BANK OF MAURITIUS

Guideline on
Maintenance of Accounting and other Records and Internal Control Systems

November 1994
Revised November 2013

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INTRODUCTION

The operations of financial institutions are often exposed to risks of losses arising from poor or lack of sound internal control systems. A financial institution is not regarded as conducting its business in a prudent manner unless it maintains adequate accounting and other records of its business and has adequate systems of control. Financial institutions should design and implement effective control systems to avoid losses arising from internal control weaknesses. Every financial institution has a statutory duty under the Banking Act 2004, namely section 33 - Records, for proper maintenance of records relating to its transactions and under section 54 - Internal Control, for maintaining adequate internal control systems.

Purpose

The guideline provides a framework for the maintenance of Accounting and Other Records and for the implementation of Internal Controls and requires all financial institutions to design and implement internal control systems having regard to the size and complexity of their operations.

Authority

This guideline draws its authority from section 50 of the Bank of Mauritius Act 2004 and section 100 of the Banking Act 2004.

Scope of Application

This guideline applies to all financial institutions licensed under the Banking Act 2004.

Effective date

This guideline takes effect as from 1 January 2014 and supersedes the previous Guidance Note on General Principles for Maintenance of Accounting and Other Records and Internal Control Systems issued by the Bank in November 1994.

Interpretation

“Financial institution” has the same meaning as in the Banking Act 2004.

“Board of Directors” has to be interpreted in line with the requirements of the Guideline on Corporate Governance.

Structure of the Guideline

The Guideline focuses on:

Part I	: Board of Directors and Senior Management
Part II	: Accounting and Other Records
Part III	: Internal Control
Part IV	: Internal Audit
Part V	: External Auditors

PART I: THE BOARD OF DIRECTORS AND SENIOR MANAGEMENT

Responsibility of the board of directors[1] and senior management

1. The board of directors is responsible for setting up the organisational structure[2] and establishing and maintaining effective internal control and risk management having regard to the complexity of the activities of the financial institution, its size, scope of operations and risk profile.

2. The board of directors should, at least annually, conduct a review of the effectiveness of the internal controls and report to the shareholders accordingly.

3. The board of directors should hold periodic meetings with interested parties such as senior management, internal auditors, external auditors and the audit committee[3] in the evaluation of the effectiveness of the internal control system.

4. In approving the organisation structure, the board of directors should ensure that there exists clear assignments of authority and responsibility, segregation of duties and effective communication that pervades all levels in the organisation.

5. The board of directors and senior management should be responsible for promoting high ethical and integrity standards, and for establishing a culture within the financial institution that emphasises and demonstrates to personnel at all levels, the importance of internal controls.

6. Senior management should ensure that there exists clear segregation of duties with respect to authorisation of transactions, recording of transactions, custody of assets, and periodic reconciliation of existing assets to recorded amounts.

7. Senior management should set policies and establish such communication as may be necessary to enable the personnel to understand the organisation's objectives, their role in contributing towards those organisational objectives, and the extent of their accountability.

8. Senior management should be responsible for implementing the strategies and policies as approved by the board; the setting up of appropriate internal control policies and the monitoring of the effectiveness of the internal control systems.

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[1] Branches of foreign banks which have been dispensed from setting up a Local Advisory Board, the board responsibility should be shouldered by the Regional/Head Office, as appropriate.

[2] Branches of foreign banks are dispensed from this requirement in case the organisation structure is defined at Group level.

[3] In the absence of a Local Advisory Board, branches of foreign banks should report to the Regional/ Head Office, as appropriate.

9. In fulfilling its responsibilities, senior management should ensure that:

- the organisation structure is well defined and that there are clear lines of responsibility and authority.
- work is conducted by qualified staff having the necessary skills and training.
- regular training is conducted to update and enhance staff's skills.
- proper compensation and promotion policies are in place to reward appropriate behaviour and minimise incentives for staff to ignore or override internal control mechanisms.

10. Internal audit should be maintained as an integral part of the systems of internal control and as an independent assurance over the integrity and effectiveness of these systems.

11. Senior management are encouraged to maintain a risk register where key risks would be identified, recorded and monitored through application of suitable controls to mitigate keys risks.

12. Senior management should make a statement on the accounting system and the internal control system as per the format set out in **Annex I** of the Guideline.

PART II: ACCOUNTING AND OTHER RECORDS

13. The scope and nature of the accounting and other records which are required for the business to be conducted in a prudent manner should commensurate with a financial institution's needs and particular circumstances and should have regard to the manner in which the business is structured, organised and managed, its size and the nature, volume and complexity of its transactions and commitments. The accounting and other records should be located where they will best assist management to conduct the business of the financial institution in a prudent manner on a day-to-day basis.

General requirements

14. The accounting and other records should capture and record on a timely basis and in an orderly manner every transaction and commitment which the financial institution enters into with sufficient information to explain:-

    (i) its nature and purpose;

    (ii) any asset and/or liability, actual and contingent, which arises or may arise from it: and

(iii) any income and/or expenditure, current and/or deferred, which arises from it.

15. The accounting and other records should provide details, as appropriate, for each transaction and commitment, showing:-

(i) the parties;

(ii) the amount and currency;

(iii) the contract, rollover, value and settlement or repayment dates;

(iv) the contracted interest rates of an interest rate transaction or commitment;

(v) the contracted exchange rate of a foreign exchange transaction or commitment;

(vi) the contracted commission or fee payable or receivable together with any other related payment or receipt;

(vii) the nature and current estimated value of any security for a loan or other exposure; the physical location and documentary evidence of such security; and

(viii) in the case of any borrowing stating whether it is subordinated and if secured, the nature and book value of any asset upon which it is secured.

16. The accounting and other records should be maintained in such a manner that financial and business information can be extracted promptly to enable management to:-

(i) monitor the quality of and safeguard the financial institution's assets, including those held as custodian;

(ii) identify, quantify, control and manage its exposures by related counterparties across all products;

(iii) identify, quantify, control and manage its exposures to liquidity risk and foreign exchange and other market risks across all products;

(iv) monitor the performance of all aspects of its business on an up-to-date basis; and

(v) make timely and informed decisions.

17. The accounting and other records should contain details of the factors considered, the analysis undertaken and the authorisation or rejection by management of a loan, advance or other credit exposure.

18. The accounting and other records should provide on a memorandum basis details of every transaction entered into in the name of or on behalf of another party on an agency or fiduciary (trustee) where it is agreed that the financial institution itself is not legally or contractually bound by the transaction.

Information for management

19. Every financial institution should prepare information for directors and senior management so that they can monitor, assess and control the performance of its business, the state of its affairs and the risk to which it is exposed. This information should be prepared on individual companies and, where appropriate, on a consolidated basis. The frequency with which the information is prepared, its level of detail and the amount of narrative analysis and explanation will depend on the level of management to which it is addressed. Some types of information will be needed on a more frequent basis and it may be appropriate for some to be presented on a basis of breaches from agreed limits by way of exception reports.

20. It is the responsibility of directors and senior management to decide on the information that would be required by them and of the persons who should so receive. Appropriate management information should be provided to:-

    (i) persons responsible for exercising managerial functions or for maintaining accounting and other records;

    (ii) senior management who, either alone or jointly, are responsible under the immediate authority of the directors for the conduct of the business of the financial institution; and

    (iii) the directors of the financial institution.

21. This information should be prepared:-

    (i) to show the state of affairs of the financial institution;

    (ii) to show the operational results of the business both on a cumulative basis and by discrete period and to give a comparison with budgets and previous periods;

    (iii) to provide an analysis of assets and liabilities and off balance sheet positions showing the manner in which they have been valued;

    (iv) to provide an analysis of income and expenditure showing its relationship to different categories of asset and liability and off-balance sheet positions; and

(v) to show the financial institution's exposure to each type of risk, compared to the relevant limits set by management.

PART III: INTERNAL CONTROL

22. The framework outlined in the guideline provides the minimum principles that financial institutions should follow for the sound implementation of internal control systems. Financial institutions may adopt broader principles of internal control, as outlined in the *Framework of Internal Control Systems in Banking Organisation* issued by the Basel Committee on Banking Supervision-September 1998.

Definition

23. Internal control is defined as the process designed and implemented by the management of a financial institution to ensure the following

    (i) the effectiveness and efficiency of its operations

    (ii) that instructions and directional guidelines fixed by management are adhered to

    (iii) applicable laws and regulations are complied with

    (iv) appropriate controls are in place to safeguard its assets, and

    (v) financial information is complete and reliable

Elements of Internal Control Process

24. Each financial institution should have in place an internal control system designed in accordance to its size, complexity and nature of its operations. However, financial institutions at a minimum should ensure that their internal control systems comprise the following components:

    1. Control Environment
    2. Risk Assessment
    3. Control Activities
    4. Accounting, Information and Communication
    5. Self assessment and Monitoring

Control Environment

25. The control environment reflects the overall attitude, awareness, and actions of the board and management concerning the importance of internal control. Control environment factors include integrity, ethical values and competence of the organisation's people, management's philosophy and operating style, the way management assigns authority and responsibility and how it organises and develops its human resource.

26. The various responsibilities of the board of directors and senior management as spelt out in Part I of the guideline are the central principles of the control environment. In addition, it is imperative that personnel, at all levels, understand their role in the internal controls process and be fully engaged in the process.

Risk Assessment

27. Risk assessment is the process undertaken by the board and senior management to identify and evaluate risks that could hamper the financial institution from achieving its organisational objectives.

    In addition to credit risk, market risk, liquidity risk and operational risk, circumstances that expose the organisation to increased risk may include the following:

    - Changes in management's responsibilities
    - New lines of business, products or activities
    - Changes in laws and regulations
    - A change in the financial institution's operating environment
    - Emerging technologies and new IT system
    - Rapid staff turnover

28. Senior management should ensure that internal controls are effective and need to continually evaluate the risks that could infringe its organisational goals and objectives due to changing circumstances and environment.

Control Activities

29. Control activities involve policies, procedures and practices put in place by the financial institution to ensure that its personnel carry out their duties according to the directives of management and the board. Senior management should ensure that control activities are applied at different levels of the organisation. Typical control activities will comprise the following:

Top level reviews

30. Senior management and the board of directors should undertake to carry on reviews of actual financial performance versus budgeted figures. In performing these reviews, the financial institution should relate data – operational, risk related, or financial- to one another. The financial institution should use these comparisons to analyse it's actual against projected performance to identify reasons for significant variances.

Activity controls

31. At this level, middle management should make use of exception reports, and other reports generated on a daily, weekly, monthly, quarterly or yearly basis to determine deviances from standard performance. Such reports may include reports on missed instalments, past dues claim, payments received, interest income on portfolio, and provisioning.

Physical control

32. These controls are designed to ensure the physical security of the financial institution's assets. They include safeguarding assets, records and restricting access to sensitive area. Control activities include physical limitations, dual control, and periodic inventories.

Limits control

33. As part of its risk management process, the financial institution should set limits to exposures such as on related parties, credit concentration, and sectorwise limit on credit. It is important that there are periodic reviews to assess compliance with those limits.

Computer controls

34. Senior management should ensure that adequate internal control measures are maintained for its information systems.

35. There are several control activities that are unique to a computer environment. These controls apply to all computerized information systems- mainframe, minicomputer, and end-user environments. Typical types of controls to be found in an information system will consist of general and application controls.

36. General controls in an information system are those controls that relate to the environment surrounding the information system and commonly includes the following:

    - Control over data centre operations
    - System software acquisition, development and maintenance
    - Access security

    - Telecommunications security
    - Contingency planning, backup and disaster recovery

37. Application controls relate to the specific tasks performed by the computer system that help to ensure that transactions are valid, properly authorised and reported completely and accurately. These controls cover the whole range of transaction processing from the preparation of the initial source document or online data entry, to the creation and use of the final output. As such, application controls consist of input, processing and output controls:

    - Input controls include processes for verifying data accuracy and completeness upon data –entry to a system. These controls also provide specific mechanisms for input authorisation, data conversion, data editing and error handling.
    - Processing controls help to ensure that data remains complete and accurate during updating, and that the application programs perform as intended.
    - Output controls help ensure that system-generated information is accurate, property recorded, and received or reviewed by authorized individuals only.

Approval and authorizations

38. Financial institutions should ensure that there are clear written procedures that place authorisation limits for transactions. A financial institution is required to establish adequate controls to ensure that transactions approved are within authorisation limits.

Verification and reconciliation

39. As part of control measure, financial institutions should ensure that periodic reconciliation of records and accounts form an integral part of the risk management process and that reports on such reconciliation are circulated to appropriate levels of management.

Segregation of duties

40. Financial institutions should establish segregation of duties by assigning different people the responsibilities for authorization, custody, record keeping and reconciliation.

    Proper segregation of duties is considered essential in avoiding any conflict of responsibilities and thus reduces the possibility of individuals being in a position to both perpetrate frauds and conceal errors and irregularities.

Information and Communication Systems

41. Senior management should ensure 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. To be useful, information should be timely, accurate and accessible and should be provided in a consistent format.

42. Senior management should ensure that relevant information reaches those who have rights to such information. For instance, it is essential that established standards and policies are communicated to the financial institution's personnel to enable them to carry out their duties within the framework set by the organisation.

Self assessment and Monitoring

43. Self-assessment or monitoring can provide oversight of a financial institution's control system performance. Senior management should periodically assess the overall effectiveness of internal control systems and monitor internal controls to ascertain whether they are functioning properly.

44. Where deficiencies or breaches have been identified in internal control policies and procedures, they should be reported on a timely manner for appropriate management actions.

45. Internal quality control reviews should form an integral part of the whole process of the monitoring activities. Internal audit of internal control, carried out by competent and trained staff would contribute towards ensuring that internal controls are working as per rules and procedures established by management. Weaknesses, irregularities, and deficiencies must be highlighted to management. It is recommended that the internal auditor reports its findings directly to the top level management, usually the board of directors or its audit committees or to senior management.

PART IV: INTERNAL AUDIT

46. The scope and objectives of internal audit are dependent upon the judgement of management as to its own needs and duties, the size and structure of the institution and the risks inherent in its business. Important considerations in assessing the effectiveness of internal audit include the scope of its terms of reference, its independence from operational management, its reporting regime and the quality of its staff.

The following control functions could be undertaken by internal audit:

(i) review of accounting and other records and the internal control environment;

(ii) review of the appropriateness, scope, efficiency and effectiveness of internal control systems;

(iii) detailed testing of transactions and balances and the operation of individual internal controls to ensure that specific control objectives have been met;

(iv) review of the implementation of management policies; and

(v) special investigations for management.

47. The internal audit should provide management with recommendations, on the weaknesses/deficiencies identified, to enhance the internal control system.

48. The internal audit function should be appropriately structured and resourced to enable it to provide an independent appraisal of internal controls. There should be clearly defined terms of reference and its independence should be assured by an obligation to report regularly to the audit committee. Normally internal audit should not have authority or responsibility for the activities it audits.

49. Internal audit should have unrestricted access to all of a financial institution's activities, records, property and personnel to the extent necessary for the effective completion of its work. The internal audit function should be staffed with individuals who are appropriately qualified for the function either by holding professional qualifications or by having the requisite experience.

PART V: EXTERNAL AUDITORS

50. Financial institutions should ensure and should so include in the terms of reference of the external auditors that the external auditors should submit to its board of directors a report on the financial and accounting system and internal control of the financial institution. The report should state whether the management of the financial institution has maintained effective internal control over financial reporting for the period examined in accordance with the requirements set out in this guideline.

51. For that purpose external auditors will have to conduct an evaluation of the internal control system in order to assess whether they can rely on the system in determining the nature, timing, and scope of their own audit procedures.

52. In forming this opinion, external auditors are expected to have regard to the nature and scale of the business undertaken by the financial institution. The external auditors' report should be addressed to the directors and should take the form of the proforma report set out in **Annex II** of the guideline.

53. Where the report is qualified by exceptions, it should clearly set out the risks which the financial institution runs by not correcting the weakness, with an indication of the severity of the weakness in the case that it is not corrected.

54. The report[4] with such comments as the financial institution's management see fit to make should be submitted to the Bank by the financial institution along with its audited accounts on a yearly basis. The comments of the financial institution's management should be copied to the external auditors at the same time as these are submitted to the Bank. If the external auditors conclude, after discussing the matter with the financial institution, that they will give a negative opinion (as opposed to one qualified by exceptions), they must immediately inform the Bank in writing giving their reasons. They should also send a copy of their letter to the board of directors of the financial institution. If the financial institution, for whatever reason, is unable to submit a report to the Bank within the required period, it should inform the Bank in writing of the reasons for the delay, as soon as the financial institution becomes aware that the deadline will not be met.

[4] Distinct from the Management Letter issued by external auditors following their audit of the financial year accounts.

Annex I

Senior Management's Report on Internal Control Systems

The Senior Management of XYZ Bank Limited is responsible for establishing and maintaining proper books of account and other records and internal control systems at all places of operations of the bank.

Senior Management has evaluated the bank's internal control systems during the year ended (……..) taking in account the requirements of the *Guideline on Maintenance of Accounting and other Records and Internal Control Systems* and believes that XYZ Bank Limited has maintained effective internal control systems.

There are no material weaknesses identified by senior management in this regard.

…………………….... **……………………………..**

Chief Executive Officer **Deputy Chief Executive Officer/Chief Financial Officer**

Annex II

Proforma Report

External Auditor's Report on Maintenance of Accounting and Other Records and Internal Control System

The Board of Directors, XYZ Bank Limited

Dear Sir(s)

In accordance with the instructions in the ***Guideline on Maintenance of Accounting and other Records and Internal Control Systems***, we have examined the internal control systems of XYZ Bank Limited which were in existence during the year ended (……..).

As directors, you are responsible for establishing and maintaining adequate accounting and other records and internal control systems. Our responsibility is to express opinions on whether management has established and maintained proper accounting records and effective internal control systems.

We conducted our audit of internal control system. We planned and performed our audit to obtain reasonable assurance about whether effective internal control was maintained in all material respects. We believe that our audit provides a reasonable basis for our opinions.

Our examination has been carried out having regard to the Bank of Mauritius' Guideline on Maintenance of Accounting and other Records and Internal Control Systems of November 2013. Appendix 1 to this report summaries the key risks faced by the bank, the key controls in place and our overall assessment control environment.

In our opinion having regard to the nature and scale of its business, during the year ended (……..),

Either the accounting and other records and internal control systems examined by us were established and maintained and that internal control was effective in accordance with the requirements of the *Guideline on Maintenance of Accounting and Other Records and Internal Control Systems of November 2013* (with the exception of the matters set out in the Appendix 2 attached to this report).

Or that the accounting and other records and internal control systems examined by us were not established and maintained in accordance with the requirements of the *Guideline on Maintenance of Accounting and Other Records and Internal Control Systems of November 2013* for reasons set out in Appendix 2 attached to this report.

Signature of audit firm

Date