

Annexure 6.1

PRINCIPLES OF INTERNAL CONTROLS - BASLE COMMITTEE

Principle 1

The Board of Directors should have responsibility for approving and periodically reviewing the overall business strategies and significant policies of the bank; understanding the major risks run by the bank, setting acceptable levels for these risks and ensuring that senior management takes the steps necessary to identify, measure, monitor and control these risks; approving the organisational structure and ensuring that senior management is monitoring the effectiveness of the internal control system.

The BoD is ultimately responsible for ensuring that an adequate and effective system of internal control system is established and maintained.

Principle 2

- Senior Management should have responsibility for implementing strategies and policies approved by the Board, developing processes that identify, measure, monitor and control risks incurred by the bank; maintaining an organisational structure that clearly assigns responsibility, authority and reporting relationships ensuring that delegated responsibilities are effectively carried out; setting appropriate internal control policies and monitoring the adequacy and effectiveness of the internal control system.

Principle 3

- The BoD and senior Management are responsible for promoting high ethical and integrity standards and for establishing a culture within the organization that emphasizes and demonstrates to all levels of personnel the importance of internal controls. All personnel at banking organization need to understand their role in the internal controls process and be fully engaged in the process.

Principle 4 – Risk Recognition and Assessment

- An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goals are being recognised and

continually assessed. This assessment should cover all risks facing the bank and the consolidated banking organisation (credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputation risk). Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

Principle 5

- Control activities should be an integral part of the daily activities of a bank. An effective internal control system requires that an appropriate control structure is set up with control activities defined at every business level. These should include:

Top level reviews

- appropriate activity controls for different departments or divisions
- Physical controls
- Checking for compliance with exposure limits and follow-up on non-compliance
- A system of approvals and authorisations; and
- A system of verification and reconciliation

Principle 6

An effective internal control system requires that there is appropriate segregation of duties and that personnel are not assigned conflicting responsibilities. Areas of potential conflicts of interest should be identified, minimised and subject to careful, independent monitoring

Principle 7 – Information and Communication

An effective internal control system requires that there are adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making.

Information should be reliable, timely, accessible and provided in a consistent format.

Principle 8

An effective internal control system requires that there are reliable information systems in place that cover all significant activities of the bank. These systems, including those that hold and use data in an electronic form, must be secure, monitored independently and supported by adequate contingency arrangements.

Principle 9

An effective internal control system requires effective channels of communication to ensure that all staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that other relevant information is reaching the appropriate personnel.

Principle 10

The overall effectiveness of the bank's internal controls should be monitored on an ongoing basis. Monitoring of key risks should be part of the daily activities of the bank as well as periodic evaluations by the business lines and internal audit.

Principle 11

There should be an effective and comprehensive internal audit of the internal control system carried out by operationally independent, appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, should report directly to the BoD or its audit committee and to senior management.

Principle 12

Internal control deficiencies whether identified by business line, internal audit or other control personnel, should be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies should be reported to senior management and the BoD.

Regardless of size, every banking organisation should have an effective system of internal controls that is consistent with the nature, complexity and risk inherent in their ON and OFF Balance Sheet activities and that responds to changes in the bank's environment and conditions.