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Subject: Comments on the consultative document on The Internal Audit Function in Banks
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Attachments: [Annexure I - Comments on The Internal Audit Function in Banks.docx](#)

27 February 2012

Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements,
CH-4002
Basel
Switzerland

Subject: Comments on the consultative document on *The Internal Audit Function in Banks*

Dear Sir/ Madam:

The Institute of Chartered Accountants of Pakistan (ICAP) is a professional body of Chartered Accountants in Pakistan, and represents accountants employed in public practice, business and industry, and the public and private sectors. ICAP has formed a forum for its female members called the Chartered Accountant Women's Forum (CAWF). As qualified professional women we take this opportunity to comment on the consultative document on *The Internal Audit Function in Banks* issued by the Basel Committee on Banking Supervision. Our comments are based on a thorough analysis and discussion, utilizing the professional skills of our management committee and women members. These individuals consist of experienced Chartered Accountants who are working in public accounting and audit management positions in small, medium and large multinational companies and in the banking sector as well as the regulatory authorities in Pakistan. Please note that this is the view of CAWF on the exposure draft and does not represent the combined view of ICAP and all its members.

The following are our major comments and observations. More detailed responses to the draft paper are included in Annexure-I.

1. Overall the document is very well written. We agree that internal audit function to be effective needs to be independent and objective and should possess professional competence and act with integrity in the discharge of its duties and responsibilities. We also agree that bringing the internal auditor under the audit committee or its equivalent gives the internal audit more independence from senior management.
2. The establishment of the internal audit functions centrally by the parent bank in

a group structure or holding company would help in exercising more control and would further enhance the effectiveness of internal audit.

3. We agree with the role of supervisory authorities in the supervision of internal audit function of a bank and also the impact of the supervisor's assessment of the internal audit function on its assessment of the bank's risk profile and on its own supervisory work.
4. We feel there is a need to include definitions part in the principles relating to the supervisory expectations relevant to the internal audit function. (Suggested definition of important terms is included at no. 21)
5. The meaning of "entity" in the draft paper should be made more clear and understandable and should include explanation whether it covers subsidiary companies or is it limited to branch network of a bank.

The CAWF welcomes the opportunity to discuss any or all of these recommendations with you.

Best Regards,

Huma Pasha FCA, CIA
Chairperson of Chartered Accountant Women's Forum
Pakistan

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| Principles relating to the Supervisory Expectations relevant to the Internal Audit Function | | | Annexure I |
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| No. | Principles | Comments of the Members of CAWF | Remarks by the Members of CAWF |
| 1 | An effective internal audit function independently and objectively evaluates the quality and effectiveness of a bank's internal control, risk management and governance processes, which assists senior management and the Board of Directors in protecting their organization and its reputation. | Agree with the principle. | This has made the independence of the internal audit function very strong. This area was previously covered in principle 3 of 2001 under which the internal audit function only assisted senior management and the board of directors and was part of the ongoing monitoring of the bank's system of internal controls. |
| 2 | The bank's internal audit function must be independent of the audited activities. This requires that the internal audit function has an appropriate standing within the bank, enabling internal auditors to carry out their assignments with objectivity. | Quality Assurance and Improvement program should be refer to in the main text of Principle 2 and that it should be mandatory. | Currently Quality Assurance and Improvement program are covered in the commentary point no 43 of Principle 9 and I quote "From time to time, the board of directors should consider commissioning an independent review of the internal audit function. Our view is that Quality Assurance and Improvement program should be part of Principal 2 and should be made mandatory. |
| 3 | Professional competence, including the knowledge and experience of each internal auditor and of internal auditors collectively, is essential to the effectiveness of the bank's internal audit function | Agree with the principle. | |
| 4 | Internal auditors should act with integrity | Agree with the principle. | |
| 5 | Each bank should have an internal audit charter that articulates the purpose, standing and authority of the internal audit function within the bank. | Principal 5 and 8 should be merged to read as follows: <i>"Each bank should have a permanent internal audit function and it should have a charter that articulates the purpose, standing and authority of</i> | |

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| | | <i>the internal audit function within the bank”.</i> | |
| 6 | Every activity (including outsourced activities) and every entity of the bank should fall within the overall scope of the internal audit function. | What is meant by “entity” in this principle and does it cover subsidiary companies or is it limited to branch network of a bank? | |
| 7 | The internal audit function should ensure adequate coverage of regulatory matters within the audit plan. | Principle be modified to read as follows: <i>“The internal audit plan should ensure adequate coverage of regulatory matters”.</i> | |
| 8 | Each bank should have a permanent internal audit function | Refer Principle 5 for comments. | |
| 9 | The bank’s board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control framework and internal audit function. | <p>“to work under the charter as stated in Principal 5” be added in Principal 9 and it should read as follows:</p> <p><i>“The bank’s board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control framework and internal audit function to work under the charter as stated in Principal 5”.</i></p> | <p>This was previously covered under principle 1 which ended with the following sentence:</p> <p>“At least once a year, the board of directors should review the internal control system and the capital assessment procedure.”</p> <p>This is now covered under commentary point 43 and we quote “At least once a year, the board of directors should review the effectiveness and efficiency of the internal control framework based, in part, on information provided by the internal audit function. Moreover, as part of their oversight responsibilities, the board of directors should review the performance of the internal audit function.” Our comments on mandatory QCR are covered under principle 2 above.</p> |

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| 10 | The audit committee, or its equivalent, should oversee the bank's internal audit function. | Agree with the principle. | Bringing the IA under the audit committee or its equivalent gives the IA more independence from senior management. |
| 11 | The head of the internal audit department should be responsible for ensuring that the department complies with sound internal auditing standards and with a relevant code of ethics. | <p>Principle 11 and 12 be merged to read as follows:</p> <p><i>"The head of the internal audit department should report to the audit committee or the board of directors and should be responsible for ensuring that the department complies with sound internal auditing standards and with a relevant code of ethics and should inform senior management about its findings".</i></p> | In the survey carried out in 2002, it appeared (point 14) that whistle blowing by IA compromised their functions. Here they have no choice but to report to the Audit Committee and the Board and also "inform" senior management. |
| 12 | The internal audit function should report to the audit committee or the board of directors and should inform senior management about its findings. | Refer principle 11 for comments. | |
| 13 | Internal audit should both complement and assess operational management, risk management, compliance and other control functions | The principle should include the word "function" after internal audit. | |
| 14 | The internal audit function in a group structure or holding company structure should be established centrally by the parent bank. | Agree with the principle. | |
| 15 | Regardless of whether internal audit activities are outsourced, the board of directors remains ultimately responsible for ensuring that the system of internal control and the internal audit function are adequate and operating effectively. | <p>"and as per the charter approved by the board of directors in principle 5" be added in principal 15 and it should read as follows:</p> <p><i>"Regardless of whether internal audit activities are outsourced, the board of directors remains ultimately responsible for ensuring that the system of internal control and the</i></p> | |

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| | | <i>internal audit function are adequate and operating effectively and as per the charter approved by the board of directors in principle 5".</i> | |
| 16 | Supervisors should have regular communication with the bank's internal auditors to: (i) discuss the risk areas identified by both parties, (ii) understand the risk mitigation measures taken by the bank, and (iii) monitor the bank's response to weaknesses identified. | Agree with the principle. | |
| 17 | Bank supervisors should regularly assess whether the internal audit function has an appropriate standing within the bank and operates according to sound principles. | Agree with the principle. | |
| 18 | Supervisors should formally report all weaknesses identified in the internal audit function to the board of directors and require remedial actions. | Agree with the principle. | |
| 19 | The supervisory authority should consider the impact of its assessment of the internal audit function on its assessment of the bank's risk profile and on its own supervisory work | Agree with the principle. | |
| 20 | The supervisory authority should be prepared to take informal or formal supervisory actions requiring senior management and the board to remedy any identified deficiencies related to the internal audit function within a specified timeframe and to provide the supervisor with periodic written progress reports. | Agree with the principle. | |
| 21 | | Other suggestions / comments | |
| | | The members of CAWF feel there is a need to include definitions part in the principles relating to the supervisory expectations relevant to the internal audit function. Suggested definition of important terms are as follows: | |

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| | | <p>Audited activities: means independent audit activities conducted by an internal audit function according to an approved charter.</p> <p>Supervisor: all authorities in accordance with their respective responsibility in relation to the supervision of the banking sector rather than necessarily by only one authority.</p> <p>Entity: Requires clarification from the Basel Committee on Banking Supervision, refer comment on principle 6.</p> | |
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