

Official Gazette of the FBiH, number 3/03

Based on Articles 4, 9 and 25 of the Law on Banking Agency of the Federation of Bosnia and Herzegovina ("Official Gazette of the Federation of BiH, No. 9/96, 27/98, 20/00, 45/00 and 58/02) and Article 38, Paragraph 1 and Article 51, Paragraph 2 related to Article 69 of the Law on Banks ("Official Gazette of the Federation of BiH, No. 39/98, 32/00, 48/01, 27/02, 41/02 and 58/02), Managing Board of the Banking Agency of the Federation of BiH declares

DECISION ON MINIMUM STANDARDS FOR BANKS' INTERNAL CONTROL FUNCTION

Article 1

This Decision defines obligatory minimum of internal control standards that a bank is obliged to prepare, implement and continuously maintain within its business operations.

Article 2

The Supervisory Board of the bank is responsible, based on the proposal made by bank's Management, for providing decisions related to establishment, maintenance and development of efficient internal control system, and for ensuring that the Management of the bank provides for conditions necessary for its implementation, that is that Management and other bank's personnel establish and implement detailed procedures and actions related to the whole system of control and monitoring of all business activities and operations at all business levels (functional and operational) and operations departments of the bank. At the same time the bank's Supervisory Board is responsible, based on the proposal made by bank's Management, to determine main objectives and establish and monitor implementation of policies related to bank's internal control system and to ensure that those authorizations are being implemented continuously throughout the whole organizational structure of the bank.

Article 3

The Supervisory Board of the bank is obliged to assure that internal control system incorporates elements from this Decision, at a minimum, therefore to implement following:

- 1) to determine and ensure establishment of efficient organizational structure in the bank;
- 2) to pass written business plan of the bank including precise and clearly defined objectives and business polices of the bank which encompass definitions of acceptable and unacceptable risks along with responsibilities

- of the Management of the bank related to providing conditions for identification, overview, and control over those risk;
- 3) to assure that business plan of the bank includes strategic and operational plans;
 - 4) to provide that business plan of the bank includes clear and precise authority levels and responsibilities, just as reporting system form;
 - 5) to assure that managerial levels implement constant overview and control of lower managerial staff actions;
 - 6) to assure implementation of appropriate accounting procedures in the bank;
 - 7) to assure implementation of appropriate procedures for protection of assets;
 - 8) to assure that internal control system is under the constant overview of internal and external audit; and
 - 9) to pass the plan for constant overview and periodical control of internal control and internal audit systems' function by the Audit Board, just as plans for their improvement and time adjustments.

Article 4

Internal control system primarily covers accounting and financial functions in the bank, including special controls of financial plan and planning, standard and non-standard contingencies, statistics analyses and their publishing, periodical operational and business reports, training prepared for improvement of executive staff performance and to have close relation to the internal audit that: a) overviews internal control system; and b) provide timely information on its adequacy and efficiency to the Audit Board and bank's Management.

Article 5

Internal control system is obliged to consist of administrative and accounting sector control.

Administrative control includes:

- a) establishment, overview, development, and control of the organizational structure (organizational scheme) of the bank; and
- b) control of procedures and other records in the bank related to the decision making on business transactions in different levels of management.

Administrative control represents a starting point for the establishment of accounting control.

Accounting control covers procedures plan, procedures, and records related to the insurance of assets and reliability of financial records in the bank.

Accounting control has to assure that:

- 1) business transactions in the bank are proceeded in compliance with general or specific decisions and approvals given by the authorized members of the management;

- 2) business transactions in the bank are recorded timely and accurately;
- 3) business transactions in the bank are recorded in compliance with the law and so that it is possible to make financial statements in accordance with the approved accounting standards, International Accounting Standards, and other criteria implemented to the financial reporting;
- 4) business transactions are recorded in the manner so that responsibility over assets in the bank is apparent and transparent;
- 5) access to the assets of the bank is allowed only with the approval of the authorized Management;
- 6) book keeping records of assets positions are checked and matched with real asset balances in specific, the shortest regulated time intervals and in case of any errors, the appropriate corrective measures will be recommended.

Article 6

Internal control system have to assure that no person in the banks is given possibility to make significant error or violate laws, regulations and internal regulations in the bank, and which cannot be discovered in a short period of time.

Article 7

The internal control system in the bank has to provide for following procedures:

- 1) for establishment and maintenance of efficient organizational structure in the bank;
- 2) for establishment and maintenance of appropriate accounting in the bank;
- 3) for efficient protection of assets of the bank;
- 4) for enabling establishment and maintenance of efficient internal and external audit program in the bank; and
- 5) for efficient protection of the bank against being misused for criminal purposes (money laundering, robberies, terrorism, etc.).

Article 8

Organizational scheme of the bank, which was approved by the Supervisory Board, has to clarify authorities and responsibilities including precise separation of managing, supervising and governing functions.

Regarding organizational structure of the bank, the internal control system, at a minimum, has to assure that:

- 1) authorizations and limitations of bank's staff are approved by the Supervisory Board of the bank and clearly and precisely described in the job descriptions. The Board has to control periodical compliance with job descriptions. This should provide reporting system for the Audit Board about following, at a minimum:
 - a) bank's liquidity;

- b) bank' capital adequacy;
 - c) quality and classification of bank's assets;
 - d) past due loans
 - e) all new placements and new off-balance sheet items;
 - f) new large credit risk exposures separately;
 - g) new large loan exposures towards entities related to the bank;
 - h) transactions with securities;
 - i) payment system transactions;
 - j) balance sheet of banks;
 - k) profit and loss statement, that is bank's income statement;
 - l) implementation of bank's financial plan;
 - m) reports of the internal and external audit of the bank; and
 - n) status of the bank in relation to the bank's strategic plan.
- 2) to implement sound staff polices in the bank in the way that staff will be employed to the positions which respond to their qualifications, capabilities, and appropriate work experience.
 - 3) to implement complete, continuous and successful training of staff;
 - 4) to implement continuous control and evaluation of operations' quality performed by each employee;
 - 5) in the bank is provided separation of jobs which are not similar, so one employee can not perform jobs of assets protection and duties related to the book keeping simultaneously, and that he/she can not perform particular business operations and to be authorized for the control of those operations at the same time which especially relates to the following:
 - a) loan official should not perform payment of loans;
 - b) loan official can not perform activities related to bookkeeping procedures for loans;
 - c) staff authorized for signing orders and checks at corresponding banks should not perform activities of reconciling accounts at those banks;
 - d) activities of reconciling records with general ledger should be performed only by the person that did not work on previous records;
 - e) to respect in all cases separation of non-similar duties.
 - 6) to, where applicable, implement principle of planned and unannounced periodical rotation of daily duties. This principle has to be implemented in the process of general training of the staff.
 - 7) to implement rule that the staff uses their vacation continuously two weeks each year, at least.

Article 9

In order to assure efficiency and quality in management of the bank, the Supervisory Board is obliged to assure that accounting system in the bank can be used to prepare all necessary regular and periodic internal reports and information for their needs and need of other beneficiaries.

Article 10

Records in the bank have to be maintained in accordance with all regulated and determined accounting and banking principles, just as in accordance with international standards.

Records and accounts in the bank have to display genuine financial condition and precise results of its operations in all times, and especially regarding:

1. Operational responsibilities, so accounting system provides preparation of internal reports for the control. The records have to be up dated on daily bases and to include (analytical) additional control accounts matching general ledger balances.
2. Control tapes (electronic records, discs, etc.) which have to be created so each item can be examined and traced in the business books of the bank;
3. Obligatory numeration of all financial instruments, which will simplify demonstration, reconciling and control of used and unused items.
4. Obligatory accounting manual, which contain guidelines for processing daily transactions. The manual should contain standard procedures for, as a minimum:
 - a) Book keeping of business operations;
 - b) Daily reconcilment of items, sums and general ledger;
 - c) Preparation and control of source documents;
 - d) Control of documentation trail starting from beneficiary ending in electronic data processing (if there is any) and the other way around;
 - e) Changes in the central computer.
 - f) Saving, that is archiving source documentation for accounting; etc.

Article 11

Basic method for protection of specific assets items of the bank has to include special authorization for access to those assets.

The bank is obliged, within its internal control system, to prepare plan for physical protection of assets. The plan should incorporate, at a minimum:

- 1) Cash control by assigning particular amount for each employee (cashier) at the counter made to their disposal for performing business operations. Group handling of cash is not allowed;
- 2) Provide that all operations related to the cash in treasury, marketable pawns, storage, unused checks and other securities, spare locks and keys for handling citizens deposits, spare keys of treasury safes and related activities have a mutual control system implemented by two persons each having one key and one combination out of two possible;
- 3) Provide that all activities that are in need of control and approval, just as are general ledger and analytical evidence manipulation, assets transfer, issuing letters of credit and related activities have to employ double control system. It is differing from the mutual control function, because one person activity has to be verified by the other person to reassure that there is only one person performing particular transaction and that the transaction is adequately recorded and/or that reconciling is properly performed;
- 4) Plans for exceptional situations and maintaining additional registers and documentation incorporating all basic information and records out side of the bank premises;
- 5) Reporting system on oversights, which is supposed to be utilized for instant report preparation and starting investigation on problems such as

cash shortage or other deficiencies in the moment of discovery. This system has to provide that investigation results are submitted to the authorized persons and bank's departments, and as needed to insurance companies, control institutions, and other authorized bodies;

- 6) Staff employment procedures which, especially for particular jobs, have to include obligatory investigation of reliability, education, and recommendations of the future employee;
- 7) Procedures for physical and electronic security.

Article 12

As of the effective date of this decision, the Decision on Minimum Standards for Bank's Internal Control Systems ("Official Gazette of the Federation BiH" No. 47/98) cease to exist.

Article 13

This Decision comes into effect on the day of its declaration and will be published in the "Official Gazette of the Federation BiH".

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Sarajevo, 19th December 2002

CHAIRMAN OF
THE MANAGEMENT BOARD
M.A. Eldar Arnautovic