

# **RISK BASED INTERNAL AUDIT MANUAL 2075**



(RBIA Manual-2075)

**Approved by:**  
706<sup>th</sup> Board Meeting  
Held on 2075-05-20 (5<sup>th</sup> September, 2018)




# NCC Bank

नेपाल क्रेडिट एण्ड कर्मा बँक लि.  
Nepal Credit & Commerce Bank Ltd.

*Your Business Bank*

The Board Meeting No. 706<sup>th</sup>  
held on 2075.05.20 (5<sup>th</sup> September, 2018)  
has decided to approved, the  
**"RISK BASED INTERNAL AUDIT MANUAL-2075"**

  
2075/05/20



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## Contents

1.	Introduction to Manual .....	1
1.1	Need for Risk Based Internal Audit (RBIA) Manual .....	1
2.	Risk Based Internal Audit (RBIA).....	1
2.1	Meaning.....	1
2.2	Objectives of RBIA .....	1
2.3	Nature of Risks in Audit Process.....	1
2.4	RBIA procedural map.....	2
2.5	Types of Audit.....	3
2.5.1	Based on Site .....	3
2.5.2	Based on Nature / Function.....	3
2.6	Audit Techniques .....	4
2.7	Infrastructure for RBIA .....	4
2.8	Scope of IAD under RBIA .....	4
2.9	RBIA Stakeholders .....	5
2.10	RBIA towards organizational Goals achievement .....	5
3.	Resources for RBIA .....	5
3.1	IAD Staffing.....	5
❖	Staffing Structure of IAD.....	5
3.2	Need for Outsourcing.....	6
3.3	IAD References .....	6
3.4	Empowerment the IAD Staffs.....	6
▪	Internal Meeting.....	7
▪	Trainings .....	7
4.	Framework of RBIA Function.....	7
4.1	Risk Scoring & Grading Modality .....	7
4.2	Grading of Branches .....	7
4.2.1	Risk Assets (Loans & Advances).....	8
4.2.2	Deposit Liability .....	9
4.2.3	Age of Operation .....	10
4.2.4	Compliance Profile.....	10
4.2.5	Branch Management Profile .....	11
4.2.6	Previous Audit Score.....	11

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4.2.7	Judgmental Score and Risk Matrix .....	11
4.2.8	Audit Grading of Branches & Frequency of Audit .....	12
4.3	Audit Grading of Departments & Frequency of Audit.....	13
5.	Audit Unit Selection & Planning .....	13
5.1	Selection of Audit Unit .....	13
5.2	Annual Audit Plan .....	14
5.3	Time Planning .....	14
5.4	Manpower Planning .....	14
5.5	Change in Plan .....	15
6.	Audit Procedures.....	15
6.1	Specific Audit Program .....	15
6.2	Entry Meeting.....	15
6.3	Application of audit procedures and techniques .....	16
6.4	Exit Meeting.....	16
7.	Reporting.....	17
7.1	Quality Control Review.....	17
7.2	Reports to audit committee .....	17
7.3	Final Report .....	18
7.4	Follow Up.....	18
8.	Sampling Techniques.....	18
8.1	Branch Credit Sampling .....	18
8.1.1	New Credit Files.....	18
8.1.2	Non-Performing Credits.....	19
8.1.3	High Value Credit Files.....	19
8.1.4	Non Funded Facilities .....	19
8.2	Branch Operations Sampling .....	19
9.	Audit Documentation .....	19
9.1	Forms and Content of Documentation.....	20
9.2	Safe Custody, Retention and Assembly.....	20
9.3	Confidentiality .....	20
10.	Review and Amendment .....	20

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## 1. Introduction to Manual

### 1.1 Need for Risk Based Internal Audit (RBIA) Manual

Nepal Rastra Bank (NRB) has recently issued its Inspection and Supervision Bylaw 2074 and it focuses on risk-based supervision of Banks and Financial Institutions. It has also been stressing the importance of risk-based internal audit via Inspection Reports to Banks and Financial Institutions (BFIs). Additionally, NRB Directive-6, 2074, Clause 7 (2Cha) also requires Audit Committee to prepare an Internal Audit Guideline / Manual and accordingly perform the audit function.

In the recent years, the Modern Auditing Concepts also tend to have globally switched the focus from Conventional compliance audits to Risk-based audits.

For effective and efficient audit mechanism in the Bank and to be in line with NRB's inspection & supervision modality ensuring the more audit resources in relatively higher risk zone, Risk Based Internal Audit has been felt necessary to implement in NCC Bank.

## 2. Risk Based Internal Audit (RBIA)

### 2.1 Meaning

RBIA is internal methodology which focuses on the inherent risk of the activities or system of the audit unit and provides assurance that risk is being managed by the management within the defined risk appetite level. In other words, it is risk based audit that links internal auditing to an organization's overall risk management framework. Ultimately, RBIA is about identifying risk areas in audit, prioritizing audit units based on their riskiness and directing more audit resources towards relatively risky areas compared to low risk areas.

### 2.2 Objectives of RBIA

The objectives of RBIA manual are to:

- a. Provide independent assurance to the management about the adequacy and effectiveness of devised internal controls system, risks inherent in the business and control measures.
- b. Identify the potential risks and suggesting measures for their mitigation.
- c. Prioritize entire audit areas and employment of more audit resources towards high risk areas and vice-versa.
- d. Encourage risk – sensitive culture in the Bank
- e. Formulate risk based annual audit plans.
- f. Enable better risk monitoring and reporting system.
- g. Encourage the business by managing risk and ensuring compliance.
- h. Promote good corporate governance practices in the Bank etc.

### 2.3 Nature of Risks in Audit Process

An auditor shall assess the associated risk in audit process and stays alert for the inherent risk, control risk and detection risk while discharging his duty from the beginning to end of the assignment.

There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable levels of detection risk need to be low to reduce overall audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level.

Besides these, internal auditor shall have sound understanding of the following risks of the banking industry:

**a. Strategic Risk**

It is the possibility of loss or adverse effects that might arise from the pursuit of an unsuccessful or poor implementation of the plan.

**b. Legal / Compliance Risk**

It arises from non-compliance to legal / regulatory provisions including internal policies.

**c. Financial Reporting Risk**

It is the risk of failure to comply with financial reporting framework set by the Governing Body or a failure to make MIS reports as per decision maker needs on a timely manner.

**d. Staffing Risk**

It arises when principle of right man at right place within the organization structure is violated thereby resulting failure to achieve desired organizational objectives and strategic goals.

**e. Credit Risk**

It is the risk that funds lent would not be repaid on time or not being repaid in full as agreed upon initially with the Borrower.

**f. Market Risk**

It is the risk of possible loss from adverse movements in market prices. It could result from interest rate movements, foreign currency exposures and investments.

**g. Operational Risk**

It is the possibility of losses arising from poor procedures, people and systems in operations.

**h. Technology / System Risk**

It is the risk arising from systems and software with inadequate Controls.

## 2.4 RBIA procedural map



## 2.5 Types of Audit

Audit may be broadly classified as below:



Internal Audit Department (IAD) shall perform audit of Branches/Departments on both grounds as per need and risk in the audit unit.

### 2.5.1 Based on Site

#### A. Off-site Audit

As part of the RBIA, IAD shall plan for Off-site audit on a need basis. IAD shall continuously monitor Branches and Departments through the periodic returns, incident reports, MIS reports and other system generated reports.

Major objectives of Off-site audit shall be:

- To ensure better planning for on-site review.
- To ensure better quality and effectiveness of on-site review.
- To enable continuous monitoring of designated audit units.
- To get updated about the financial position / performance of the audit units.
- To monitor whether early warning signal and indicator is triggered, requiring special on-site review.
- To monitor whether audit units are operated within organizational risk appetite.
- To prepare an off-site audit report on the basis of the materiality and severity of the offsite findings.

#### B. On-site Audit

As part of RBIA, IAD shall make specific visits to the site of audit units [Branches / Departments] of the Bank. The frequency of on-site visits, procedures and other details shall be as stated in **Para #5**.

### 2.5.2 Based on Nature / Function

#### A. Compliance Audit

It aims for the reasonable assurance that there is compliance to relevant laws and regulations, regulatory directions circulars, internal policies / circulars etc.



**B. Performance Audit**

It aims to test economy, efficiency and effectiveness in functions and processes for the maximum return from input resource.

**C. Business Process Audit**

It aims to examine whether business processes are being conducted as per established procedures and prudent banking norms. It also involves checking whether bank personnel have appropriately exercised their authority in banking business processes.

**D. Internal Controls Audit**

It involves observation of system of internal controls in place of the audit units, effectiveness of their design and obtaining reasonable assurance that they are operating throughout the review period. It also involves identification of gap and control weaknesses (if any) in the business process and recommending improvements for efficient and effective operations.

**E. Post Implementation Audit**

It involves monitoring of implementation status of previous audit findings.

**F. Surprise Audit**

It involves audit of specific area(s) in the deliberately selected audit unit without any prior notice or indication of the auditor visit. It is non-routine in nature and is carried out to test the live application of internal control system and procedures in the audit unit.

**G. Forensic Audit / Investigation**

It involves in-depth audit of specific area(s) in the selected audit unit with a view to establish a fact and evidence. It is normally initiated when indication of any fraud or major lapses in the instilled controls system are observed and/or reported.

## 2.6 Audit Techniques

For performing the audits, the following techniques (but not limited to) shall be applied:

- a. Inquiry to personnel
- b. Observation of processes / Inspection of documents
- c. Re-calculation / Re-performance of processes
- d. External Confirmation
- e. Analytical Procedures
- f. Casting Checking
- g. Reconciliation Checking
- h. Physical Verification etc.

## 2.7 Infrastructure for RBIA

Switch over from Conventional audit to RBIA needs certain infrastructural support for effective implementation. Some of those are:

- a. Promotion of a risk sensitive organizational culture.
- b. Empowerment of IAD as one of the key control departments.
- c. Linkage of IAD reporting towards personnel and audit unit's appraisals.
- d. Support from those charged with Governance for implementation of RBIA.
- e. Provision of adequate internal audit manpower with sufficient knowledge and experience.

## 2.8 Scope of IAD under RBIA

Scope of Internal Audit Department under RBIA shall be as per the Internal Audit Policy 2075.

## 2.9 RBIA Stakeholders

The following are the inclusive stakeholders for RBIA reports of IAD:

- a. Concerned Branches & Departments
- b. Chief Executive Officer (CEO)
- c. Senior management and Heads of Department (HOD)
- d. Audit Committee and Board of Directors (BOD)
- e. Risk Department / Compliance Department
- f. Nepal Rastra Bank (NRB)
- g. External Auditors

## 2.10 RBIA towards organizational Goals achievement

Primary focus areas under RBIA include identifying, assessing and minimizing the risk of business process. It is also expected to help in devising more effective internal controls and corporate governance in place thereby allowing the organization to achieve its corporate goals in a more systematic and accountable manner.

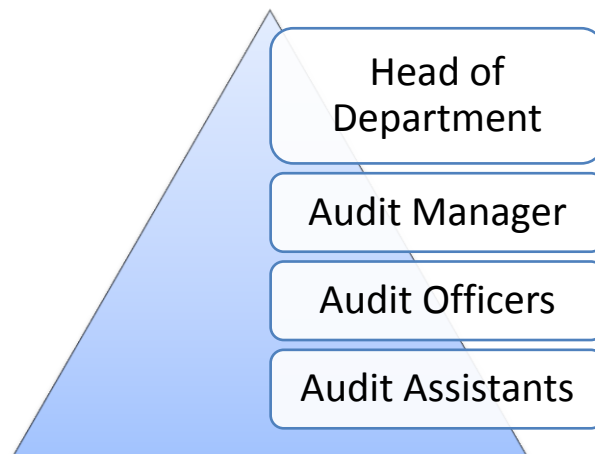
## 3. Resources for RBIA

### 3.1 IAD Staffing

Head IAD shall prepare the requirement of Human Resources with necessary qualification, skills and experience needed to execute the RBIA which shall be approved by Audit Committee of the Bank. Whenever deemed necessary, experts may also be hired for the special technical assignments with approval from competent authority. Staffs at IAD shall comply with the following basic principles during execution of their duties in IAD:

- a. Integrity
- b. Objectivity
- c. Confidentiality
- d. Professional Behavior
- e. Professional Competence and Due Care

### ❖ Staffing Structure of IAD



#### ▪ Head IAD

Head IAD shall be responsible for the entire affairs of the Department by meeting the requirements of compliance set by Nepal Rastra Bank (NRB) and other laws in effect. Responsibilities of Head IAD shall be as per the Internal Audit Policy 2075 of the Bank.

▪ **Audit Manager**

There shall be an Audit Manager designated by the Head IAD. Audit Manager shall be responsible for following activities:

- a. To act as the bridge between Head IAD and audit officers & assistant.
- b. To supervise the work of audit team.
- c. To review Draft reports prepared by the Audit Officers.
- d. To forward Draft Report to Head IAD for review before forwarding to concerned audit units.
- e. To finalize Audit Report after receiving reply from the audit unit and forward to Head IAD.
- f. To monitor periodic returns and MIS of the Branches and Departments as part of offsite audit.
- g. To supervise whether audit units are being audited as per approved audit plan.
- h. To keep the Department up to date in regards to internal and external Circulars / Directives.
- i. To assist Head IAD on other matters that Head IAD may, from time to time, ask for.

▪ **Audit Officers & Audit Assistants**

The primary jobs of audit officer and assistant are to perform internal audit and reporting under the supervision of audit manager. They shall work as per the designated audit program and plan. They shall always keep themselves updated about internal policy, manuals, circulars and the provision of NRB Directives and other relevant laws of the country which they require to refer to while discharging their duties. They shall apply the audit techniques and skill for effective audit.

Major responsibilities are to:

- a. conduct the audit of Braches and Departments as per plan and program.
- b. perform the audit per RBIA Manual.
- c. prepare the audit report.
- d. assist the Head IAD or Audit Manager on other matters deemed necessary for IAD.

### 3.2 Need for Outsourcing

Sometimes IAD may require performing specific and technical assignment for which it may not have expertise. Similarly, the available staff resource of IAD may not be sufficient for the adequate coverage of internal audit under RBIA framework. In such case, technical consultant, expertise or skill manpower can also be hired for meeting the resource gap in IAD.

### 3.3 IAD References

IAD shall refer to several documents and guidelines as a base for conduction of audit such as:

- a. NRB Directive associated Circulars, BAFIA, NRB Act, Company Act and other regulator publications.
- b. Internal Policies of NCC Bank Ltd., including Memos and other HR Circulars.
- c. Decisions of meetings of Board, Audit Committee and other Management levels.
- d. Decisions of meeting of IAD itself.
- e. Finance Act including Taxation laws – Income Tax Act, VAT Act etc.
- f. Internet & newspapers for latest banking news, developments in banking, risks etc.
- g. Nepal Financial Reporting Standards (NRFS) and Nepal Standards on Auditing (NSA).
- h. Prudent practices in Banking Industries.
- i. Other relevant local laws.

### 3.4 Empowerment the IAD Staffs

IAD shall empower its staffs through regular meetings and trainings.

- **Internal Meeting**

IAD shall conduct staff meeting on a weekly basis. All staffs except on outstation for on-site visits shall be present in the meeting. A person designated by Head IAD shall act as meeting secretary. Every meeting shall generally discuss on:

- a. Problems faced during audit.
- b. Sharing of findings relating to procedure, control system and compliance in the audit unit.
- c. Progress of work of audit manager, audit officers and audit assistants.
- d. Changes in laws / regulations, new circulars or internal memos issued etc.
- e. General and prudent banking practices.
- f. Pre-informed agenda(s), if any.
- g. Any other matters.

In order to be updated on the change in the external and internal regulation and procedures, presentations may be arranged in the weekly meetings so as to make clear and consistent understanding of new provisions and implication of such changes. Meetings may, sometimes be called on a non-routine schedule by the Head IAD considering severity and urgency of matter to be discussed.

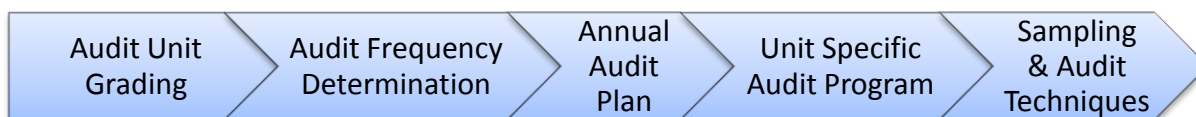
- **Trainings**

IAD shall empower its manpower through trainings relevant for audit. Head IAD shall, in coordination with Human Resource Department (HRD), arrange for trainings/workshop to empower IAD personnel.

## 4. Framework of RBIA Function

The basic principle of RBIA is focusing on using the available resources of IAD on to the high risk audit units. The functions of audit such as selection of audit unit, audit planning, execution of audit, reporting and follow up shall be carried out as per risk profile of the audit unit.

General frame of RBIA Function shall be as below:



### 4.1 Risk Scoring & Grading Modality

Unlike in Conventional Audit, under Risk-Based Internal Audit, all branches shall be graded by IAD based on broad parameters namely Risk, Volume and Issues in the business, operation, management, control system, housekeeping and result of off- site review. In fact, risk scores are calculated by IAD for planning and setting out the frequency of the audit so as to direct its eyes on the audit of high risk scoring Branches. Branches and Departments shall be separately graded as their function and nature are different to each other.

### 4.2 Grading of Branches

In order to grade, Branches shall be provided risk scores based on 6 different parameters. These parameters are Risk Assets (Loans & Advances), Deposit Liability, Age of Operation, Compliance Profile, Branch Management Profile and Previous Audit Score. Parameters considered risky and requiring more auditor's concentration, are provided higher weights and vice versa. Possible

room for judgment is designed only in few parameters having lower weights so as to ensure more systematic and more elaborative scoring.

The broad parameters and their weight for scoring are designed below:

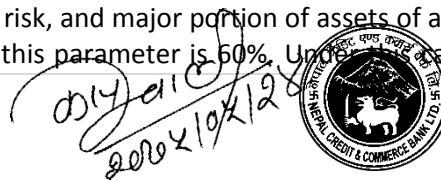
#### Branch Risk Scoring Model

SN	Parameter	Weight
<b>A</b>	<b>Risk Assets (Loans &amp; Advances)</b>	
<b>A.1</b>	<b>Volume of Risk Assets</b>	<b>30%</b>
<b>A.2</b>	<b>Portfolio Mix and Assets Quality</b>	<b>8%</b>
	i. Risk Assets Portfolio Mix	4%
	ii. Risk Assets Quality	4%
<b>A.3</b>	<b>Risk Assets Monitoring &amp; Housekeeping</b>	<b>12%</b>
	Loan Expiry Status	2%
	DP Update Status	2%
	Insurance Update Status	2%
	Interest Recovery Status	2%
	Status of loan documentation and filing	4%
<b>A.4</b>	<b>Volume of New Risk Assets in Last 12 Months</b>	<b>10%</b>
	<b>TOTAL OF (A)</b>	<b>60%</b>
<b>B</b>	<b>Deposit Liability</b>	
<b>B.1</b>	<b>Volume of Deposit</b>	<b>5%</b>
<b>B.2</b>	<b>Number of account</b>	<b>5%</b>
	i. Total No. of Accounts	3%
	ii. Active Accounts (% of Total account)	2%
	<b>TOTAL OF (B)</b>	<b>10%</b>
<b>C</b>	<b>Age of operation</b>	<b>5%</b>
<b>D</b>	<b>Compliance Profile</b>	
<b>D.1</b>	<b>KYC &amp; Account Opening Documentation</b>	<b>2%</b>
<b>D.2</b>	<b>Implementation Status of Previous Audit</b>	<b>2%</b>
<b>D.3</b>	<b>Internal Non-Compliances incl. Control issues</b>	<b>2%</b>
<b>D.4</b>	<b>External Non-Compliances [NRB, Other laws]</b>	<b>4%</b>
	<b>TOTAL OF (D)</b>	<b>10%</b>
<b>E</b>	<b>Branch Management Profile</b>	
<b>E.1</b>	<b>Branch Manager</b>	<b>2%</b>
<b>E.2</b>	<b>Second Man of the Branch</b>	<b>2%</b>
<b>E.3</b>	<b>Rotation of staffs Job /Branch meeting</b>	<b>2%</b>
<b>E.4</b>	<b>Quality of Audit Reply</b>	<b>2%</b>
<b>E.5</b>	<b>Response time to Audit</b>	<b>2%</b>
	<b>TOTAL OF (E)</b>	<b>10%</b>
<b>F</b>	<b>Previous Audit Score</b>	<b>5%</b>
<b>G</b>	<b>TOTAL (A to F)</b>	<b>100%</b>

The parameter and its weight for scoring is further divided by developing sub-parameters wherever deemed necessary, to ensure specific consideration for the particular business, process and the risks therein.

#### 4.2.1 Risk Assets (Loans & Advances)

Every asset has some amount of risk, and major portion of assets of a Branch is Risk Assets (RA). Hence Total weight assigned to this parameter is 60%. Under this category, the volume of RA,



portfolio mix of high risk nature RA, quality of RA, monitoring and housekeeping issues in RA management, and volume of new loan shall be considered for scoring of each branch. Accordingly, the total weight has been further sub-divided as detailed below:

1	Risk Assets (Loans & Advances)	Score Range	Weight	Weighted Score
<b>A</b>	<b>Total Volume of Risk Assets in the Branch</b>		<b>30%</b>	
a	More than and equal to 1 Billion	100		
b	Less than 1 and equal to 0.50 Billion	80		
c	Less than 0.50 and equal to 0.30 Billion	60		
d	Less than 0.30 and equal to 0.15 Billion	40		
e	Less than 0.15 Billion	20		
<b>B</b>	<b>Portfolio Mix &amp; Assets Quality</b>		<b>20%</b>	
<b>B.1</b>	<b>Risk Assets Portfolio mix</b>		<b>4%</b>	
a	For 60% and more	100		
b	Less than 60% and equal to 45%	80		
	Less than 45% and equal to 30%	60		
c	Less than 30%	40		
<b>B.2</b>	<b>Risk Assets Quality</b>		<b>4%</b>	
a	NPA above 1%	100		
b	NPA less than 1% and equal to 0.5%	80		
c	Less than 0.50%	40		
<b>B.3</b>	<b>Risk Assets Monitoring &amp; Housekeeping</b>		<b>12%</b>	
a	Loan Expiry Status	(0-100)	2%	
b	DP Update Status	(0-100)	2%	
c	Insurance Update Status	(0-100)	2%	
d	Interest Recovery Status	(0-100)	2%	
e	Status of loan documentation and filing	(25-100)	4%	
<b>C</b>	<b>Volume of New Risk Assets in Last 12 Months</b>		<b>10%</b>	
a	More than 0.50 Billion	100		
b	More than 0.30 Billion up to 0.50 Billion	80		
c	More than 0.10 Billion up to 0.30 Billion	60	10%	
d	More than 0.05 Billion up to 0.10 Billion	40		
e	Up to 0.05 Billion	20		
<b>Total Weight and Score for Risk Assets</b>			<b>60%</b>	

For B.3, there shall be link between the audit issues in the area of loan documentation and other credit issues and scores which shall also be provided by respective audit team on the basis of overall risk derived from the risk matrix.

#### 4.2.2 Deposit Liability

Considering the fact that volume of transaction and business process of a Branch also depends on deposit volume and number of accounts in that Branch, total weight of 10% is assigned to it. The weight has been further sub-divided into 2 sub-parameters viz. total volume of deposit liability in the branch [5% weight] and number of accounts [5% weight].

2	Deposit Liability	Score Range	Weight	Weighted Score
<b>A</b>	<b>Volume of Deposit</b>		<b>5%</b>	
	More than equal to 1 Billion	100		
	Less than 1.0 and more than equal to 0.70 Billion	80		
	Less than 0.70 and more than equal to 0.40 Billion	60		
	Less than 0.40 and more than equal to 0.15 Billion	40		
	Less than 0.15 Billion	20		
<b>B</b>	<b>Number of accounts</b>		<b>5%</b>	
<b>B.1</b>	<b>Total No. of Accounts</b>		<b>3.00%</b>	
	More than 12,000	100		
	Less than 12,000 and more than equal to 8,000	80		
	Less than 8000 and more than equal to 4000	60		
	Less than 4000 and more than equal to 1500	40		
	Less than 1500	20		
<b>B.2</b>	<b>Active Accounts (% of Total account)</b>		<b>2.00%</b>	
	More than 60%	100		
	Less than 60% and more than equal to 40%	80		
	Less than 40%	40		
<b>Total Weight and score for Deposit Liability</b>			<b>10%</b>	

#### 4.2.3 Age of Operation

The level of operational excellence and smoothness is generally expected higher in older branches whereas the same is lower in newly opened branches. Hence, higher score shall be provided to new branches and vice versa considering the fact of the need to keep newer branches under close monitoring.

3	Age of operation	Score Range	Weight	Weighted Score
	Newly open Branch	100		
	Less than 3 years and equal to 1 year	80		
	Less than 5 years and equal to 3 year	60	5%	
	Less than 7 years and equal to 5 year	40		
	More than equal to 7 years	20		
<b>Total Weight and score for Age of Operation</b>			<b>5%</b>	

#### 4.2.4 Compliance Profile

Total weight assigned to this parameter is 10%. The parameter is divided into 4 sub-parameters. Higher scores shall be provided where KYC/ account opening documentation are not properly maintained, compliance issues appears severe and implementation status of previous audit issues appears weak. Scoring under this category for each Branch shall be done by audit team of respective branch:

4	Compliance Profile	Score Range	Weight	Weighted Score
<b>A</b>	KYC & Account Opening Documentation	(25-100)	2%	
<b>B</b>	Implementation Status of Previous Audit	(25-100)	2%	

<b>C</b>	Internal Non-Compliances incl. Control issues	(25-100)	2%	
<b>D</b>	External Non-Compliances [NRB, Other laws]	(25-100)	4%	
<b>Total Weight and score for Compliance Profile</b>			10%	

#### 4.2.5 Branch Management Profile

Every business and process has certain risk but it is the branch management who is trusted to operate the business by managing the risk and ensuring compliance. Hence the structure and working culture of branch management is also considered for RBIA.

10% of total weight is assigned to this parameter. The parameter is again sub-divided into 5 sub-parameters where position of branch manager, position of branch second man, job rotation / effective of staff meeting/affair at branch, quality of reply to audit report and response time to audit have been considered as basis for scoring.

<b>5</b>	<b>Branch Management Profile</b>	<b>Score Range</b>	<b>Weight</b>	<b>Weighted score</b>
<b>A</b>	<b>Branch Manager</b>		<b>2%</b>	
	Below Junior Officer	100		
	Junior Officer	80		
	Officer	60		
	Senior Officer	40		
	Managerial Level	20		
<b>B</b>	<b>Second Man of the Branch</b>		<b>2%</b>	
	Below Junior Officer	100		
	Junior Officer	80		
	Officer	60		
	Senior Officer	40		
	Managerial Level	20		
<b>C</b>	<b>Rotation of staffs Job /Branch meeting &amp; effectiveness of staff's affair</b>	(0-100)	<b>2%</b>	
<b>D</b>	<b>Quality of Audit Reply</b>	(0-100)	2%	
<b>E</b>	<b>Response time to Audit</b>	(0-100)	2%	
<b>Total Weight and score for Branch Management Profile</b>			<b>10%</b>	

#### 4.2.6 Previous Audit Score

Total weight assigned to the parameter is 5%. Higher the previous audit score for the Branch, higher shall be the score for current year under audit and vice versa.

For the first time adoption of RBIA, it shall be provided based on scores provided in **points #1 to 5** (i.e. 5% of summation of parameter 1 to 5)

#### 4.2.7 Judgmental Score and Risk Matrix

There shall be correlation between judgmental scores and results of risk assessment done on the basis of the number and severity of audit issue. For this, IAD has to assess the risk of the Branches based on the audit issues in the area of Credit, Operation and Compliance which is



solely for the purpose of scoring where judgmental scoring is allowed and provisioned in the above model. The assessment of the audit issues shall be broadly categorized into Control Risk (for Credit and Operation Issue) and Compliance Risk (for compliance issues). The risk is graded as either of Low Risk, Medium Risk or High Risk and accordingly Overall Risk of the Branch shall be arrived by way of risk matrix as given below:

#### Risk Matrix

<b>Compliance Risk</b>	H	M	H	H
	M	L	M	H
	L	L	L	M
		L	M	H
<b>Risk types</b>	<b>Control Risk (CR)</b>			

#### Overall Risk

Overall Risk	=	Compliance Risk	+	Control Risk
<b>Low</b>		L	+	L
		L	+	M
		M	+	L
<b>Medium</b>	=	L	+	H
		H	+	L
		M	+	M
<b>High</b>	=	H	+	M
		M	+	H
		H	+	H

The internal audit shall consider the overall risk score derived on the basis of the audit issues for the judgmental scoring (where applicable) in “Compliance profile”, “Branch Management Profile” and “Risk Assets Monitoring and House Keeping” section of the above model.

#### **4.2.8 Audit Grading of Branches & Frequency of Audit**

Based on the risk scores of the Branches, all Branches shall be classified into 3 types and accordingly frequency of Branch audit shall be determined as below:

Branch IAD Score	Branch Grading	Frequency of Audit
Score > 60	A	100% Every Year
Score >45 and <=60	B	At least 70% in the Year and Coverage 100% in every 2 years (i.e. 30% in the following year)
Score <=45	C	40% in a year and 100% in every 3 years

A minimum of 60% of **total number of Branches** shall be audited every year. Further IAD shall ensure internal audit of all “B” grade branches in every 2 years and all “C” grade branches at least in every 3 years.

### 4.3 Audit Grading of Departments & Frequency of Audit

Departments shall not be graded with risk scores like Branches since function of each department is unique and not comparable to other. However, departments have been graded considering factors like nature and complexity of Department’s functions (business related department or support department or control department) and risk factors inherent therein. Detail is presented as under:

SN	Departments	Departments Grading	Frequency of Audit
1	Finance & Planning (F&P)	A	Every Year
2	Treasury Dept.	A	
3	Centralized Trade Finance Unit (CTFU)	A	
4	Information Technology (IT)	A	
5	Compliance Department	A	
6	General Administration (GAD)	B	All these departments to be audited in 2 years cycle, with at least 50% of these in the first year and remaining in the next year.
7	Card Dept.	B	
8	Branch Operation (BOD)	B	
9	Centralized Credit Operation (CCOD)	B	
10	Share Department	B	
11	Human Resource (HRD)	B	
12	Centralized Clearing Unit (CCU)	B	
13	Remittance Dept.	C	All these departments to be audited at least in 3 years cycle.
14	Credit Monitoring Dept.	C	
15	Operational Risk Dept.	C	
16	Legal Dept.	C	
17	Corporate Banking Dept. (Corporate)	C	
18	SME & Retail Credit Dept. (Corporate)	C	
19	Marketing Dept.	C	
20	Risk Management (RMD)[Credit / Operations]	C	
21	Recovery Department	C	
22	Others, if any	C	

## 5. Audit Unit Selection & Planning

### 5.1 Selection of Audit Unit

Considering the following factors, Head IAD shall finalize the selection of audit units:

- Selection of audit units as per **Para# 4**.
- Availability of resources in the IAD.
- Need of audit based on control issues, and feedback of senior management.
- Geographical location of the audit unit(s).

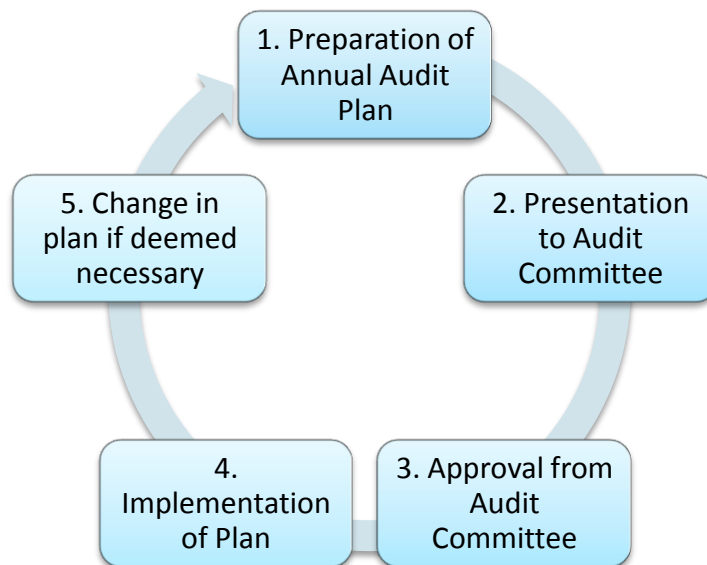
While deputing audit staffs for outstation Branches, all Branches falling under Grade – A and B within the geographical cluster shall be planned for audit in the same visit.

## 5.2 Annual Audit Plan

IAD shall, before commencement of every financial year, plan the audit for upcoming year so that the engagement would be performed in an effective manner. Planning shall address matters such as:

- a. Review of the current year audit coverage.
- b. Total audit units to be covered for audit in a year.
- c. Time frame for audit coverage of the audit units.
- d. General Sampling techniques to be applied in different areas.
- e. Need to use experts/ outsourcing in audit (if any).
- f. Change in business and control environment.
- g. Training to empowering audit staff.
- h. Estimated Budget for IAD.
- i. Statutory function of IAD.

Annual Audit Plan process shall be as under:



## 5.3 Time Planning

Head IAD shall present a break-down of time plan with the annual audit plan which reveals how completion of audit of targeted audit units shall be achieved.

## 5.4 Manpower Planning

Annual audit plan should include manpower analysis and planning for audit of targeted audit units within the given time frame. Manpower planning shall include:

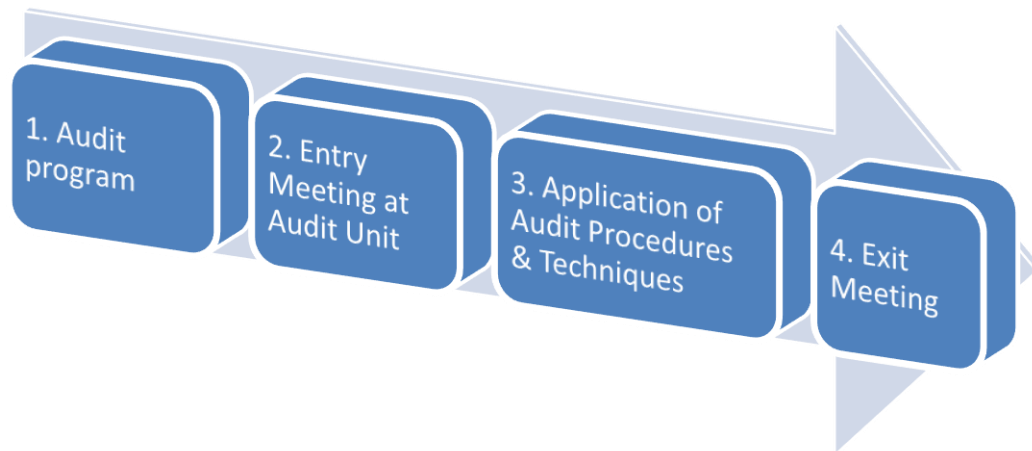
- a. Assessment of required skills, education and experience to execute work of IAD.
- b. Assessment of required number of staffs in the IAD to achieve the audit plan.
- c. Identification of gap (if any) on required manpower and available manpower.
- d. Identification of ways to fill up the gaps, for example via addition of head count or outsourcing or removal of excess manpower etc.
- e. Assignment of the audit unit by forming appropriate audit team.

## 5.5 Change in Plan

Plans are subject to change when there is change in initially assessed risk levels, availability of resource of IAD and as per the request of senior management for additional audit requirement. Sometimes, urgent need of audit of unplanned audit unit and volume of non-routine jobs of IAD (investigation, special inspection, verification work etc.) might also increase. Hence the audit plan and progress report of audit completion shall be periodically reviewed by audit committee and it can endorse the changes in plan.

## 6. Audit Procedures

Upon the assignment of the audit unit to the audit team, it shall prepare for on-site audit and inspection. For effective and efficient audit, the team shall follow some basic procedures and document the same for the future reference.



### 6.1 Specific Audit Program

The team leader of the audit team shall prepare the unit specific audit program based on previous audit report, grade of the audit unit, off-site report and other periodic returns of the unit. Such program shall be further reviewed by either audit manager or Head IAD. The audit program shall be formulated considering the following factors:

- a. Internal Audit score provided to the audit unit for Current year.
- b. Extracts of Reports of NRB / External Audit that relate specifically to the audit unit.
- c. Overview of Internal Audit Report of previous period.
- d. Overview of financial position and performance of the audit unit from periodic returns.
- e. Preliminary assessment of possible inherent and control risks.
- f. Application of sampling techniques considering materiality, risk scores, risk grade of audit unit etc.
- g. Preliminary identification of areas requiring special audit considerations.
- h. Sampling methodologies for credit and non-credit areas as per **Para# 8**.
- i. Planning of tentative days for on-site visits.

Based on aforesaid considerations, it shall make an assessment of nature, timing and extent of audit procedures and techniques to be applied during the audit for minimizing the detection risk.

### 6.2 Entry Meeting

In every Branch / Department audit, the Internal Audit Team shall conduct an Entry Meeting in the presence of Branch Manager / Head of respective Department (HOD) and key staff(s) of the

audit unit. IAD staffs shall discuss about the Branch / Department performances and internal control issues in the review period so as to obtain a preliminary overview of the areas requiring specific attention of the auditors.

An entry meeting minute shall then be prepared with signatures of all present members.

### 6.3 Application of audit procedures and techniques

After obtaining overview from the audit unit officials, audit staffs shall convene the audit. Different audit procedures and techniques for the selected (sample) areas can be applied for efficient audit. If actual risk levels appear to be significantly different than assessment of risks made during planning phase, the audit team may accordingly make necessary changes to nature, timing and extent of audit procedures.

Audit team shall maintain documentation [hardcopy / softcopy] of their work and obtain necessary evidences for issues to be presented in the report. Audit team may make site visits, if deemed necessary, to different locations that are relevant to audit of the audit unit. Audit team may conduct surprise checks to certain audit areas as well. Audit team shall exercise basic principles as listed in **Para# 3.1** during conduct of the audit. The team shall coordinate among themselves for identified risks and flaws and reach to common conclusion before calling for exit meeting with staffs of the audit unit.

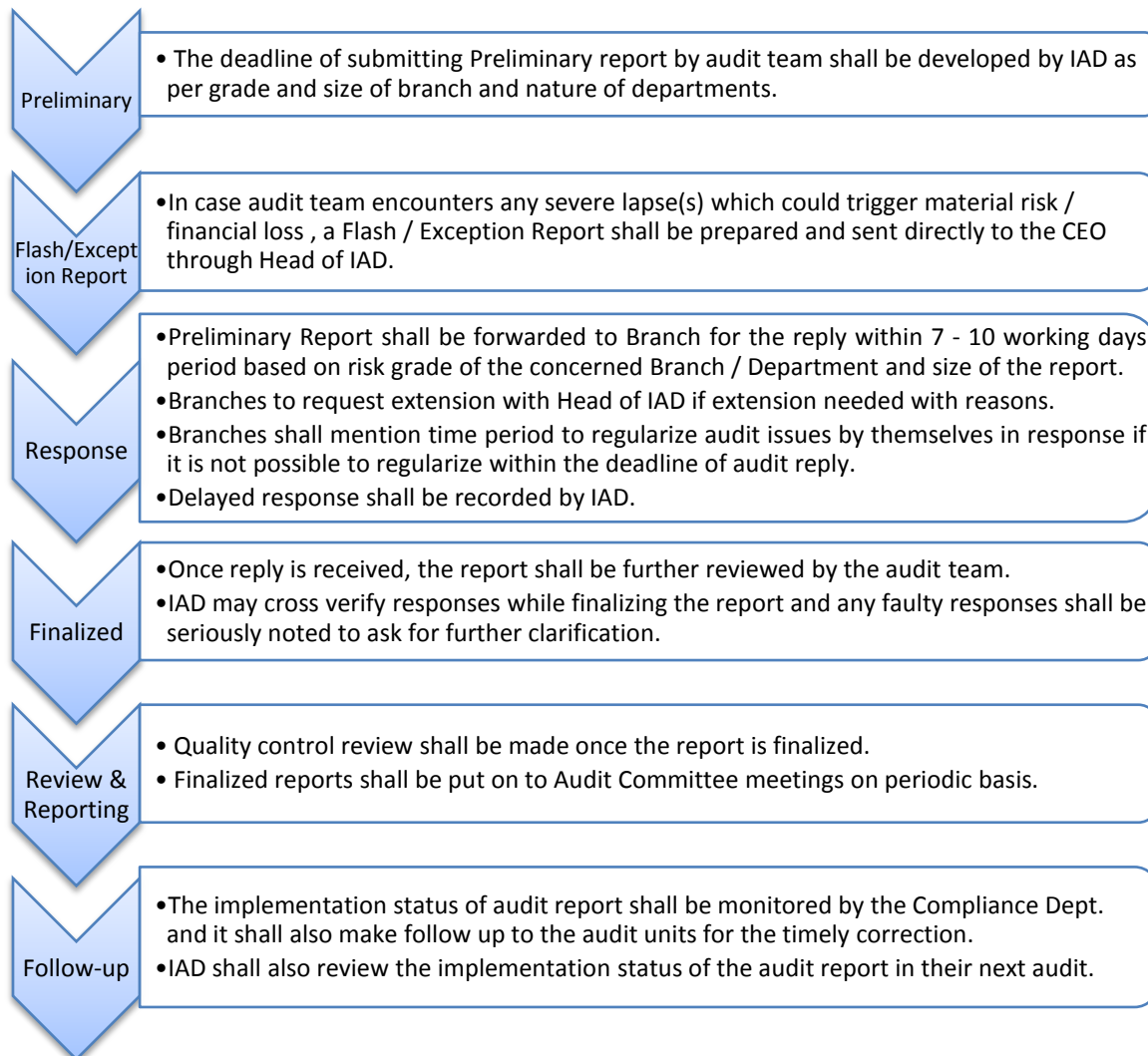
The audit team shall also take initiation to correct the severe nature lapses found during the course of audit in order to avoid possible loss from such lapses in future. They shall also notify the management in case of lapses/remark of serious nature immediately as exceptional report/flash report.

### 6.4 Exit Meeting

At the end of the audit, the auditor shall conduct exit meeting with the staffs of the audit unit and summarize audit findings, risks and lapses. The meeting shall discuss on all material audit issues and risk that could come as part of Preliminary Report. Auditors shall also brief the nature and format of the report for easy understanding and timely response on Preliminary Report by the audit unit.

At the end, an exit meeting minute shall be prepared with signatures of all present members.

## 7. Reporting



### 7.1 Quality Control Review

Before finalizing the report, it shall be followed by quality review by the Audit Manager or any other staff assigned by Head IAD. The reviewer shall:

- Review the content of audit report, its completeness, audit reply etc.
- Ensure that working papers have been duly maintained for observations noted.
- See if there have been any weaknesses in the application of audit procedures.
- Review the issues raised by auditor and ensure that these are well elaborated and specific.
- Discuss the weaknesses identified in the Report and material part of the report with Head IAD before finalizing the report.

Once the review is completed, then the report is forwarded to Head IAD for the final review and placing on the audit committee for the discussion and endorsement of the audit report.

### 7.2 Reports to audit committee

Head IAD who is also member secretary of Audit Committee shall call the committee meeting in consultation with coordinator of the Audit Committee on a periodic basis for the discussion on internal audit reports. The member secretary shall prepare the agenda comprising the major

and material issues of the audit reports and summary report for the discussion and endorsement of the audit report in the committee meeting.

### 7.3 Final Report

Upon the endorsement of audit report by the committee, the final report of the audit units, decision and instruction of the committee shall be forwarded as below:

SN	Recipients	Deliverables
1	Audit Unit [Branch / Department]	Final Audit Reports
2	Board of Directors	Synopsis of Internal Audit Report, Minute & decision of Audit Committee- On semi-annual basis
3	Chief Executive Officer	Flash Reports, Summary report of Audit Units, Minute & decision of Audit Committee
4	DCEO –Operation and DCEO- Credit	Final Audit Reports
5	CRO- Risk Department	Final Audit Reports
6	Compliance Department	Final Audit Reports, Summary report of Audit Units, Minute & decision of Audit Committee

The reports may also be provided to External auditor and officials of Nepal Rastra Bank as per their request during their audit and inspection in the Bank.

### 7.4 Follow Up

Compliance Department shall follow-up for the correction of audit report and keeps track of its implementation status. IAD shall also review the implementation status and repetition of similar issues in their next audit.

## 8. Sampling Techniques

Risk based audit is about concentrating the audit function over risk areas and applying audit resources accordingly. Hence, use of sampling techniques is very important tool in devising RBIA. Sampling for audit of Credit and other areas of the Branch are to be done separately considering the transactions volume and risk involved therein.

### 8.1 Branch Credit Sampling

#### 8.1.1 New Credit Files

The general sampling technique for new credit file review shall be as below:

Branch Category	100% samples	40% samples	20% samples	5% samples	Random
Group A	>Rs. 10 Million	5M - 10M	2.5M - 5M	0.5M - 2.5M	Upto 0.5M
Group B	>Rs. 7.5 Million	5M - 7.5M	2.5M - 5M	0.5M - 2.5M	Upto 0.5M
Group C	>Rs. 6 Million	4M - 6M	2.5M - 4M	0.5M - 2.5M	Upto 0.5M

To ensure good coverage of new Credits, at least 75% of value of new loans issued during the review period shall be covered by audit. Hence, if it does not cover 75% of total new loans, random sample size has to be increased to ensure that 75% coverage is reached.

While sampling the new credits, priority shall be given to relatively riskier credit products.

Where a credit file constitutes part of audit sample, the entire credit limit and exposure of that borrower (incl. non-funded) shall be reviewed.

#### **8.1.2 Non-Performing Credits**

For sampling of NPA files, the files converted into NPA during the review period shall be covered.

#### **8.1.3 High Value Credit Files**

While considering credit files for sampling, priority may also be given to high value files despite not being new credit file in order to get sufficient audit coverage in terms of volume as well.

#### **8.1.4 Non Funded Facilities**

At least top 5 non-funded exposure of the Branch shall be reviewed.

The above sample size and technique is only a general guideline which may not fit for all branches at all time. Hence, aforesaid sampling techniques shall not be rigid. However where less coverage is considered than that stated above, due to time or resource constraints and any whatsoever reason, Head IAD shall be informed with reasons.

### **8.2 Branch Operations Sampling**

Sampling for operational areas shall be done on the basis of risk scores in the operational parameters of the Branch. Sample size shall be determined on a judgmental basis but without any prejudice. While sampling operational areas, factors like overall risk score, grade of Branch, issue discussed in entry meeting, issues in other similar branch, previous audit comments and branch responses thereto shall be taken into consideration. Audit of operations in Branches shall cover following general areas:

- a. Customer Service Department
- b. Cash Operation
- c. Remittance & clearing department
- d. Account and Operation
- e. General Administration
- f. IT system
- g. Human Resources
- h. Follow up of last Audit Reports

Sampling techniques may differ from branch to branch which depends on audit team's judgment in assessment of operational risk, size and other specific operation issues of the branch. Whatsoever adopted, the audit team shall maintain the documentation of such sampling techniques used while discharging audit assignment.

## **9. Audit Documentation**

IAD shall timely maintain audit documentation which shall act as evidence that audit was conducted as per Internal Audit Policy / Manual of the Bank. It will also help in accessing the record and supporting for future reference by auditor and others. Such documentation shall link the audit work performed from the beginning to final report. It shall also enable others to understand:

- a. Nature, timing and extent of audit procedures performed.
- b. Results of audit procedures performed.
- c. Significant matters arisen during the audit and conclusions reached thereon.
- d. Content and matter of discussion with audit unit and their response.



### 9.1 Forms and Content of Documentation

The form and content of documentation to be maintained is a matter of judgment of the auditor. Audit Documentation may be hard copy or soft copy of supporting document and working papers obtained during the audit. It may also be minutes, agreement, plan, program, MIS report, copies of decision & process followed and sampling techniques used while performing audit. Audit documentation of the material and major issues of the report shall be collected and maintained safely by the audit team for future reference.

### 9.2 Safe Custody, Retention and Assembly

Audit Documentation shall remain the property of IAD and IAD shall maintain it under safe custody. Such documentation shall be retained safely for a period of at least 5 years, after which they could be destroyed with approval of Audit Committee. Audit documentation shall be assembled together and completed before finalization of reports. A file log may be maintained for easy locating to Audit Documentations at the time of need in future.

### 9.3 Confidentiality

All staffs of IAD shall strictly maintain confidentiality of information obtained during the course in execution of their duties as auditors. None of such information shall be disclosed to outsiders without consent/approval in writing from Head IAD / Audit Committee unless the same is exclusively allowed and required by the law of the country.

## 10. Review and Amendment

This RBIA Manual shall be reviewed annually. However it can also be amended or changed as per the requirements as to the change in the business scenario, control environment & process and degree / nature of risks. It can also be changed to meet the requirement of internal policy, priorities of the Bank and the requirement of regulator.

### **Board of Directors:**

S.N.	Name	Position	Signature
1.	Mr. Upendra Keshari Neupane	Chairman	
2.	Mr. Iman Singh Lama	Director	
3.	Mr. Chandra Prasad Bastola	Director	
4.	Mr. Madhav Prasad Bhatta	Director	
5.	Mr. Krishna Shrestha	Director	
6.	Dr. Kailash Patendra Amatya	Director	