due to rigorous follow up the back log in the Inter-company Account transactions has been cleared to a considerable extent.
- In Export Refinance cases the field offices have started prompt recovery of fine on account of non shipment, shortfall in performance and retention of proceeds.
- Instructions issued on various subjects are complied with meticulously.
- Time lag has been reduced in various business processes.

9.8 Capacity Building of IAD Employees

During the period under review, various training and skill development programs were provided to the employees of Internal Audit Department and Internal Audit Units to enhance their knowledge, skill and capacity to perform their functions in a better way, solve problems and set and achieve objectives in a sustainable manner.

S #	Module	Participants
1	Report Writing	25
2	Currency Management	11
3	Corporate Governance	1
4	Communication skill	5
5	Basel II Accord	1
6	Foreign Exchange Operation	7
7	Fundamental of Accounting	12
8	Line Management	1
9	Internal Auditing	7
10	Conflict Resolution	1
11	Issues in Pak Economy	10
12	Forex & Liability Management	10
13	Financial Statement	9
Total		100

S #	Module	Number
1	Internal Audit for Banks	1
2	Operational Risk & Basel II	1
3	Corporate Governance	1
4	Preparation & Presentation of Financial Statements	2
5	Operational Risk Management	2
Total		7

S #	Module	Number
1	Oracle ERP	2
2	Globus PAD / DAD	8
3	Globus NSS	13
4	Globus Navigation	1
5	Globus Prize Bonds	9
6	Globus Cash	2
Total		35

9.9 Meetings of the Sub-committee of the Board on Audit

Sub-committee of the Board on Audit looks into the internal audit reports, their findings and recommendations including the detection of acts of fraud and irregularities of material nature, provides guidance and gives instructions for implementation. The committee gives recommendation for appointment of external auditors, the audit fee and any question of resignation or removal and also reviews half yearly and annual financial statements and budget before submission to the Board. During FY07, two meetings of the sub-committee of the Board on Audit were held on 8th November 2006 and 7th December 2006 at Karachi to discuss the important issues of the Bank.