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## Internal Control and Compliance of Banks

### Review Team

**Md. Mohiuddin Siddique**  
*Professor, BIBM*

**Dr. Md. Mahabbat Hossain CIPA, CSAA**  
*Associate Professor, BIBM*

**Maksuda Khatun**  
*Assistant Professor, BIBM*

**Imran Ahmed FCA, CSAA**  
*General Manager & Chief Audit Officer, Sonali Bank PLC*

**Suprova Saeed**  
*Deputy General Manager & Head of Audit Monitoring Division, Agrani Bank Limited*



**Bangladesh Institute of Bank Management (BIBM)**  
Mirpur, Dhaka-1216, Bangladesh

## Internal Control and Compliance of Banks

- Editor** : **Md. Akhtaruzzaman, Ph.D.**  
*Director General, BIBM*
- Executive Editor** : **Md. Alamgir**  
*Associate Professor & Director (Training & Certification Program), BIBM*
- Associate Editor** : **Md. Shahid Ullah, Ph.D.**  
*Associate Professor, BIBM*
- Preparation Team** : **Md. Mohiuddin Siddique**  
*Professor, BIBM*  
: **Dr. Md. Mahabbat Hossain CIPA, CSAA**  
*Associate Professor, BIBM*  
: **Maksuda Khatun**  
*Assistant Professor, BIBM*  
: **Imran Ahmed FCA, CSAA**  
*General Manager & Chief Audit Officer, Sonali Bank PLC*  
: **Suprova Saeed**  
*Deputy General Manager & Head of Audit Monitoring Division, Agrani Bank Limited*
- Support Team** : **Md. Al-Mamun Khan**  
*Publications-cum-Public Relation Officer, BIBM*  
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**Sumona Moqutadar Happy**  
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*Proof Reader, BIBM*  
**Nippon Chakma**  
*Computer Operator & Program Associate (Certification Program), BIBM*
- Graphics & Illustration** : **Azizur Rahman, Computer Operator, BIBM**

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## **Forewords**

It gives me great pleasure to introduce this insightful report on "Internal Control and Compliance of Banks" in the context of Bangladesh. The global banking sector operates in a highly regulated environment, and the Internal Control System (ICS) stands as a linchpin for stability and integrity. This research delves into the dynamics of ICS in the competitive landscape of Bangladesh's banking sector. The findings emphasize the pivotal role of the Internal Control and Compliance Department (ICCD), robust corporate governance, compliance with regulations, balanced loan treatment, and the need for enhanced tools and customized dashboards for real-time monitoring.

I extend my sincere appreciation to all the stakeholders who have played a crucial role in the successful completion of this research. I am optimistic that this study report will significantly contribute to our understanding of the ICCD's functions and effectiveness. We also believe this report will be a valuable resource for industry experts, academics, policymakers, and anyone interested in Bangladesh's banking sector.

We eagerly look forward to valuable feedback from respected industry experts, academics, policymakers, and all interested readers. Your insights are of great value as they will guide us in further improving our research endeavors in the future.

**Md. Akhtaruzzaman, Ph.D.**

Director General, BIBM

## **Acknowledgment**

The research study on "Internal Control and Compliance of Banks" has reached its culmination thanks to the collaborative efforts and support of numerous individuals and institutions. We extend our heartfelt appreciation to Dr. Md. Akhtaruzzaman, the esteemed Director General of BIBM, for his invaluable guidance and unwavering support during the entire research process. This study, delving into the intricate domain of internal control and compliance, was enriched by the insights and contributions of various stakeholders.

We extend our sincere gratitude to the Bangladesh banking community, whose cooperation and input significantly enhanced the depth and quality of this review paper. Special appreciation goes to the senior executives, including MD/CEOs, and the banks for their generous provision of essential data, greatly enriching the quality of our study.

We would like to acknowledge the contributions of Mr. Md. Shihab Uddin Khan, the then Director (Training & Certification Program) at BIBM and an Associate Professor, for his constructive suggestions and thoughtful guidance that shaped the paper. The dedicated efforts of the Training, Administration and Accounts, and Publication Wings of BIBM were instrumental in facilitating this study.

Furthermore, we want to recognize the significant contributions of Mr. Md. Tousif Eskander, a student in the MBM program at BIBM, who provided valuable assistance as a research assistant. We appreciate the open and sincere support received from all individuals who played a role in advancing our research efforts.

As we present this research, we are grateful for the collective efforts that have made it possible, and we look forward to ongoing collaboration and discussions that will further enhance our understanding of internal control and compliance in the banking sector of Bangladesh.

**Prof. Md. Mohiuddin Siddique**

**Dr. Md. Mahabbat Hossain CIPA, CSAA**

**Maksuda Khatun**

**Imran Ahmed FCA, CSAA**

**Suprova Saeed**

## **Executive Summary**

The global banking sector operates in a highly regulated environment, driven by its significance and inherent vulnerabilities. One critical component of these regulations is the Internal Control System (ICS), a cornerstone for maintaining the stability and integrity of banks. In the context of the banking industry, ICS serves the dual purpose of achieving business objectives and ensuring financial transparency and compliance with laws and regulations. Moreover, it plays a central role in risk management, safeguarding stakeholder interests, enhancing corporate governance, promoting transparency, and preventing fraud. Following the 2007 global financial crisis, there has been a concerted global effort to reinforce corporate governance practices, highlighting the pivotal role of ICS across all levels of banking operations.

In the competitive landscape of Bangladesh's banking sector, Internal Control and Compliance (ICC) have emerged as paramount elements, given the industry's impressive growth and intensified competition. The Bangladesh Bank (BB) issued ICC guidelines in 2003, subsequently revised in 2016, to foster a dynamic and robust ICC culture. This research delves into the activities of the Internal Control and Compliance Department (ICCD) within Bangladesh's banks for the year 2022, seeking to identify noteworthy changes and assess strengths and weaknesses within the realm of ICC. The study methodically collected primary data through questionnaires distributed to thirty banks, with a commendable 75 percent response rate for both 2022 and 2020. Additionally, a focus group discussion involved 45 banking professionals, and interviews were conducted with various stakeholders. Secondary data sources included documents from the Bangladesh Bank, Basel guidelines, COSO frameworks, the Institute of Internal Auditors (IIA), prior research from the Bangladesh Institute of Bank Management (BIBM), and academic research articles.

The examination revealed that the effectiveness of the comprehensive Internal Control System (ICS) is contingent not only on the functions of the ICCD but also on the performance of branches and head office departments. Notably, the Head of ICCD, guided by Bangladesh Bank's directives, assumes a dual role in overseeing monitoring and compliance functions, with the responsibility to report on internal control and compliance activities to senior management. This report also emphasizes the significance of robust corporate governance practices, commencing

with the Board and senior management, and underscores the importance of rigorous compliance with regulations. Furthermore, it highlights the need for a delicate balance between regulatory forbearance and maintaining credibility. Equitable treatment of all types of loans is a critical aspect of preserving credit discipline. Additionally, tools such as DCFCL, QOR, and LDCL would benefit from improvements and automation. The establishment of customized dashboards is recommended to enhance real-time monitoring, anomaly detection, and the timely implementation of corrective actions.

## **List of Abbreviation**

|        |   |
|--------|---|
| AAOIFI | Accounting and Auditing Organization for Islamic Financial Institutions |
| ACB    | Audit Committee of Board  |
| AML    | Anti-Money Laundering   |
| BAMLCO | Branch Anti-Money Laundering Compliance Officer                         |
| BB     | Bangladesh Bank   |
| BCBS   | Basel Committee on Banking Supervision                                  |
| BIS    | Bank for International Settlements                                      |
| BoD    | Board of Directors  |
| BRPD   | Banking Regulation and Policy Department                                |
| BSEC   | Bangladesh Securities and Exchange Commission                           |
| CAAT   | Computer Assisted Auditing Techniques                                   |
| CAMLCO | Chief Anti-Money Laundering Compliance Officer                          |
| CCC    | Central Compliance Committee  |
| CCU    | Central Compliance Unit   |
| CEO    | Chief Executive Officer   |
| CFT    | Combating the Financing of Terrorism                                    |
| CTR    | Cash Transaction Report   |
| COSO   | Committee of Sponsoring Organizations of the Treadway Commission        |
| DCFCL  | Departmental Control Function Checklist                                 |
| DOS    | Department of Offsite Supervision                                       |
| FCBs   | Foreign Commercial Banks  |
| FX     | Foreign Exchange  |
| GB     | General Banking   |
| IA     | Internal Audit  |
| IASFD  | Internal Audit Surveillance and Follow-up Department                    |
| ICC    | Internal Control and Compliance   |
| ICCD   | Internal Control and Compliance Department                              |
| ICS    | Internal Control System   |
| ICT    | Information and Communication Technology                                |
| IIA    | Institute of Internal Auditors  |
| IFIs   | Islamic Financial Institutions  |
| ITP    | Independent Testing Procedures  |
| KYC    | Know Your Customer  |
| LDCL   | Loan Documentation Checklist  |
| MD     | Managing Director   |
| MoF    | Ministry of Finance   |
| NPL    | Non-Performing Loan   |
| PCBs   | Private Commercial Banks  |
| QOR    | Quarterly Operations Report   |
| SMT    | Senior Management Team  |
| SOCBs  | State-owned Commercial Banks  |
| STP    | Suspicious Transaction Report   |



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# **Internal Control and Compliance of Banks**

## **1. Introduction**

The global banking sector is characterized by stringent regulations due to its vital role in the economy and inherent operational vulnerabilities. High leverage ratios, maturity mismatches between assets and liabilities, lack of transparency, and systemic risks make robust regulations essential. The loss of public confidence in even a single bank can trigger widespread bank runs, emphasizing the need for comprehensive governance, policy, and operational regulations to ensure the safety and soundness of banks. These regulations include prudential norms and best practices for operational procedures, supervised by the central bank, external audits, and internal control systems (ICS).

Among these, the internal control system (ICS) is considered paramount (Ehiedu & Ogbeta, 2014). Bangladesh Bank aligns its ICS objectives with global principles, focusing on achieving business goals, ensuring financial report reliability, and complying with laws, regulations, and policies (Bangladesh Bank, 2016). A robust ICS supports risk management by identifying, measuring, monitoring, and mitigating risks (Siddique et al., 2021). The internal control function is critical for stakeholders' mutual interests, corporate governance, quality assurance, corporate risk management, transparency, accuracy, accountability, sustainability, and competitiveness (Aksoy & Mohammed, 2020). It aids compliance, fraud prevention, operational efficiency, cost reduction, and enhances the bank's reputation and customer trust.

Following the 2007 global financial crisis, the financial industry worldwide strengthened corporate governance practices. The Basel Committee on Banking Supervision (BCBS) emphasizes the role of boards, including senior management, in ensuring efficient operations and compliance. Internal control is crucial at all organizational levels to promote ethical norms and integrity (Sokol, 2011). A solid ICS prevents internal fraud, while a weak system makes the bank susceptible to fraud (Udoayang & Ewa, 2012). Inefficient ICS leads to accounting system deficiencies, asset deterioration, and increased wrongdoing (Yayla, 2006). Research has shown the lack of an effective ICS as the main cause of bank frauds (Olatunji, 2009) and a determinant of banks' profitability and compliance (Koutoupis & Malisiovas, 2021). Poor or ineffective internal control has caused

losses in many banks and operational failures (Nandum et al., 2017). Enhanced compliance reduces imprudent risk-taking and the risk of bank failure (Jin et al., 2013). Internal control strengthens corporate governance (Maijoor, 2000) and builds stakeholder confidence (Rittenberg & Schwieger, 2001). Additionally, it minimizes agency costs (Alves & Mendes, 2004; Goncharov, Werner & Zimmermann, 2006) and enhances the image and reputation of listed companies (Fombrun & Shanley, 1990).

In Bangladesh's competitive banking sector, impressive growth brought increased competition and various risks, including credit, market, operational, and strategic risks. Given this backdrop and recent governance failures, internal control and compliance (ICC) have become of paramount importance. To foster a dynamic and robust ICC culture, Bangladesh Bank (BB) issued ICC guidelines alongside other core risk management guidelines in 2003, which were significantly revised in 2016. BB has made several modifications since to address emerging issues. This study examines the activities of the Internal Control and Compliance Department (ICCD) of banks in Bangladesh for 2022, comparing the current ICC status with the previous year to identify changes and assess strengths and weaknesses.

The paper comprises five sections: an introductory part with the methodology and limitations in Section 1, a typical ICS framework in Section 2, domestic and international ICC regulations in Section 3, a comprehensive review and analysis of ICCD activities in Section 4, and observations and recommendations in Section 5.

## **1.1 Methodology with Limitations of the Study**

The study entails the comprehensive review and summarization of ICCD activities for the year 2022, providing comparative insights into the year 2020. Both primary and secondary data sources were utilized in this research endeavor. Primary data were procured through the distribution of questionnaires to ICCD departments across all banks, with responses received from thirty banks, representing a spectrum of bank categories (refer to Appendix I). Notably, 75 percent of the banks responded to both the 2022 and 2020 surveys. Additionally, a focus group discussion (FGD) took place at BIBM, involving the participation of 45 branch chiefs/managers and senior executives from diverse banks (see Appendix II). The research team also conducted interviews with various stakeholders. Secondary data were gathered from an array of publications by Bangladesh Bank, Basel guidelines, COSO-issued frameworks, the Institute of Internal Auditors (IIA), previous BIBM ICC review reports, and various published research articles. The research findings

are primarily presented in tabular formats. The report encompassed the valuable insights and recommendations from the review workshop where applicable.

It's noteworthy that the fundamentals of ICS, its components, objectives, and regulatory requirements are firmly established. As this review occurs at regular intervals, significant disparities in certain aspects of the report may not be discerned compared to previous reports in the series. Due to the study's focus on 30 surveyed banks, generalizations should be made cautiously. Careful interpretation is required when comparing various indicators between 2022 and 2020, given the non-homogeneity of the banks included in those respective years.

## **2. Framework for an Internal Control System: A Standard Approach**

### **2.1 Internal Control System (ICS) Framework**

A widely recognized definition of Internal Control (IC) has been established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In accordance with COSO's guidelines (2013), IC is recognized as a process implemented by an organization's board of directors, management, and staff to reasonably ensure the achievement of objectives related to operations, reporting, and compliance. These objectives encompass performance (the realization of the organization's mission and vision), information (the provision of timely and accurate reporting), and compliance (the adherence to relevant laws and regulations).

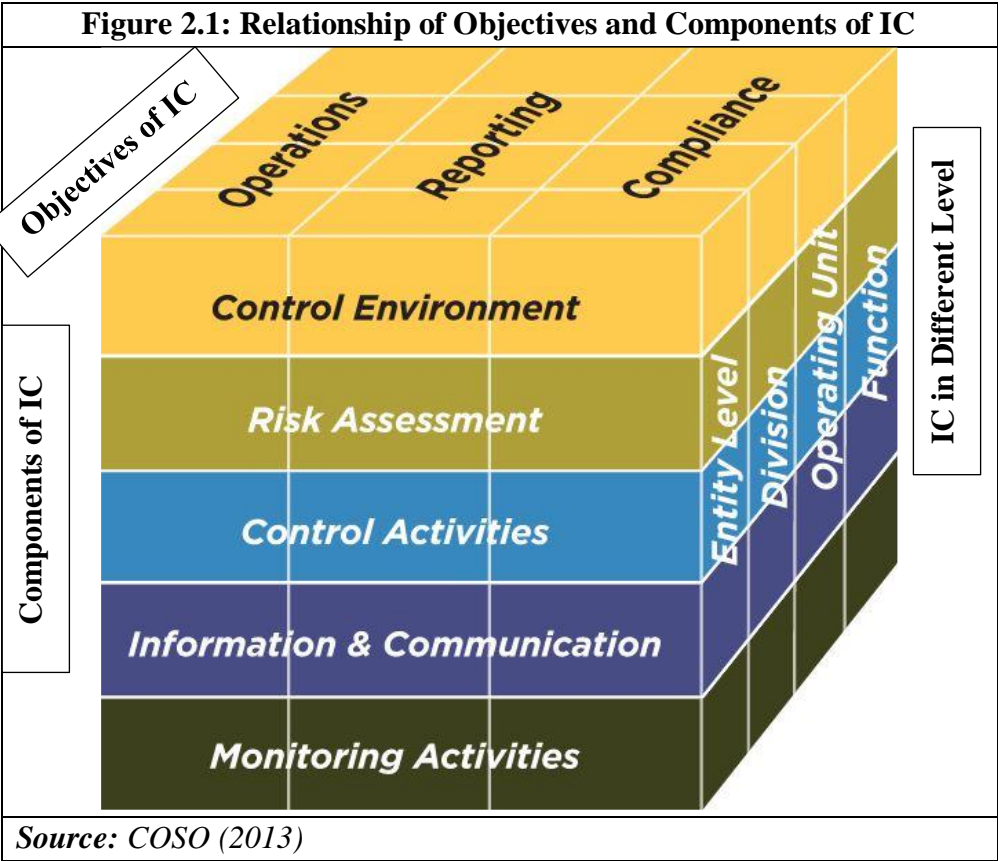
The fundamental purpose of IC is to serve as a protective shield for assets, affirm the precision of financial statements, minimize the occurrence of fraud and errors, and harmonize business performance with the ultimate objectives of the organization. COSO (2013) delineates five interlinked components constituting the framework of internal control, as depicted in Figure 2.1. These components are as follows: (a) Control Environment; (b) Risk Assessment; (c) Control Activities; (d) Information & Communication; and (e) Monitoring.

### **2.2 The Nature of Internal Control (IC)**

It is essential to recognize that IC should be perceived as a set of interconnected processes rather than a rigid framework. Rather than an isolated activity, it functions as an integral component interwoven with an organization's broader business activities (Bangladesh Bank, 2016). In the banking context, three pivotal control functions are prominent: (i) risk management, (ii) compliance, and (iii)

internal audit. The initial two functions collectively constitute the second line of defense against potential issues, while the internal audit function represents the third line of defense.

To enhance risk management, COSO (2017) recommends the integration of strategy with performance. The primary focus of COSO (2017) lies in managing risks within processes and performance management. In this context, the framework's traditional cube structure has evolved into a helical design, as illustrated in Figure 2.2. The components encompass Strategy and Objective Setting, Performance and Review, and Revision, acting as pathways for executing processes within the organization. Concurrently, the components of Governance and Culture, along with Information, Communication, and Reporting, function as foundational pillars that guide the success of the Enterprise Risk Management (ERM) framework. Both an augmented internal control and an enterprise risk management system contribute to the enhancement of management and governance processes. As per COSO (2023), effective fraud risk management is not only supportive but also inherently aligned with the principles of internal control.



**Figure 2.2: Enterprise Risk Management—Helix Framework**



*Source: COSO (2017)*

### **2.3 Roles and Responsibilities of the Internal Control and Compliance Department (ICCD)**

In accordance with Bangladesh Bank's stipulations, it is mandatory for all banks to establish an Internal Control and Compliance Department (ICCD) at the head office level. The ICCD operates through a network of three interconnected units: (a) Internal Audit Unit, (b) Monitoring Unit, and (c) Compliance Unit. These units exhibit a mutual reliance on each other's activities to ensure their collective efficacy. The ICS is not an isolated entity within the banking sector; rather, it is an integral facet seamlessly interwoven into every banking operation. It involves the active participation of every individual within the bank, spanning from the Board of Directors (BoD) to the staff at the lowest echelons. ICCD, nevertheless, plays a central role in guaranteeing the bank's strict adherence to regulatory directives, institutional policies, and procedures approved by the Board of Directors. Additionally, ICCD is entrusted with the responsibility of identifying any potential shortcomings within the bank's internal policies and procedures across various operational domains.

It is pivotal to underscore that the effectiveness of the comprehensive Internal Control System (ICS) hinges not solely on the functions of ICCD but also on the collective performance of branches and the diverse departments located within the head office. In consonance with the directives of Bangladesh Bank (BB, 2016), the Head of ICCD assumes a dual role, overseeing both monitoring and compliance functions. They are held accountable for delivering reports on internal control and compliance activities to the senior management. In contrast, the Head of Internal Audit, who is an integral part of ICCD, directly reports to the Audit Committee of

the Board (ACB), with their performance evaluation overseen by the ACB Chairman.

### **2.3.1 Roles and Duties of the Internal Audit Unit**

The Institute of Internal Auditors (IIA) underscores the pivotal role of the Internal Audit (IA) function, which significantly contributes to an organization's objectives by employing a systematic and disciplined approach to evaluate and enhance the effectiveness of governance, risk management, and control processes. IA is defined as an independent and objective service that offers both assurance and consulting services, with the aim of adding value and enhancing the overall efficiency of an organization's operations (IIA, 2016).

As an integral component of the organization's internal control framework, internal audit functions as the paramount control mechanism, ensuring the validation of the proper operation of all other control measures. It assumes a supervisory role over all other control mechanisms. Importantly, internal auditors are not charged with the responsibility of executing specific control procedures; instead, their primary role revolves around auditing the bank's internal control policies, practices, and procedures. This is done to ascertain that these controls are robust and adequate in fulfilling the organization's mission. It is of utmost significance for internal audits to uphold a distinct separation between business operations and managerial functions. Typically, the audit department is organized into various specialized cells, as illustrated in Box 2.1.

#### **Box 2.1: Various Units within Internal Audit**

- ✓ The General Banking Cell is responsible for auditing the general banking operations of the branch.
- ✓ The Credit Cell conducts audits on the credit operations of the branch.
- ✓ The FOREX Cell carries out audits on foreign exchange operations at the branch level.
- ✓ The IS Cell performs information system audits at the branch level.
- ✓ The Head Office Cell conducts audits within departments and divisions of the head office.
- ✓ The Subsidiaries Cell is in charge of auditing subsidiaries and other affiliated organizations.
- ✓ The Shariah Cell handles Shariah audits for Islamic banks.
- ✓ The Concurrent Audit Cell conducts audits in selected branches or units as events occur.
- ✓ The Vigilance and Special Inspection Cell conducts special audits and inspections as instructed by the Chairman of the BOD, the Managing Director, and the Head of ICCD.



### **2.3.2 Roles of the Monitoring Unit as Surveillance**

Within ICCD, the Monitoring unit plays a pivotal role, primarily focusing on off-site surveillance activities. Its core responsibilities encompass the continuous monitoring of the daily operations conducted by branches and departments, ensuring strict adherence to approved policies and procedures. This oversight is facilitated through the utilization of advanced ICT infrastructure and documentation. Furthermore, the unit meticulously assesses a variety of reports and information received from branches at varying intervals.

As part of its comprehensive monitoring process, the unit conducts assessments of critical components such as the Departmental Control Function Checklist (DCFCL), Investment/Loan Documentation Checklist (LDC), and Quarterly Operation Report (QOR). In instances where exceptions or irregularities are identified, the unit takes prompt corrective measures by instructing the respective branch or office to address the issues and provide reports on the resolution. In cases deemed significant, the unit may recommend an audit and inspection by the Internal Audit (IA) unit to thoroughly investigate specific issues or deviations.

The Monitoring unit is also entrusted with the preparation of the "Self-Assessment Report of Anti-Fraud Internal Control" for the bank. This task involves the collection of pertinent documents and compliance data from relevant divisions and departments. Once compliance is verified, this report is submitted to Bangladesh Bank on a quarterly basis. Additionally, the unit may be called upon to prepare the Annual Health Report of the bank, which is then submitted to the Chief Executive Officer and the Audit Committee of the Board (ACB) for further submission to the Board of Directors and Bangladesh Bank.

On a daily basis, the Monitoring unit actively and vigilantly observes various aspects, including employees' accounts, mandatory leave and transfers, deposit and investment/loan accounts, and various general ledger entries. This real-time monitoring is facilitated through specialized software. In the event of detecting any unusual activities or discrepancies, the unit promptly reports these findings to the Senior Management Team (SMT) and the Board of Directors through the Head of ICCD.

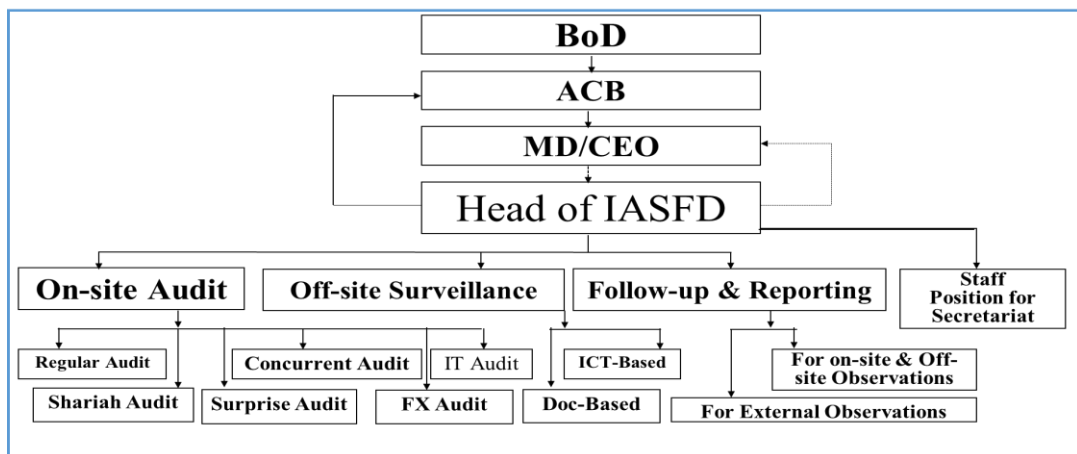
### 2.3.3 Responsibilities of the Compliance Unit (Follow-up and Reporting)

The Compliance unit, an integral part of ICCD, carries a paramount responsibility in ensuring strict adherence to all findings and recommendations made by the Internal Audit (IA), external audits, and Bangladesh Bank (BB) inspections. Their primary function encompasses the creation and dissemination of a compliance report, which is then shared with the Senior Management Team (SMT) and the Audit Committee of the Board (ACB). Hence, this unit aptly functions as the "Follow-up and Reporting" unit under ICCD. It is essential to note that the compliance unit diligently operates in full compliance with the Bangladesh Bank ICC Guideline of 2016.

Proactively, the unit actively participates in the formulation of policies and procedures, contributes to knowledge dissemination and awareness initiatives, issues and maintains circulars, collaborates on organizing training sessions related to regulatory matters with the training institute, and maintains open lines of communication with regulators to seek clarifications on compliance procedures and regulations. They diligently undertake necessary actions to ensure compliance and rectify any identified shortcomings within the stipulated time-frame.

To facilitate seamless communication and the efficient exchange of information, the compliance unit conducts weekly meetings. Additionally, they maintain a comprehensive archive of audit reports. The organizational structure of ICCD, including its various units, is visually represented in Figure 2.3 for clarity.

**Figure 2.3: Suggested Organizational Chart for ICCD/IASFD**



*Source: Siddique et al. (2018)*

**Notes:**

- i) Board of Directors (BoD): The BoD holds the highest authority in crafting standard operating procedures (SOPs) and overseeing the comprehensive operations of the banks.
- ii) Audit Committee of the Board (ACB): As a board committee, the ACB plays a pivotal role in the evaluation of the banks' overall Internal Control System (ICS) and the activities of the Internal Audit Surveillance and Follow-up Department (IASFD).
- iii) Chief Executive Officer (CEO): The CEO assumes responsibility for executing all observations and recommendations put forth by the IASFD via the ACB. While the CEO may offer suggestions to the IASFD to conduct audits (dotted line reporting), they must not compromise its independence.
- iv) Head of Internal Audit Surveillance and Follow-up Department (IASFD): The head of IASFD holds a supervisory role over all the department's activities and communicates relevant information to both the ACB and CEO in a parallel structure (dotted line reporting).
- v) On-Site Audit Unit: The on-site audit unit carries out routine audits according to the established audit plan. Moreover, it conducts surprise audits, IT audits, FX audits, and Shariah audits. A team of concurrent auditors, under the on-site audit unit, is responsible for auditing high-value branches, including the top 20 branches.
- vi) Off-Site Surveillance Unit: The off-site surveillance unit consists of two sub-sections. One focuses on surveillance using ICT infrastructure, while the other examines collected documents and reports for monitoring purposes.
- vii) Follow-up and Reporting Unit: Within the IASFD, this unit serves as the central point for tracking the status of rectifying internal and external audit observations. It consolidates all observations and recommendations from on-site audit, off-site surveillance, external audits, regulators, and monitors the progress of their implementation. At specific intervals, this unit communicates compliance status to the ACB, Senior Management Team (SMT), and regulatory bodies.
- viii) SMT, Off-Site Surveillance Unit, and Follow-up & Reporting Unit: These entities have the authority to recommend to the on-site audit unit, through the head of IASFD, the necessity of conducting special audits as circumstances warrant.

## **2.4 Internal Audit in its Role as Third Line of Defense**

The proficiency of an organization is contingent on its adeptness in risk management across diverse functions. In the realm of banking, a three-tiered defense system is established to fortify risk management.

The initial tier encompasses operational management, who shoulder direct ownership and accountability for assessing, controlling, and mitigating risks within their domains. Their compliance with established policies is paramount, as deviations from these policies can incite risks. The second line of defense encompasses facets of internal governance, comprising compliance, risk management, and quality control. This segment oversees and bolsters the implementation of robust risk management practices by operational management. It acts as a safeguard, preventing the operational unit from embracing risks that yield negative risk-adjusted returns.

In contrast to the first line, internal audit, forming the third line of defense, functions independently from the management. Its principal focus lies in uncovering deficiencies within the control framework. Internal auditors scrutinize the compliance of tasks performed by operational units and proffer remedial measures to forestall lapses. The extent of their examination is contingent upon the magnitude of errors or deviations committed by the first or second lines of defense. Nevertheless, the efficacy of internal audit hinges on the prompt and effective implementation of their recommendations by the organization. If these suggested measures remain unheeded or are ineffectively executed, the internal audit may not serve as an efficient mechanism for safeguarding the organization. Thus, a synergistic effort among these three lines of defense is indispensable for proficient risk management.

### **3. Regulatory Framework of Internal Control and Compliance (ICC)**

#### **3.1 International Context for the Internal Control System Framework**

To align with global best practices, Bangladesh's banking industry can draw guidance from various international standards, guidelines, and principles established by authoritative bodies such as the Organization for Economic Co-operation and Development (OECD), Basel Committee on Banking Supervision (BCBS), The International Ethics Standards Board for Accountants (IESBA) of the International Federation of Accountants (IFAC), Institute of Internal Auditors (IIA), Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The "G20/OECD Principles of Corporate Governance" serve as an internationally recognized standard for corporate governance. These principles were initially issued in 1999, endorsed by G20 Leaders in 2015, and revised in 2023. They aid policymakers in evaluating and enhancing the legal, regulatory, and institutional framework for corporate governance, with the aim of fostering economic efficiency, sustainable growth, and financial stability.

The BCBS has released a set of corporate governance principles for banks in 2015. Furthermore, the "Core Principles for Effective Banking Supervision," issued in 2023, form a foundational component of global standards for sound prudential regulation and bank supervision.

IFAC published the "Handbook of the International Code of Ethics for Professional Accountants, including International Independence Standards" in 2021, while IIA issued the "International Professional Practice Framework (IPPF)" in 2017.

The IFSB issues various standards related to the governance of Islamic financial institutions, and AAOIFI is dedicated to establishing standards that ensure good governance and effective IC.

COSO, on the other hand, has released multiple vital frameworks and guides, including "Internal Control - Integrated Framework" (2013), "Enterprise Risk Management—Integrating with Strategy and Performance" (2017), and "Fraud Risk Management Guide" (2023). These frameworks aim to provide management with guidance for enhancing management and governance processes.

COSO defines internal control as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance." The five key components of the COSO internal control framework include risk assessment, control activities, information and communication, control environment, and monitoring activities.

Within the banking sector, compliance functions represent a pivotal element of the second line of defense for risk management. Their primary role is to ensure that banks operate with integrity and adhere to relevant laws, regulations, and internal policies. A robust and independent compliance function plays a critical role in mitigating risks associated with misconduct, money laundering, and other forms of non-compliance.

### **3.2 Local Context for the Internal Control System Framework**

The banking industry in Bangladesh is subject to rigorous regulation and supervision due to the nature of its asset-liability portfolio and business operations. The establishment of a bank is primarily regulated by the Registrar of Joint Stock Companies (RJSC). The overall supervision and regulation of banking license matters and activities in the industry fall under the purview of Bangladesh Bank (BB), the central bank of the country. The Bangladesh Securities and Exchange Commission (BSEC) oversees fund mobilization through equity or debt instruments, while the Financial Reporting Council (FRC) regulates reporting and transparency.

In its "Strategic Plan 2020-2024 Fostering Stable Financial System," Bangladesh Bank mentions the use of frameworks such as COBIT (Control Objectives for Information and Related Technologies), ISO, ITIL, among others. COBIT, in particular, serves as an internal control framework aimed at helping organizations implement, monitor, and improve IT management best practices. It has been instrumental in assisting organizations in developing internal controls to prevent fraud. COBIT has garnered global recognition, and internationally accepted standards, including ISO 27000, ITIL<sup>1</sup>, COSO, and PMBOK<sup>2</sup>, have acknowledged its significance. The principles underlying the COBIT framework are centered on control and Info-Tech control objectives. Control refers to having authority over key IT management practices, structures, policies, and procedures to ensure that pre-defined goals are achieved. IT control objectives involve clearly defining achievable results that can be easily accomplished during IT operations. The six principles of COBIT 2019 are: Provide Stakeholder Value, Holistic Approach, Dynamic Governance System, Governance Distinct from Management, Tailored to Enterprise Needs, and End-to-End Governance System. COBIT is employed for various aspects of internal IT audit, including developing audit plans, conducting audit engagements, and communicating results to stakeholders.

ISO/IEC 27001<sup>3</sup>, under Clause 8, mandates that organizations must plan, implement, and control processes to meet requirements and prevent undesired effects while achieving continual improvement. Clause 9 requires the conduct of internal audits to assess the organization's information security management system's conformity to its own requirements and to ensure effective implementation and maintenance. Internal audits involve a defined audit program, auditor selection, and the reporting of results to relevant management.

The Bank Companies Act 1991, Section 15C, stipulates that the Board of Directors shall ensure the existence of an effective internal audit and control system. This internal audit must operate independently from management, and its reports should be submitted to the Audit Committee of the Board (ACB). The internal auditor may collect information and records from the management for auditing purposes, but

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<sup>1</sup> ITIL is a framework designed to standardize the selection, planning, delivery, maintenance and overall lifecycle of IT services within a business.

<sup>2</sup> PMBOK is a set of standard terminology and guidelines for project management

<sup>3</sup> ISO/IEC 27001: Information security, cybersecurity and privacy protection – Information security management systems — Requirements.

they should not be involved in the agreements or transactions of the banking company.

Bangladesh Bank issued the "Code of Conduct for Banks and Non-Bank Financial Institutions" in 2017, emphasizing the importance of the Internal Control and Compliance Department (ICCD) in maintaining the highest degree of integrity. Furthermore, various BB circulars underscore the significance of strengthening internal control and compliance for preventing irregularities in non-bank financial institutions (NBFIs) <sup>4</sup>. In 2013, revised<sup>5</sup> Memorandums of Understanding (MoUs) were signed between Bangladesh Bank and State-Owned Commercial Banks (SOCBs) to enhance monitoring and supervision for good corporate governance. SOCBs formulated revised policies, including credit policy, credit risk management policy, internal control and compliance policy, loan review policy, and liquidity management policy. They are also instructed to diligently implement these policies. One requirement of the MoU is that loans with an outstanding principal balance over Tk. 10 crore should be certified by the Chief Internal Auditor to comply with credit policies, customer identification requirements, and consultation with the Credit Information Bureau of Bangladesh Bank.

The Securities and Exchange Rules, 2020 of BSEC also emphasize the importance of internal control. BSEC may appoint an auditor to conduct a special audit of the financial statements of an issuer of a listed security. To ensure meaningful and objective audits, the audit firm is expected to focus on the composition and effectiveness of internal checks and controls.

FRC issued a notification in 2020, requiring banks to follow International Financial Reporting Standards (IFRS) to enhance the qualitative characteristics of financial information. This mandate is aimed at improving the transparency and reliability of financial reporting in the banking industry.

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<sup>4</sup> DFIM circular# 05 dated 29 May 2023, DFIM circular# 13 dated 26 October 2011, and DFIM circular # 07 dated 25 September 2007.

<sup>5</sup> The MoUs (Memorandum of Understandings) were first introduced and signed with SOCBs in the year 2003 to monitor their activities more closely and intensively.

## 4. Results and Discussion of ICCD Activities

### 4.1. Summary of Findings of Questionnaire Survey

This section summarizes data collected through questionnaire and discussion with key stakeholders covering different dimension of ICS, especially ICCD, of the banking industry of Bangladesh.

**Table 4.1: CAMELS and ICC Rating of Banks**

| Rating       |                | No. of Banks in 2020 |            | No. of Banks in 2022 |            |
|--------------|----------------|----------------------|------------|----------------------|------------|
|              |                | CAMELS (Dec.)        | ICC (Dec.) | CAMELS (June)        | ICC (June) |
| 1            | Strong         | 0                    | 0          | -                    | -          |
| 2            | Satisfactory   | 38                   | 29         | 28                   | 29         |
| 3            | Fair           | 7                    | 23         | 17                   | 23         |
| 4            | Marginal       | 11                   | 5          | 8                    | 6          |
| 5            | Unsatisfactory | 1                    | 0          | 5                    | -          |
| <b>Total</b> |                | <b>57</b>            | <b>57</b>  | <b>58</b>            | <b>58</b>  |

*Source: Bangladesh Bank*

CAMELS and ICC ratings of banks are supervisory rating systems conducted by Bangladesh Bank. CAMELS rating using 5 scales indicates the overall financial condition of a bank whereas ICC rating focuses on quality and strength of internal control system of a bank. Table 4.1 presents the CAMELS and ICC ratings of all the banks for the year 2020 and 2022. As per the table, no bank achieved strong position in CAMELS and ICC rating for the year 2020 and 2022. It is also an alarming issue that the number of banks belonging to satisfactory category have significantly reduced from 38 in 2020 to 28 in 2022. In addition to that, the number of ‘unsatisfactory’ banks in CAMELS rating turned out to be 5 in 2022 whereas only 1 bank was in that category in 2020.

**Table 4.2: The Head of ICCD and Portfolio (% of banks)**

| Aspects  |                              | 2020 | 2022 |
|--|------------------------------|------|------|
| Does the head of ICCD perform any operational duties for the banks or its affiliates?                    |                              | 18   | 12   |
| Is there any requirement in bank’s policy for the ICCD head?   | Academic/Professional Degree | 04   | 03   |
|  | Years of banking experience  | 04   | 03   |
|  | Areas of working experience  | 04   | 03   |
| Is there any tenure in the bank’s policy for the ICCD head?  |                              | 04   | 04   |
| Is there any instance of transferring ICCD head before the completion of 3 years tenure in last 5 years? |                              | 10   | 19   |

*Source: Survey data*



As per requirement of BB guidelines on ICC in banks, all banks have established separate ICCD and assigned an executive as the head. However, it has been observed that only few banks do not have policy requiring specific academic qualification and experience for the post of ICCD head. About 19 percent banks transferred the head of ICCD in 2022 before the completion of three years' tenure which is noticeably higher than the previous study year (Table 4.2).

**Table 4.3: Rank of the Head of the Committee/Department/Unit**

| S/N | Aspect                              | Position of the Head              | % of Bank (2020) | % of Bank (2022) |
|-----|-------------------------------------|-----------------------------------|------------------|------------------|
| 1.  | Rank of the Head of ICCD            | 1/2 steps immediate below CEO     | 48               | 46               |
|     |                                     | 3 steps immediate below CEO       | 28               | 30               |
|     |                                     | 4 steps immediate below CEO       | 17               | 15               |
|     |                                     | 5 steps immediate below CEO       | 3                | 5                |
|     |                                     | More than 5 steps below CEO       | 4                | 4                |
| 2.  | Rank of the Head of Internal Audit  | Up to 3 steps immediate below CEO | 24               | 12               |
|     |                                     | 4 steps immediate below CEO       | 14               | 20               |
|     |                                     | 5 steps immediate below CEO       | 24               | 28               |
|     |                                     | More than 5 steps below CEO       | 38               | 40               |
| 3.  | Rank of the Head of Monitoring Unit | Up to 3 steps immediate below CEO | 15               | 8                |
|     |                                     | 4 steps immediate below CEO       | 8                | 13               |
|     |                                     | 5 steps immediate below CEO       | 8                | 12               |
|     |                                     | 6 steps immediate below CEO       | 39               | 35               |
|     |                                     | More than 6 steps below CEO       | 30               | 32               |
| 4.  | Rank of the Head of Compliance Unit | Up to 3 steps immediate below CEO | 25               | 28               |
|     |                                     | 4 steps immediate below CEO       | 4                | 6                |
|     |                                     | 5 steps immediate below CEO       | 17               | 12               |
|     |                                     | 6 steps immediate below CEO       | 33               | 32               |
|     |                                     | More than 6 steps below CEO       | 21               | 22               |

**Source:** Survey data

BB recommended banks to appoint an executive as the Head of ICCD who will not stand more than two steps below the CEO at the time of appointment. However, it is depicted that 54 percent banks did not adhere to this regulation and the compliance status is even worse than the previous year. (Table 4.3). So, the expected or desired level of authority of the ICCD has not yet been established in

the banking industry of Bangladesh. Deployment of higher-level executives as heads of audit, monitoring and compliance is also required.

**Table 4.4: Composition of Audit Committee of Board (%)**

| S/N | Aspect   |           | 2020 | 2022 |
|-----|--|-----------|------|------|
| 1.  | Banks having independent director (ID) as chairman of the Audit Committee of Board (ACB) |           | 100  | 100  |
| 2.  | Banks (PCB's) with two or more independent director                                      |           | 92   | 100  |
| 3.  | No. of members in ACB  | 2 members | 6    | 15   |
|     |  | 3 members | 32   | 15   |
|     |  | 4 members | 21   | 35   |
|     |  | 5 members | 41   | 35   |
| 4.  | Banks with common members of ACB and ECB   |           | 7    | 4    |
| 5.  | Banks with common members of ACB and RMC   |           | 68   | 56   |

**Source:** Survey data

As per regulation, banks are required to constitute their Audit Committee of the Board (ACB) and the Chairman of ACB should be an independent director. In addition to the Chairman, a minimum of one independent director should be there in the ACB. According to the latest available data, 35 percent banks have five members in their ACB. There is a restriction that the member of ACB and Executive Committee of the Board (ECB) would not be common and only 4 percent of banks have common members of ACB and ECB.

**Table 4.5: Effectiveness of ICS and Preparation & Submission of Summary Audit Findings (%)**

| S/N | Aspect   |                      | 2020 | 2022 |
|-----|--|----------------------|------|------|
| 1.  | BoD of bank met with internal auditors in the year   |                      | 37   | 30   |
| 2.  | How many meetings of BoD were held in a year for reviewing the effectiveness of the internal control process?                | 0 meeting            | 25   | 20   |
|     |  | 1-2 meetings         | 50   | 50   |
|     |  | 3-4 meetings         | 18   | 26   |
|     |  | More than 4 meetings | 7    | 4    |
| 3.  | Banks having policy/system approved by BoD for direct reporting by IA to the board/ACB                                       |                      | 82   | 83   |
| 4.  | Banks having mechanism in the hand of BoD/ACB for ensuring timely and effective correction by management as per audit report |                      | 83   | 88   |
| 5.  | Banks where ACB has taken initiative for ensuring accuracy of financial reporting  |                      | 80   | 96   |
| 6.  | Banks having system of meticulously examining minutes and memos of BoD/ECB by ICCD/IA  |                      | 46   | 50   |
| 7.  | Banks where ACB has discussed with external auditors regarding accuracy of financial statement of 2022                       |                      | 85   | 77   |

| S/N | Aspect  |                            | 2020 | 2022 |
|-----|---|----------------------------|------|------|
| 8.  | Banks where ACB has evaluated the performance of external auditors/ audit report and implementation thereto   |                            | 82   | 77   |
| 9.  | Banks where ACB has prepared compliance report on regularization of the omission, fraud & forgeries and other irregularities detected by external/internal auditors |                            | 78   | 65   |
| 10. | No. of meeting of ACB held in 2022  | 4 (as minimum requirement) | 10   | 20   |
|     |   | 4-11                       | 79   | 70   |
|     |   | 12 (as maximum)            | 7    | 5    |
|     |   | More than 12               | 4    | 5    |
| 11. | Banks where ACB could ensure an adequate number of skilled manpower and proper IT support for effective audit   |                            | 82   | 81   |
| 12. | Banks that referred to ACB to settle dispute between senior management and IA   |                            | 4    | 0    |
| 13. | Banks having SMT and MANCOM   | Only MANCOM                | 26   | 12   |
|     |   | Only SMT                   | 22   | 23   |
|     |   | Both MANCOM and SMT        | 52   | 65   |

*Source: Survey data*

The activities of ICS of a bank should be assessed regularly. As per Table 4.5, about 30 percent banks have met with the internal auditors in 2022 for getting inputs and giving directions. BoDs review the activities of internal control process of the majority of the bank.

**Table 4.6: Manpower composition of ICCD –categorized by banking experience average (%)**

| S/N | Aspect  | 2020 | 2022 |
|-----|---|------|------|
| 1   | Employees of ICCD having more than 20 years of experience       | 25   | 26   |
| 2   | Employees of ICCD having 15 to 20 years of experience           | 14   | 12   |
| 3   | Employees of ICCD having 5 to less than 15 years of experience  | 44   | 48   |
| 4   | Employees of ICCD having 1 to less than 5 years of experience   | 16   | 14   |
| 5   | Employees of ICCD having less than 1 year of banking experience | 1    | 0    |
|     |   | 100  | 100  |

*Source: Survey data*

Audit is a specialized profession and it is expected that the employees in the internal audit have adequate working experience in various departments of the bank. Table 4.6 shows that more than 25 percent ICCD employees have banking experience for 20 years or more.

**Table 4.7: Executives of ICCD receiving training (%)**

| S/<br>N | Aspect  | 2020 | 2022 |
|---------|---|------|------|
| 1.      | Executives not receiving any training   | 46   | 20   |
| 2.      | Executives getting training once in a year  | 31   | 37   |
| 3.      | Executives getting training twice in a year   | 9    | 19   |
| 4.      | Executives getting training more than twice in a year   | 14   | 24   |
| 5.      | ICCD having authority in arranging training program for its own employees (as % of total banks) | 67   | 77   |

*Source: Survey data*

ICC arranges both local and foreign training for their employees in order to enhance their efficiency. Table 4.7 shows that about 80 percent ICCD employees got training in 2022 and the situation is developing gradually.

**Table 4.8: Provision for mandatory leave in banks (% of banks)**

| S/N | Aspect   | Option                  | 2020  | 2022  |
|-----|--|-------------------------|-------|-------|
| 1.  | Banks having mandatory leave policy for the employees other than ICCD of the bank                            | No provision            | 10    | 8     |
|     |  | Once a year             | 87    | 92    |
|     |  | Once in two years       | 0     | 0     |
|     |  | Once in three years     | 3     | 0     |
| 2.  | Banks having similar mandatory leave provision for the employees working in ICCD of bank                     |                         | 100   | 88    |
| 3.  | Banks having separate provision for recreation leave   |                         | N/A   | 19    |
| 4.  | Duration of the mandatory leave (in days)  |                         | 10-15 | 10-15 |
| 5.  | Financial benefit for mandatory leave  | No benefit (% of banks) | 40    | 50    |
|     |  | Benefit (basic salary)  | 0.5-1 | 1     |
| 6.  | Banks opining mandatory leave provisions as equally important for executives working in any unit of the bank |                         | 96    | 88    |
| 7.  | Employees enjoying mandatory/recreation leave fully who were eligible in the year (as perceived by ICCD)     | More than 90%           | 25    | 23    |
|     |  | 81%-90%                 | 4     | 7     |
|     |  | 71%-80%                 | 7     | 3     |
|     |  | Below 71%               | 64    | 57    |

*Source: Survey data*

In accordance with BB regulation, all the employees working in the branch and head office should avail 10-15 days of mandatory leave in each year. But deviation has been observed regarding the employees working in ICCD. Roughly 23 percent of bank employees can avail of the leave (more than 90%) who were eligible in the year 2022.

**Table 4.9: Provision for job rotation in banks (% of banks)**

| S/N | Aspect   |               | 2020 | 2022 |
|-----|--|---------------|------|------|
| 1.  | Bank having job rotation policy for the employees other than ICCD of the bank                              |               | 92   | 92   |
| 2.  | Banks being similar job rotation policy for the employees working in ICCD of the bank                      |               | 96   | 84   |
| 3.  | Banks thinking job rotation provisions as equally important for executives working in any unit of the bank |               | 78   | 85   |
| 4.  | Banks able to implement the job rotation provision (as perceived by ICCD/IA)                               | More than 90% | 11   | 11   |
|     |  | 81%-90%       | 11   | 19   |
|     |  | 71%-80%       | 15   | 24   |
|     |  | Below 71%     | 63   | 46   |

*Source: Survey data*

As per regulation, all employees (except the CEO, Deputy Managing Director or equivalent and any one recruited for special purposes) of banks should be transferred in every 3 years. It is noticed that most of the banks have such policy but could not be implemented in all the cases (Table 4.9).

**Table 4.10: Status of reviewing banking manual/guidelines for the last time (% of banks)**

| S/N | Name of Manual                | Last Three Years<br>(2020, 2021 & 2022) | Before Three Years<br>(Before 2020) |
|-----|-------------------------------|---|-------------------------------------|
| 1.  | Credit Policy Manual          | 79                                      | 21                                  |
| 2.  | Operational Manual            | 39                                      | 61                                  |
| 3.  | Finance and Accounting Manual | 46                                      | 54                                  |
| 4.  | Treasury Manual               | 57                                      | 43                                  |
| 5.  | HR Policy Manual              | 54                                      | 46                                  |
| 6.  | ICC Manual                    | 75                                      | 25                                  |
| 7.  | ICT Security Policy           | 68                                      | 32                                  |
| 8.  | FOREX Manual                  | 54                                      | 46                                  |

*Source: Survey data*

Banks are required by BB to prepare banking manual/guidelines and review the same at least once in a year. Table 4.10 shows that the highest number of banks have modernized their credit policy manual in last three years followed by ICC manual. There are some banks who did not update/review banking manuals on timely manner.

**Table 4.11: Perception of ICCD regarding its target (%)**

| S/<br>N | Aspect   | 2020 | 2022 |
|---------|--|------|------|
| 1.      | Does ICCD have any target other than completing audit plan?  | 64   | 50   |
| 2.      | Does ICCD think that minimizing irregularities/mistake should be a target of it?                         | 89   | 85   |
| 3.      | Satisfaction level of ICCD to keep the extent of irregularities within tolerance level in the bank       | 86   | 84   |
| 4.      | Does ICCD think that minimizing fraud should be a target of it?  | 82   | 84   |
| 5.      | Satisfaction level of ICCD to keep the extent of fraud committed within tolerance level in the bank      | 86   | 86   |
| 6.      | Does ICCD think that minimizing lapses in documentation should be a target of it?                        | 82   | 80   |
| 7.      | Satisfaction level of ICCD to keep the extent of documentation lapses within tolerance level in the bank | 85   | 83   |
| 8.      | Does ICCD think that ensuring proper credit appraisal should be a target of it?                          | 85   | 76   |
| 9.      | Satisfaction level of ICCD with the credit appraisal process followed by the bank                        | 88   | 88   |
| 10.     | Does ICCD think that ensuring proper credit approval should be a target of it?                           | 82   | 76   |
| 11.     | Satisfaction level of ICCD with the credit approval process followed by the bank                         | 91   | 91   |
| 12.     | Does ICCD have any role in minimizing NPL?   | 68   | 76   |
| 13.     | Satisfaction level of ICCD with the NPL position of the bank   | 75   | 79   |
| 14.     | Does ICCD think that ensuring proper posting of executives should be a target of it?                     | 64   | 60   |
| 15.     | Satisfaction level of ICCD with the placement approach followed by the bank                              | 83   | 83   |
| 16.     | Does ICCD think that minimizing customer complaints should be a target of it?                            | 65   | 62   |
| 17.     | Satisfaction level of ICCD with the magnitude of complaints raised by customers against the bank         | 93   | 92   |

*Source: Survey data*

Though implementing audit plan is the primary target of ICCD, it may have some other targets related with internal control process such as minimizing number of irregularities, upgrading branches' rating, minimizing fraud and regularizing documentation lapses may be some important dimensions of an effective audit. Table 4.11 summarizes the perceptions of banks in this regard.

**Table 4.12: Perception of ICCD regarding its independence (% of banks)**

| S/<br>N | Components  | 2020      | 2022 |
|---------|---|-----------|------|
| 1.      | Do you think that ICCD should be independent from management?   | 86        | 96   |
| 2.      | Is ICCD fully independent for discharging its duties/responsibilities?                                  | 94        | 97   |
| 3.      | Do you think that activities of ICCD should be controlled and evaluated by CEO?                         | 41        | 42   |
| 4.      | Is ICCD satisfied with support provided by the BoD?   | 97        | 98   |
| 5.      | Is ICCD satisfied with support provided by the ACB?   | 97        | 98   |
| 6.      | Is ICCD satisfied with support provided by the CEO/SMT?   | 96        | 97   |
| 7.      | Is ICCD satisfied with support provided by the BB?  | 96        | 97   |
| 8.      | Are all recommendations made by ICCD time bound for implementation?                                     | 93        | 96   |
| 9.      | In how many cases ICCD can enforce the compliance with the recommendations made by ICCD?                | (91-100)% | 43   |
|         |   | (81-90)%  | 50   |
|         |   | (71-80)%  | 7    |
| 10.     | Is there any instance in your bank that any decision of ACB was not implemented by the bank management? | 7         | 4    |

*Source: Survey data*

As per Table 4.12, 97 percent banks opined that the ICCD is fully independent for discharging their duties and responsibilities. Majority of the banks opined that they are satisfied with the support provided by the BoD, ACB, CEO and BB. But in some cases, the ratifications recommended by ICCD could not be enforced by the department.

**Table 4.13: Achievement of objectives of internal control system**

| Achievement of objectives of internal control system of bank (% of banks) |                      |      |                     |      |                      |      |
|---|----------------------|------|---------------------|------|----------------------|------|
| % of Achievement  | Operations Objective |      | Reporting Objective |      | Compliance Objective |      |
|   | 2020                 | 2022 | 2020                | 2022 | 2020                 | 2022 |
| Above 90%   | 50                   | 60   | 68                  | 80   | 50                   | 64   |
| 81% - 90%   | 39                   | 36   | 25                  | 20   | 32                   | 28   |
| 71% - 80%   | 4                    | 0    | 7                   | 0    | 18                   | 8    |
| Below 71%   | 7                    | 4    | 0                   | 0    | 0                    | 0    |
| Achievement of objectives of different units of ICCD (% of banks)         |                      |      |                     |      |                      |      |
| % of Achievement  | Audit Unit           |      | Monitoring Unit     |      | Compliance Unit      |      |
|   | 2020                 | 2022 | 2020                | 2022 | 2020                 | 2022 |
| Above 90%   | 63                   | 80   | 40                  | 60   | 52                   | 52   |
| 81% - 90%   | 33                   | 16   | 52                  | 36   | 41                   | 41   |
| 71% - 80%   | 0                    | 1    | 4                   | 4    | 7                    | 7    |
| Below 71%   | 4                    | 0    | 4                   | 0    | 0                    | 0    |

*Source: Survey data*

Operating, reporting and compliance are the main objectives of Internal Control System (ICS). As per Table 4.13, 80 percent cases reporting objectives have been achieved however a good number of banks could not achieve operations and compliance objectives in both the years. Moreover, banks may rethink about the the monitoring unit's achievement is lowest as compared with the audit and compliance units.

**Table 4.14: Health report of the banks (% of banks)**

| S/N | Aspect  |            | 2020 | 2022 |
|-----|---|------------|------|------|
| 1.  | Health report for the year                          |            | N/A  | 100  |
| 2.  | Submission of health report to BB for the year      |            | N/A  | 91   |
| 3.  | Customization the format of health report by banks  |            | 43   | 48   |
| 4.  | Bank taking any decision based on the health report |            | 26   | 66   |
| 5.  | Unit of ICCD preparing the health report            | Audit      | 0    | 8    |
|     |   | Monitoring | 96   | 84   |
|     |   | Compliance | 4    | 8    |

\* *Questionnaire Survey was completed by March 2021. Some banks have completed the report by this time.*

**Source:** Survey data

As per BB instruction, all scheduled banks have to prepare annual health report. And usually the health report is prepared by the monitoring unit of ICCD in coordination with other units though audit and compliance units also prepared the health report in some cases. As per Table 4.14, most of the banks have already prepared and submitted the health report and a good number of banks have customized their report.

**Table 4.15: Perception of the Head of ICCD Regarding Compliance with the Principles of Internal Control as Mentioned ICC Guideline 2016**

*[1=Fully Compliant; 2=Reasonably Compliant; 3=Partially Compliant; 4=Not Compliant; and 5=No Comment]*

| S/N      | Components and Principles of Internal Control  | Compliance Status |    |   |   |   |
|----------|--|-------------------|----|---|---|---|
|          |  | 1                 | 2  | 3 | 4 | 5 |
| <b>A</b> | <b>Control Environment</b>   |                   |    |   |   |   |
| 1.       | The bank demonstrates a commitment to integrity and ethical values.  | 84                | 16 | 0 | 0 | 0 |
| 2.       | The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control. | 58                | 38 | 0 | 0 | 4 |



| S/N      | Components and Principles of Internal Control   | Compliance Status |    |    |   |   |
|----------|---|-------------------|----|----|---|---|
|          |   | 1                 | 2  | 3  | 4 | 5 |
| 3.       | Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in pursuit of objectives.                   | 58                | 42 | 0  | 0 | 0 |
| 4.       | The bank demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.  | 38                | 50 | 12 | 0 | 0 |
| 5.       | The bank holds individuals accountable for their internal control responsibilities in pursuit of objectives.  | 35                | 58 | 7  | 0 | 0 |
| <b>B</b> | <b>Risk Assessment</b>  |                   |    |    |   |   |
| 6.       | The bank specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.                                      | 31                | 58 | 11 | 0 | 0 |
| 7.       | The bank identifies risks to the achievement of its objectives across the bank and analyzes risks as a basis for determining how the risks should be managed.           | 31                | 50 | 19 | 0 | 0 |
| 8.       | The bank considers the potential for fraud in assessing risks to the achievement of objectives.   | 58                | 32 | 0  | 0 | 0 |
| 9.       | The bank identifies and assesses changes that could significantly impact the system of internal control.  | 31                | 65 | 4  | 0 | 0 |
| <b>C</b> | <b>Control Activities</b>   |                   |    |    |   |   |
| 10.      | The bank selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.                      | 27                | 69 | 4  | 0 | 0 |
| 11.      | The bank selects and develops general control activities over technology to support the achievement of objectives.  | 32                | 61 | 7  | 0 | 0 |
| 12.      | The bank deploys control activities through policies that establish what is expected and procedures that put policies into  | 31                | 69 | 0  | 0 | 0 |
| <b>D</b> | <b>Information and Communication</b>  |                   |    |    |   |   |
| 13.      | The bank obtains or generates and uses relevant, quality information to support the functioning of internal control.  | 35                | 65 | 0  | 0 | 0 |
| 14.      | The bank internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control. | 35                | 58 | 7  | 0 | 0 |
| 15.      | The bank communicates with external parties regarding matters affecting the functioning of internal control.  | 19                | 62 | 11 | 4 | 4 |
| <b>E</b> | <b>Monitoring Activities</b>  |                   |    |    |   |   |

| S/N | Components and Principles of Internal Control   | Compliance Status |    |   |   |   |
|-----|---|-------------------|----|---|---|---|
|     |   | 1                 | 2  | 3 | 4 | 5 |
| 16. | The bank selects, develops, and performs on going and/or separate evaluations to ascertain whether the components of internal control are present and functioning.  | 35                | 58 | 7 | 0 | 0 |
| 17. | The bank evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the Board of Directors, as appropriate. | 35                | 65 | 0 | 0 | 0 |

COSO's 17 principles regarding internal control have been incorporated by BB in the revised guidelines on ICC 2016. Table 4.15 depicts that significant number of banks of our country could not be fully compliant with most of the principles. The matter should be considered by the concerned authority for smooth functioning and good governance of banks.

**Table 4.16: General information regarding audit and inspection unit of ICCD (% of banks)**

| Aspect  | Option          | 2020 | 2022 |
|---|-----------------|------|------|
| 1. Do you have separate Audit and Inspection unit?  | Yes             | 100  | 100  |
| 2. Did you assign separate executive as head of the unit?                                       | Yes             | 100  | 100  |
| 3. Satisfaction level about adequate number of manpower in this unit                            | (91-100)%       | 34   | 15   |
|   | (81-90)%        | 34   | 43   |
|   | (71-80)%        | 17   | 35   |
|   | Below 70%       | 15   | 7    |
| 4. Satisfaction level about the quality of manpower in this unit                                | (91-100)%       | 28   | 23   |
|   | (81-90)%        | 38   | 54   |
|   | (71-80)%        | 24   | 15   |
|   | Below 70%       | 10   | 8    |
| 5. As per your opinion, who should apprise the head of this unit?                               | Chairman of ACB | 54   | 70   |
|   | CEO/MD          | 4    | 0    |
|   | Head of ICCD    | 42   | 30   |
| 6. Does audit unit feel comfort to report ACB directly without involvement of the Head of ICCD? | Yes             | 59   | 69   |
| 7. Average number of manpower in each team  |                 | 2-5  | 3    |
| 8. Is there any incentive for audit team members?   | Yes             | 17   | 16   |
| 9. Range of daily allowance for the audit team member   | Max. Tk.:       | 7000 | 8000 |
|   | Min. Tk.:       | 400  | 490  |
| 10. Satisfaction level about delegated authority to perform duties                              | (91-100)%       | 52   | 48   |
|   | (81-90)%        | 45   | 52   |
|   | (71-80)%        | 3    | 0    |
|   | Below 70%       | 0    | 0    |

| Aspect   | Option                    | 2020 | 2022 |
|--|---------------------------|------|------|
| 11. Does audit team conduct surprise inspection based on findings of monitoring unit?  | Yes                       | 83   | 100  |
| 12. Does the audit team evaluate the service quality of the branch?  | Yes                       | 100  | 96   |
| 13. How many cases audit team has conducted an independent testing on the anti-money laundering and prevention of terrorist financing preparation of   |                           | 94   | 100  |
| 14. How many cases audit team has received the self-assessment report on anti-money laundering and prevention of terrorist financing in due time from the branch? (within next 15 days after six-month period) |                           | 85   | 88   |
| 15. To what extent was it possible for audit unit to evaluate the self-assessment report thoroughly?   |                           | 85   | 89   |
| 16. As per evaluation of audit unit, to what extent the self-assessment report   |                           | 83   | 79   |
| 17. How many cases, audit team has conducted surprise/immediate audit/inspection if any ML/TF risk of a branch is identified through   |                           | 42   | 26   |
| 18. Did audit team report the status of due and availed mandatory leave by the auditee?  |                           | 78   | 87   |
| 19. Did audit team report the status of job rotation/transfer/posting of the branch employee?  |                           | 82   | 91   |
| 20. How many cases, audit unit has conducted audit/inspection after the branch manager is transferred in the year?   |                           | 41   | 72   |
| 21. Have lapses been categorized as given in BB guidelines on ICC in the year?   | Yes, as per BB guidelines | 68   | 67   |
|  | Own customized policy     | 32   | 33   |
|  | No categorization         | 0    | 0    |

*Source: Survey data*

Internal audit (IA) is a vital unit of ICCD for onsite supervision. According to Table 4.16, all the banks have audit and inspection units along with separate head of the unit. However, they expect more skilled and efficient manpower in ICCD. Most banks had, on an average, 3 members in an audit team. About 30 percent banks feel discomfort to report ACB directly without involvement of the ICCD.

**Table 4.17: Audit & Inspection Unit of ICCD (% of banks)**

| S/N | Aspect of Audit Plan              | Option           | 2020 | 2022 |
|-----|-----------------------------------|------------------|------|------|
| 1.  | Time of preparation of audit plan | In previous year | 74   | 73   |
|     |                                   | In current year  | 26   | 27   |
| 2.  | Risk-based audit plan             | Yes              | 92   | 100  |
|     |                                   | No               | N/A  | 0    |
| 3.  | Format of branch audit rating     | As given by BB   | 48   | 38   |
|     |                                   | Customized       | 52   | 62   |

|    |  |           |           |          |
|----|--|-----------|-----------|----------|
| 4. | Implementation status of audit plan                                    | (91-100)% | 69        | 88       |
|    |  | (81-90)%  | 17        | 8        |
|    |  | (71-80)%  | 7         | 0        |
|    |  | Below 70% | 7         | 4        |
| 5. | Average time taken by the audit team to prepare an audit report (days) |           | 10 (0-30) | 11(0-26) |

*Source: Survey data*

All banks followed a Risk Based Audit (RBA) approach, according to BB guidelines. The implementation status of the audit plan was quite encouraging in the year 2022. About 88 percent of banks' implementation status of audit plan is in between 91-100 percent and the implementation status of audit plan has increased by 28% then 2020 (Table 4.17).

**Table 4.18: Format of the audit report (% of banks)**

| Aspect   | 2020 | 2022 |
|--|------|------|
| 1. Did you devise any prescribed format of audit report?                                   | 93   | 92   |
| 2. Is the format of audit report similar to the format given in BB Guidelines on ICC 2016? | 55   | 57   |
| 3. Average time to prepare audit report after audit of a unit (0-26)                       | N/A  | 11   |

*Source: Survey data*

As per Table 4.18, significant number of the banks have prescribed format of audit report. More than 50 % banks have customized the format of audit report given by BB.

**Table 4.19: Divisions/Departments of head office audited by IA (% of banks)**

| S/ N | Name of Division                | 2020 | 2022 |
|------|---------------------------------|------|------|
| 1.   | Board Division                  | 54   | 42   |
| 2.   | Treasury                        | 93   | 100  |
| 3.   | Human Resource Division         | 79   | 73   |
| 4.   | Risk Management Unit            | 57   | 73   |
| 5.   | Credit Risk Management Division | 82   | 84   |
| 6.   | Finance and Accounting Division | 89   | 76   |
| 7.   | International Division          | 85   | 92   |
| 8.   | ICT Division                    | 89   | 92   |

*Source: Survey data*

Table 4.19 shows that majority of banks do audit for most of the divisions of head office. Mostly audited division/department of head office is treasury and the lowest audited department is board division.

**Table 4.20: Identifying core risk management status of the audited branch  
(% of banks)**

| S/<br>N | Core Risk Area                       | 2020 | 2022 |
|---------|--------------------------------------|------|------|
| 1.      | Credit Risk Management               | 81   | 62   |
| 2.      | Asset-Liability Risk Management      | 78   | 50   |
| 3.      | Foreign Exchange Risk Management     | 78   | 62   |
| 4.      | Internal Control and Compliance Risk | 77   | 62   |
| 5.      | Money Laundering Risk                | 81   | 69   |
| 6.      | Information and Communication Risk   | 74   | 65   |

**Source:** Survey data

ICCD may show an important role in risk management through the identification of risk and placing recommendations. Table 4.20 depicts that a significant number of banks' audits appraised the position of the core risks during an audit.

**Table 4.21: Impact of internal audit (IA) on the performance of banks**

| S/N | Components   |                                    | 2020 | 2022 |
|-----|--|------------------------------------|------|------|
| 1.  | Do you think that there is a relationship between quality of IA and bank performance?                                |                                    | 100  | 100  |
| 2.  | Do you think that a strong IA system may have some negative impact on bank performance?                              |                                    | 14   | 19   |
| 3.  | Do you think that a strong IA system may have some positive impact on bank performance?                              |                                    | 96   | 100  |
| 4.  | Do you think that it is possible to measure the impact of IA on the performance of bank                              |                                    | 79   | 85   |
| 5.  | Do you measure the impact of IA on bank-performance for a period separately?   | (a) Not possible to measure record | 10   | 15   |
|     |  | (b) Possible but never measured    | 55   | 73   |
|     |  | (c) Rarely measured                | 21   | 4    |
|     |  | (d) Regularly                      | 14   | 8    |
| 6.  | Do you think that it is possible to measure total cost required for conducting internal audit activities separately? |                                    | 93   | 96   |
| 7.  | Do you measure total cost incurred for conducting IA/overall ICCD activities for a period separately?                | (a) Not possible to measure cost   | 7    | 0    |
|     |  | (b) Possible but never measured    | 64   | 80   |
|     |  | (c) Rarely measured                | 7    | 8    |
|     |  | (d) Regularly/Always               | 22   | 12   |
| 8.  | Do you think that sanctioning credit/investment may be reduced if there is a very strong IA system in a bank?        |                                    | 39   | 35   |
| 9.  | Do you think that it is possible to retain record of rejected credit/investment proposals                            |                                    | N/A  | 92   |

| S/N | Components  |   | 2020 | 2022 |
|-----|---|---|------|------|
| 10. | Do you retain the record of rejected credit/ investment proposal due to audit objection?  | (a) Not possible to maintain record                     | 4    | 12   |
|     |   | (b) Possible but never retained record                  | 56   | 54   |
|     |   | (c) Rarely retained record                              | 19   | 17   |
|     |   | (d) Regularly   | 21   | 17   |
| 11. | Do you think that customers may switch over from a bank having a strong IA to a bank with lenient IA?                           | (a) It may happen generally                             | 3    | 4    |
|     |   | (b) It may happen for customers with bad intention only | 72   | 77   |
|     |   | (c) It may be for insignificant no. of customers        | 7    | 11   |
|     |   | (d) It may not happen                                   | 18   | 8    |
| 12. | Do you think that a strong IA system may be an obstacle for providing prompt and better customer services to the valued client? |   | 7    | 8    |

*Source: Survey data*

Although there is no direct relationship of internal audit (IA) and financial performance of banks, IA may have a positive role in achieving sustainable growth of a bank. Table 4.23 shows the response of the banks on various issues relating to the role of internal audit on banks' performance. All banks opine that IA system has a positive impact on the performance of the bank.

**Table 4.22: Concurrent audit (%)**

| S/N | Aspect                               |                                   | 2020 | 2022 |
|-----|--------------------------------------|-----------------------------------|------|------|
| 1.  | Banks having concurrent audit system |                                   | 18   | 32   |
| 2.  | Nature of concurrent audit           | Physical                          | 100  | 75   |
|     |                                      | ICT                               | 0    | 25   |
| 3.  | Nature of concurrent auditor         | ICCD Employees                    | 80   | 85   |
|     |                                      | Outsourced from other departments | 20   | 15   |
|     |                                      | Outsourced from outside bank      | 0    | 0    |
| 4.  | Reporting line of concurrent auditor | Head of ICCD                      | 50   | 46   |
|     |                                      | Head of IA                        | 50   | 50   |
|     |                                      | Others                            | 0    | 4    |

*Source: Survey data*

Though the concept of concurrent audit has been included in the BB guidelines on ICC, it has not been extensively practiced in banks. Table 4.22 shows that 32 percent banks have established concurrent audit system in 2022 which was 18 percent in 2020. Concurrent audit can be applied in two ways, such as physical concurrent audit and ICT based concurrent audit. Gradually ICT based concurrent audit has been increased. 25 percent banks had implemented ICT based concurrent

in 2022 and 85% banks had conducted concurrent audit by the employees of ICCD. No bank outsourced concurrent auditor from outside the bank.

**Table 4.23: Information System Audit**

| S/N | Aspect   |                                  | 2020 | 2022 |
|-----|--|----------------------------------|------|------|
| 1.  | Banks having separate Information System audit under ICCD (% of banks) |                                  | 96   | 96   |
| 2.  | Nature of Information System auditor                                   | ICCD Employees                   | 88   | 92   |
|     |  | Outsourced from other department | 8    | 4    |
|     |  | Outsourced from outside bank     | 0    | 0    |
|     |  | Conducted by other unit of bank  | 4    | 4    |
| 3.  | Reporting line of Information System audit                             | Head of ICCD                     | 50   | 54   |
|     |  | Head of IA (Audit)               | 50   | 46   |
| 4.  | Average number of information system auditors in a bank                |                                  | 3    | 3    |

*Source: Survey data*

In today's era, banking operations are highly dependent on information systems (IS). However, this system may create vulnerability for a bank. And so, information systems audit is valued by the regulatory body and top management of the banks. The majority of the banks conducted IS audit by the employees of ICCD and the average number of IS auditors in a bank was three (Table 4.22). Nowadays, a good number of banks are providing laptops to auditors and the situation is improving (Table 4.24). Some of the banks are using specialized audit software and significant number of banks believe that automation will be beneficial for them (Table 4.25).

**Table 4.24: ICT facilities for internal auditor**

| S/N | Aspect   |  | 2020 | 2022 |
|-----|--|--|------|------|
| 1.  | Banks providing laptop facilities for the auditors | For each auditor                       | 65   | 70   |
|     |  | Not for each auditor but for team only | 30   | 26   |
|     |  | Not for auditor or team                | 05   | 04   |

*Source: Survey data*

**Table 4.25: IA Automation**

| S/N | Aspect  | Positive Response (%) |      |
|-----|---|-----------------------|------|
|     |   | 2020                  | 2022 |
| 1.  | Did IA use any specialized separate software? (e.g., TeamMate+, ACL, IDEA, Tahqiq, etc.)      | 29                    | 30   |
| 2.  | Integration of the software with core banking software (those are using specialized software) | N/A                   | 50   |
| 3.  | Do you believe that audit automation will bring benefits for banks?                           | 85                    | 94   |
| 4.  | Do you believe that audit automation will bring benefits for your bank?                       | 96                    | 65   |

*Source: Survey data*

**Table 4.26: General information regarding monitoring unit of ICCD (% of banks)**

| S/N | Aspect   |                 | 2020 | 2022 |
|-----|--|-----------------|------|------|
| 1.  | Banks having separate Monitoring unit for off-site surveillance                  |                 | 100  | 100  |
| 2.  | Banks having separate executive assigned as the head of the unit                 |                 | 90   | 92   |
| 3.  | Satisfaction level about adequate number of manpower in the unit                 | a. (91-100)%    | 17   | 15   |
|     |  | b. (81-90)%     | 38   | 35   |
|     |  | c. (71-80)%     | 24   | 30   |
|     |  | d. Below 70%    | 21   | 20   |
| 4.  | Satisfaction level about quality of manpower for effective off-site surveillance | a. (91-100)%    | 31   | 42   |
|     |  | b. (81-90)%     | 45   | 35   |
|     |  | c. (71-80)%     | 17   | 15   |
|     |  | d. Below 70%    | 7    | 8    |
| 5.  | The head of Monitoring unit should be appraised by                               | a. Chairman of  | 10   | 8    |
|     |  | b. CEO/MD       | 17   | 12   |
|     |  | c. Head of ICCD | 73   | 80   |

*Source: Survey data*

The monitoring unit performs as a watch tower of the overall control system of the bank. At this moment, all banks have separate monitoring units under ICCD (Table 4.26). Most of the banks (more than 90%) have assigned separate executives as the head of the unit. About 80 percent of banks believe that the head of the monitoring unit should be appraised by the head of ICCD.

**Table 4.27: Quarterly Operations Report (QOR) of the branch (% of banks)**

| S/N | Aspect   | 2020 | 2022 |
|-----|--|------|------|
| 1.  | How many cases banks have received a copy of Quarterly Operations Report (QOR) on time (10th day of next month) from each Branch/Centre? | 88   | 91   |
| 2.  | To what extent, it was possible for banks to evaluate the Quarterly Operations Report thoroughly?  | 89   | 92   |
| 3.  | As per your evaluation, to what extent the Quarterly Operations Report show true picture?  | 87   | 84   |
| 4.  | Did you prepare the Exception Report, if necessary   | 32   | 61   |

*Source: Survey data*

QOR is an important tool of ICS. Table 4.27 depicts the current status of the QOR of the branch. However most of the banks timely receive the QOR from concerned branches, but some banks do not receive the report accordingly. ICCD evaluates the QOR to assess the strength and identify weaknesses of the reporting branch. Around in 84 percent cases, the banks find the QOR as accurate.



**Table 4.28: Determinants of the Effectiveness of Monitoring Unit (%)**

| S/N | Aspect  | Options               | 2020 | 2022 |
|-----|---|-----------------------|------|------|
| 1.  | Is it possible to develop a Customized Dashboard for close and timely monitoring by the different layers of bank management?                            | a. Yes                | 96   | 96   |
|     |   | b. No                 | 4    | 4    |
| 2.  | Do you have any online surveillance system covering all branches under monitoring unit?   | a. Yes                | 21   | 38   |
|     |   | b. No                 | 48   | 62   |
|     |   | c. No but have a plan | 31   | 0    |
| 3.  | Do you think that an audit system should be supported by a strong monitoring unit?  | a. Yes                | 100  | 100  |
|     |   | b. No                 | 0    |      |
| 4.  | Do you think that an online surveillance system covering all branches is less costly and more effective than frequently physical audit of the branches? | a. Yes                | 76   | 65   |
|     |   | b. No                 | 24   | 35   |
| 5.  | Do you have a software-based evaluation system for reviewing QOR, LDCL, and DCFCL?  | a. Yes                | 0    | 4    |
|     |   | b. No                 | 62   | 56   |
|     |   | c. No but have a plan | 38   | 40   |
| 6.  | Do you think that an online surveillance system covering all branches under the monitoring unit may be complementary to the concurrent audit?           | a. Yes                | 80   | 92   |

*Source: Survey data*

For making the monitoring unit a watchdog, most of the banks think that it is possible to develop a customized dashboard (Table 4.28). A significant improvement has taken place in the online surveillance system covering all branches under the monitoring unit. Some banks have a plan for a software-based evaluation system for reviewing QOR, LDCL, and DCFCL. It is argued that a strong online surveillance system may be complementary to audit which may reduce the time for conducting physical audits of the branches.

**Table 4.29: General information regarding compliance unit of ICCD  
(% of banks)**

| S/<br>N | Aspect  |           | 2020 | 2022 |
|---------|---|-----------|------|------|
| 1.      | Banks having separate Compliance unit                                 |           | 100  | 100  |
| 2.      | Banks having separate executives assigned as the head of the unit     |           | 72   | 96   |
| 3.      | Satisfaction level about the adequate number of manpower in this unit | (91-100)% | 17   | 27   |
|         |   | (81-90)%  | 52   | 43   |
|         |   | (71-80)%  | 17   | 15   |
|         |   | Below 70% | 14   | 15   |

|    |   |                    |    |    |
|----|---|--------------------|----|----|
| 4. | Satisfaction level about quality of manpower for effective follow-up of compliance              | (91-100)%          | 28 | 46 |
|    |   | (81-90)%           | 52 | 38 |
|    |   | (71-80)%           | 10 | 8  |
|    |   | Below 70%          | 10 | 8  |
| 5. | ICCD of bank reports the compliance status of new internal/external regulatory issue/circular   |                    | 96 | 88 |
| 6. | Banks having online system for checking compliance with audit recommendations by concerned unit |                    | 42 | 65 |
| 7. | The head of Compliance unit should be appraised by  | a. Chairman of ACB | 10 | 8  |
|    |   | b. CEO/MD          | 7  | 11 |
|    |   | c. Head of ICCD    | 83 | 73 |

*Source: Survey data*

The compliance unit of ICCD is responsible for follow-up and report compliance with audit observation, both internal and external. After receiving observations from auditors, the unit usually interacts with the concerned auditee and compiles the compliance status. Table 4.29 depicts the general information regarding the compliance unit of ICCD. All of the banks have separate compliance units under ICCD. However, the head of ICCD expects more skilled manpower in this unit. Most of the banks think that the performance of the unit should be assessed by the head of ICCD. It is portrayed in Table 4.30 that a good number of banks store and keep track of all regulations and circulars in ICCD. Besides, ICCD takes responsibility for distributing all regulations and circulars to related units of banks.

**Table 4.30: Compilation and dissemination of directives and regulations  
(% of banks)**

| S/N | Aspect  | 2020 | 2022 |
|-----|---|------|------|
| 1.  | Banks maintaining all regulations and circulars in ICCD                   | 79   | 73   |
| 2.  | Banks distributing all regulations and circulars to related units by ICCD | 71   | 84   |

*Source: Survey data*

## 4.2. Summary Outcome of FGD and Interviews

Besides the questionnaire survey, the review team shared views with some top management of banks and the head of internal audit. The top management is now trying to deploy some professional accountants and skilled manpower in ICCD. They do not consider the ICCD to be a cost centre rather they feel that this department is supporting minimizing cost and maximizing revenue. They believe that ICCD especially IA works to protect the interest of the bank. Nowadays, BoD and top management review the activities of internal audits to make them effective.

Top management expects that IA should not conduct only traditional tasks rather they will contribute to value addition in the bank. IA should make their plan properly, act proactively and communicate regularly, as opined by a CEO.

The heads of ICCD and IA strongly believe that “tone at the top” is the main determinant of an effective internal control system. The tone at the top creates and demonstrates the cultural environment and corporate values of a company. In some banks, the head of ICCD and IA expressed their satisfaction regarding support and guidance of the BoD and CEO. Some of the them are exercising independency for reporting however, some others are not. Because of control mechanisms accommodated in the core-banking system, some of the irregularities have been reduced drastically. Nevertheless, asset-quality did not improve accordingly. Appraisal and approval process of large loan and monitoring system thereof are not changing positively. There is some improvement in regard to information system audit (ISA) as shared by the executives.

One of the executives stated that the virtual workplace concept has flourished during Covid-19 pandemic tremendously. As a result, working from home through an online portal gave employees flexibility and comfort but time spent in virtual meetings (through Zoom, Microsoft Teams, Google Meet, etc.) increased exponentially. In the new normal scenario, banks are using virtual platforms for large online gatherings of employees and customers for training (e.g. hand on the training of ICC tools on DCFCL, LDCL and QOR) and for promoting awareness (e.g. ethical banking practice, cyber security awareness, service standard etc.).

Further, it is expressed that digitization of converting physical documents into digital formats, such as PDF, JPEG, or DOC files by way of scanning or taking pictures and saving them as digital files that are stored, accessed, and shared electronically, is a widespread reality. Even the central bank, BSEC and court accept digital documents as evidence subject to some conditions. As a result of keeping digital documentation and online banking through core banking software, ICC culture has also transformed. Nowadays, internal auditors can complete their entire audit testing, interviews, evidence collection and reporting online. On the other hand, auditees can ensure compliance digitally and communicate a clear certificate of rectification to the central compliance division through online. Banks now keep audit findings/observations in digital platforms sequentially – year-wise, branch-wise and division-wise. As a result, various analytics like responsibility metrics of who, what, when, how and amount responsible can be traced out easily

that in turn helps effective compliance, i.e. the auditee know exactly what is needed to do for compliance and can follow up on whether the system updates the compliance they have submitted.

Banks are implementing eKYC, expediting screening, enhancing transaction monitoring, and automating alert handling to control money laundering, enhance trade screening and reduce manual work. This way banks are improving risk mitigation and compliance culture to avoid penalties imposed by the central bank for noncompliance.

Finally, the heads of ICCD and IA recommended placing the right people in the right place in the banking sector. They expect that concerned regulators will re-think the assigned duties of IA regarding cash inventive, and tax & VAT certification on a population basis. In this regard, business unit may certify on a population basis however, IA may check on a sample basis.

While sharing with the branch manager and operational executive, a good number of issues have been discussed. Business executives are appreciating the activities of IA. They feel that IA helps them to mitigate irregularities or to take corrective actions. Conflict between business unit and IA has been minimize and supportive environment has been established. They opine that IA process and mechanism, and the knowledge and skill of the auditors have been increased. Generally, branch managers do not commit major violations only minor lapses are repeated which are regularized with the passage of time. There are some improvements in regard to job rotation and mandatory leave however, manpower constraint is the main hindrance for full compliance. Internal control tools like DCFCL, QOR, and LDCL can play a vital role. Considering the business environment and banking activities, the authority may think to amend some points in these tools. Considering the centralized and de-centralized banking environment, different approaches of IA should be designed. For improving moral values and ethics in the banking industry, a long-term vision may be set and some initiatives should be taken accordingly.

## **5. Issues and Recommendations**

### **5.1 Supervisory Rating of the Banks**

The strength of the banking system can be assessed by examining the CAMELS rating in general and ICC rating in particular for evaluating the quality of ICC operations. The study like the previous few years did not find any bank belonging to the highest category i.e with a rating of 1 neither under CAMELS rating nor in

ICC as a core risk management rating indicator. Both these ratings rather deteriorated in 2022 as compared to 2020 amidst an increasing degree of prudential regulations and level of awareness about the necessity of ICC in Banks. With a large number of banks working in a competitive environment, one would expect the presence of at least a few banks in the top-ranked category which is still not being observed in our banking industry. So, rather than remaining satisfied with the current supervisory rating, we should investigate the root causes behind the relatively weak rating of our banking industry for elevating the performance of the banking industry.

## **5.2 Automation of Internal Audit**

The nature and mode of banking operations have experienced radical transformation through the adoption of digital technology. The increasing volume and complexity of banking services makes it almost impossible for auditors to accomplish their tasks adequately through traditional on-site based audit. Off-site surveillance using specialized ICT based software increases the coverage of audit and reduces the time lag between occurrence and detection of deviation. Real time audit adds value to the management much more than the physical audit as the detection of the deviation or the problem at an early stage produces less loss or reduces the probability of the occurrence of an undesirable event. So, banks need to strike the right balance between adopting and implementing the ICT-based IA and conventional surveillance systems for making internal audits more effective.

## **5.3 Corporate Governance**

The tone at the top sets forth a bank's internal control environment and corporate values. Constituting a sound and vibrant internal control environment is the primary responsibility of the board and top management. Any forbearance or compromise with the industry's best practice by the board or top management itself gives a negative signal to the lower-level management that affects the compliance culture and makes the internal control system weak. So, an effective ICS will not be established without ensuring a proper governance structure that demonstrates a strong commitment to the rules of the game, integrity and ethical values.

#### **5.4 Credibility of the Regulations**

Regulation per se does not produce desirable outcomes unless there is compliance with the regulations. A careful examination of the ICC guidelines, let alone the other broad ranges of prudential norms demands considerable effort by the bank management including the board in ensuring compliance with all the requirements. There is reason to believe that banks are not in a position or meticulously follow all the instructions given in the core risk management guidelines among which ICC Guideline is one. Now the question is what should be the position of the regulators? What should be the level of forbearance/ tolerance or how long should be the transitional period? Lack of policy credibility sometimes may be more harmful in the long run than the forbearance cost associated with allowing the lack of compliance for an indefinite period.

#### **5.5 Establishing Credit Discipline in all Types of Loans**

A well-functioning internal control system demonstrates the same or identical level of treatment for all types of loans irrespective of the person i.e insider or outsider, size of the exposure and so on. Keeping all but few large borrowers under the control measures ultimately makes the bank vulnerable as the loss resulting from large loans given to insider and connected party without maintaining the proper credit discipline can turn an otherwise strong bank to a distressed bank within a short span of time.

#### **5.6 Effective Use of ICS Tools**

DCFCL, QOR, LDCL are some important tools of ICS. However, in some cases, these are not effectively working. Different aspects of these tools may be reviewed to ensure applicability in this banking environment. On the other have, automation of these tools may improve their effectiveness.

#### **5.7 Establishing Customized Dashboard**

For real monitoring, detection of irregularities and taking corrective actions immediately after occurrence, bank-management should establish customized dashboard. Some of the banks have already materialized the concept. Abnormality detection through alarm or flag raising, and application of various analytical tools from different dimensions will be possible by this system.

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## Appendix I

### List of Responded Banks

| S/n | Name of Bank                              | Respond in 2020 | Respond in 2022 |
|-----|---|-----------------|-----------------|
| 1.  | AB Bank Limited                           | 1               | 1               |
| 2.  | Agrani Bank Limited                       | 1               | 1               |
| 3.  | Al-Arafah Islami Bank Limited             | 1               | 1               |
| 4.  | Bangladesh Development Bank Limited       | 1               | 0               |
| 5.  | Bangladesh Krishi Bank                    | 1               | 1               |
| 6.  | Bank Asia Limited                         | 1               | 1               |
| 7.  | BRAC Bank Limited                         | 1               | 1               |
| 8.  | Dhaka Bank Limited                        | 1               | 0               |
| 9.  | Dutch-Bangla Bank Limited                 | 1               | 1               |
| 10. | Eastern Bank Limited                      | 1               | 0               |
| 11. | Export Import Bank of Bangladesh Limited  | 1               | 1               |
| 12. | First Security Islami Bank Limited        | 1               | 1               |
| 13. | Global Islami Bank Ltd.                   | 1               | 1               |
| 14. | IFIC Bank Limited                         | 1               | 0               |
| 15. | Islami Bank Bangladesh Limited            | 0               | 1               |
| 16. | Jamuna Bank Limited                       | 1               | 1               |
| 17. | Meghna Bank Limited                       | 0               | 1               |
| 18. | Mercantile Bank Limited                   | 1               | 1               |
| 19. | Mutual Trust Bank Limited                 | 1               | 1               |
| 20. | National Bank Limited                     | 1               | 1               |
| 21. | National Credit and Commerce Bank Limited | 1               | 0               |
| 22. | NRB Bank Limited                          | 0               | 1               |
| 23. | NRB Commercial Bank Limited               | 1               | 1               |
| 24. | Prime Bank Limited                        | 0               | 1               |
| 25. | Pubali Bank Limited                       | 1               | 0               |
| 26. | Repali Bank Limited                       | 1               | 0               |
| 27. | Social Islami Bank Limited                | 1               | 1               |
| 28. | Sonali Bank Limited                       | 1               | 1               |
| 29. | SBAC Bank Limited                         | 1               | 1               |
| 30. | Southeast Bank Limited                    | 1               | 1               |
| 31. | State Bank of India                       | 0               | 1               |
| 32. | The City Bank Limited                     | 1               | 1               |
| 33. | The Premier Bank Limited                  | 1               | 1               |
| 34. | Trust Bank Limited                        | 1               | 1               |
| 35. | Union Bank Limited                        | 1               | 1               |
| 36. | United Commercial Bank Limited            | 1               | 1               |
| 37. | Uttara Bank Limited                       | 1               | 0               |
| 38. | Uttara Bank Limited                       | 0               | 1               |
|     | <b>Total (n)</b>                          | <b>32</b>       | <b>30</b>       |

## Appendix II

### List of FGD Participated Banks

| S/n                   | Name of Bank                             | Number of Participant | S/n | Name of Bank  | Number of Participant |
|-----------------------|--|-----------------------|-----|---|-----------------------|
| 1.                    | AB Bank Limited                          | 1                     | 2.  | National Bank Limited                                 | 1                     |
| 3.                    | Al-Arafah Islami Bank Limited            | 2                     | 4.  | National Bank of Pakistan                             | 1                     |
| 5.                    | Bangladesh Development Bank Limited      | 1                     | 6.  | ONE Bank Limited                                      | 1                     |
| 7.                    | Bangladesh Krishi Bank                   | 1                     | 8.  | Padma Bank Limited                                    | 1                     |
| 9.                    | Bank Alfalah Bangladesh                  | 1                     | 10. | Pubali Bank Limited                                   | 1                     |
| 11.                   | Bank Asia Limited                        | 3                     | 12. | SBAC Bank Limited                                     | 2                     |
| 13.                   | BASIC Bank Limited                       | 1                     | 14. | Shahjalal Islami Bank Limited                         | 2                     |
| 15.                   | BRAC Bank Limited                        | 2                     | 16. | Shimanto Bank Limited                                 | 1                     |
| 17.                   | Community Bank Bangladesh Limited        | 1                     | 18. | Social Islami Bank Limited                            | 2                     |
| 19.                   | Dutch-Bangla Bank Limited                | 1                     | 20. | Sonali Bank Limited                                   | 1                     |
| 21.                   | Eastern Bank Limited                     | 2                     | 22. | Southeast Bank Limited                                | 1                     |
| 23.                   | Export Import Bank of Bangladesh Limited | 1                     | 24. | Standard Bank Limited                                 | 1                     |
| 25.                   | First Security Islami Bank Limited       | 1                     | 26. | State Bank of India                                   | 1                     |
| 27.                   | Global Islami Bank Ltd.                  | 1                     | 28. | The City Bank Limited                                 | 1                     |
| 29.                   | IFIC Bank Limited                        | 1                     | 30. | The Hongkong and Shanghai Banking Corporation Limited | 1                     |
| 31.                   | Islami Bank Bangladesh Limited           | 3                     | 32. | Union Bank Limited                                    | 1                     |
| 33.                   | Janata Bank Limited                      | 1                     | 34. | United Commercial Bank Limited                        | 1                     |
| 35.                   | Meghna Bank Limited                      | 1                     |     |   |                       |
| <b>Total (n) = 45</b> |  |                       |     |   |                       |

## Appendix-III

### Observations and Issues Raised in Previous ICC Review Paper of BIBM

| S/n | Recommendations   |
|-----|---|
| 1   | Bank may think about strengthening off-site surveillance using ICT including customized dashboard   |
| 2   | Bank should establish a system for proper appraisal of ICCD Activities  |
| 3   | For getting desired result, banks should have a manpower planning, in details, for ICCD   |
| 4   | Bank management may think to use ICC Health Report for decision making  |
| 5   | Ensuring effective internal control environment is a must by demonstrating a commitment to integrity and ethical values by the BoD and SMT  |
| 6   | Status of supervisory rating (CAMEL and ICC) is not an encouraging one for whole industry   |
| 7   | Higher ranked executive should be posted as the head of ICCD (Not more than two step below to the CEO as a regulatory requirement)          |
| 8   | Banks should maintain database on cost and impact of IA/ICCD  |
| 9   | Customization of policy by the individual banks without violating the spirit of BB regulations is desirable                                 |
| 10  | Bank may think about audit automation by using specialized software   |
| 11  | Independent observations of external auditors on ICS and IA would not become effective  |
| 12  | Integration of different units of ICCD (audit, monitoring & compliance) is essential for smooth functioning                                 |
| 13  | Revision and clarification of ICC Guidelines by BB and credibility of the regulations   |
| 14  | There is a lack of corporate culture and it is essential to ensure de jure and de facto freedom of the top management (the tone at the top) |
| 15  | Punitive actions should be taken against wrongdoer and credit discipline in all types of loans.   |
| 16  | Effective use of ICS tools  |

**Source:** Survey data

# **Bangladesh Institute of Bank Management**

Plot No.-4 Main Road No.-1(South), Section No. - 2, Mirpur, Dhaka - 1216

Tel: 48032091-4; 48032097-8; 48032104; email: [office@bibm.org.bd](mailto:office@bibm.org.bd); Website: [www.bibm.org.bd](http://www.bibm.org.bd)