

# **Ordinance No. 10**

## **on the Internal Control in Banks**

(Issued by the Bulgarian National Bank on 26 November 2003;  
published in the Darjaven Vestnik, issue 108 of 12 December 2003;  
amended; Darjaven Vestnik, issue 102 of 2006)

### *Chapter One*

#### **General Provisions**

##### **Subject**

**Article 1.** (1) This Ordinance shall determine the requirements to organization and activity of the internal control in banks and banking groups.

(2) The provisions of this Ordinance shall also apply to foreign banks' branches.

**Article 2.** (1) Internal control is a permanent process implemented by management bodies and by the persons performing internal control functions.

(2) Internal control within the meaning of this Ordinance shall be considered as a combination of control systems which seek to ensure:

1. achievement of the aims and purposes;
2. efficient and effective use of the funds;
3. an adequate control over various risks;
4. safeguarding the assets;
5. reliable and sufficient financial and management information; and
6. compliance of the operations with applicable law and ordinances, observance of policy, plans, internal rules and procedures.

### *Chapter Two*

#### **Internal Control Systems**

##### Section I

##### **General Requirements**

**Article 3.** (1) In matters of internal control organization, banks shall take account of:

1. the size of their business;
2. the diversity of operations and types of risks inherent;
3. the management oversight – level and scope of control exercised by the management;

4. the scope and accuracy of the accounting and other records.

(2) Efficiency and effectiveness of the internal control shall be assured by organizing it in a prudent and sufficient manner.

**Article 4.** Internal control shall consist of the following elements:

1. management oversight;
2. risk control;
3. reporting and information; and
4. internal audit.

## Section II Management Oversight

**Article 5.** The competent management body of the bank shall approve and periodically review:

1. the organizational structure of the bank;
2. (amended; Darjaven Vestnik, issue 102 of 2006) the procedure for determining and delegating powers and allocating responsibilities to administrators;
3. the business strategy and the plan of the bank's activity;
4. (amended; Darjaven Vestnik, issue 102 of 2006) the policy on risk management and control;
5. the procedure for preparing and the scope of management information;
6. the organization and functioning of the controls, including authorization, performance and reporting the operations;
7. the internal rules and procedures for risk monitoring and maintaining effectiveness of the control systems, as well as reporting of insufficiencies identified in organization and activities by business lines and structural units;
8. the code of ethics for administrators and employees;
9. the system of training, appraisal and promoting the staff in control functions.

**Article 6.** The competent management body shall segregate duties in any cases where a conflict of interests may occur, as well as require no hold of more than one of the functions in connection with authorization, performance and reporting the operations.

## Section III Risk Control

**Article 7.** Each bank shall maintain an adequate system of risk control which shall include:

1. determining all risks inherent, measurable or nonmeasurable in quantitative terms, identifying internal or external risk factors;
2. risk management framework, including risk assessment models;

3. regular reviews of the bank's overall risk matrix;
4. monitoring and periodical assessment of consistency between the internal rules for risk management, market conditions and prudential banking;
5. terms and procedures for risk assessment, determination and observance of risk limits, as well as acceptable contingency plans;
6. the type, structure and frequency of risk reports.

#### Section IV

### Reporting and Information

**Article 8.** Each bank shall maintain a reporting system and communications which shall at least allow timely access to information relative to the officials' powers and movement of the information:

- a) upward, so that the management is aware of the operations, business risks and current performance of the bank;
- b) downward, for informing the staff about the bank's aims and purposes, as well as about the policy, rules and decisions approved by the management; and
- c) across the organization, what shall ensure that information produced is properly provided to and shared among the business lines and units of the bank.

**Article 9.** (1) All bank transactions and operations shall be registered in due time and comprehensively in a chronological order.

(2) Banks shall maintain all transactions on electronic and paper files, clustered by type of operation, customer and other criteria selected by them.

**Article 10.** Bank files shall contain:

1. an inventory of the documents in the file;
2. internal bank documents, minutes, agreements, contracts, *etc.*;
3. financial and other information about the customers and the market;
4. other documents and information of essential significance for the bank.

**Article 11.** (1) To protect the information when using IT systems, the management shall ensure the segregation of duties associated with:

1. development, implementation and modification of IT systems;
2. maintenance of IT systems;
3. administration of IT systems; and
4. use of electronic information.

(2) IT systems shall ensure:

1. properly restricted access to information, consistent with the powers of the officials;
2. procedures that enable carrying out adequate controls, and incorporate internal and external audit trails.

**Article 12.** (1) The competent management body shall adopt internal policies of using IT systems which shall limit:

1. errors in stages of software development and modification, system administration and use of database;
  2. interruption of operation due to internal or external contingent factors;
  3. fraud and irregular access to information.
- (2) Banks shall update their internal policies and procedures for applying IT systems according to their sophistication and risks inherent.

### *Chapter Three*

## **Internal Audit. Internal Audit Unit**

### Section I

#### **General Requirements**

**Article 13.** (1) Internal auditing is an independent appraisal function established within a bank to examine and evaluate its transactions, operations and control systems which shall be carried out by the internal audit unit.

(2) The internal audit unit shall assist the management bodies in taking decisions and conduct follow-up reviews on their execution.

**Article 14.** (1) In performing its function, the internal audit unit shall examine and evaluate:

1. the reporting and information system, usefulness of the analyses prepared, IT systems and data accuracy;
2. compliance of operations with law, observance of internal rules and procedures, and whether objectives set by the management have been met;
3. internal controls in conducting transactions;
4. efficiency and effectiveness of the overall activity;
5. the risk management systems, risk and capital adequacy assessment;
6. reliability and timely submission of supervisory returns;
7. whether the bank's assets are properly safeguarded from ownerless treatment and fraud;
8. adherence to contracts and commitments;
9. staff recruitment and training, as well as consistency of job descriptions with duties.

(2) In carrying out their activities internal auditors shall be empowered to:

1. unimpeded access to:
  - a) the bank's premises and assets;
  - b) the decisions of the bank's management bodies and other officials;
  - c) accountancy and information systems;
2. require and collect statements and other documents, undertake inquiries in relation to the assigned tasks;
3. recruit experts in carrying out specific control actions.

(3) Internal auditors may not be authorized or held liable for the activities and subjects of examination, and they shall be independent from and may not involve in other duties.

(4) Administrators and employees of the bank shall assist the internal auditors in performing their activity.

(5) Reviews and control actions initiated by administrators and other persons from the management staff within their powers may not substitute the internal audit functions.

**Article 15.** (1) Internal auditors shall have:

1. professional skills in applying the standards for the professional practice of internal auditing, procedures and techniques of auditing;
2. knowledge and experience in applying accounting standards;
3. knowledge of management principles and prudential banking.

(2) Internal auditors shall follow the prescribed principles and best practices of ethical conduct, they shall be honest, impartial, diligent, loyal and outgoing in their contacts with people.

**Article 16.** (1) A head of the internal audit unit shall be elected a person with high ethical and professional reputation, and sufficient banking and auditing experience required for the position.

(2) The head of the internal audit unit may not hold more than one office in the bank.

(3) The head of the internal audit unit shall ensure and oversee the application of the principles and standards for the professional practice of internal auditing and the efficiency of internal audit activities.

**Article 17.** The competent management body of the bank shall approve internal rules and an annual plan of the internal audit's activities.

**Article 18.** (1) The internal rules shall regulate the powers of internal auditors, the procedure for taking control actions, their documentation and reporting results.

(2) The rules shall ensure:

1. independence and discretion to the head of the internal audit unit in planning and assigning examinations;
2. unimpeded access to the assets and information;
3. direct contact of the head of the internal audit unit with management bodies;
4. the right of the head of the internal audit unit to recruit internal auditors in compliance with the professional qualifications required;
5. avoidance of any conflict of interests in executing the tasks by the internal auditors;
6. conditions for recruitment of experts in taking specific control actions.

**Article 19.** (1) The head of the internal audit unit shall estimate resources and approve programs on execution of detailed control tasks with view to implementing the annual plan.

(2) All subjects of control shall be covered within a control period of up to two years. The frequency of control actions concerning individual subjects and control systems shall be determined according to their significance and potential risk for the bank.

## Section II

### Documentation of Control Actions and Reporting Results

**Article 20.** Any examination or other control actions of internal auditors shall finish with preparing a report which contains findings and recommendations for measures to be taken against violations of law and internal rules, and for removing malpractices in the bank's operations.

**Article 21.** (1) The head of the internal audit unit, in compliance with the principles and standards for the professional practice of internal auditing, shall approve requirements for the reports and documents prepared and collected by internal auditors.

(2) Information collected in the process of auditing shall base the findings, evaluations and recommendations made.

**Article 22.** (1) The report under Article 20 shall be submitted to the head in charge of the subject examined and to the head of the internal audit unit.

(2) within the terms set by the rules, the head of the examined unit shall submit explanations and/or lay claims concerning the findings and recommendations addressed.

(3) Internal auditors shall draw a conclusion on the written explanations or claims submitted by the head of the examined unit.

(4) Upon implementing procedures under the previous paragraphs, the head of the internal audit unit shall submit the report and the documents under paras. 2 and 3 to the executive directors.

(5) The competent bodies and the administrators shall impose remedial measures and notify the head of the internal audit thereby.

**Article 23.** (1) In case of significant violations and malpractices or where insufficient remedial measures have been taken, as well as if violations and breaches on the part of executive directors or procurators have been identified, the report shall be submitted to the competent governing body.

(2) In case of identified violations and breaches on the part of the competent governing body or if insufficient measures have been taken by this body under para. 1, the report shall be submitted to the superior body in compliance with the bank's Articles of Association, as well as to the Banking Supervision Department at the Bulgarian National Bank.

### Section III

## Annual Performance Report

**Article 24.** (1) The head of the internal audit unit shall present an annual performance report of the internal audit department at the shareholders' general assembly and the board of directors, at the supervisory board and the management board respectively.

(2) The annual report shall inform about main results of internal auditors' control actions, measures taken and their execution. It shall comprise organizational issues and underlying tasks to be fulfilled in the following year and in the future.

### Chapter Four

## Internal Control in Banking Groups

**Article 25.** The management bodies of banks which are subject to supervision on a consolidated basis shall ensure:

1. maintenance of control systems and application of procedures in compliance with the requirements of this Ordinance relating to directly and/or jointly controlled companies;

2. compatibility and coordination of systems for risk assessment and control on a consolidated basis, and

3. the required scope of management information and the order for preparing supervisory returns on a consolidated basis.

**Article 26.** Banks' management bodies under Article 25 shall ensure control systems adequate to the organization of the banking group and the specificity of enterprises controlled.

### Chapter Five

## Relationship with the Banking Supervision

**Article 27.** (1) Banking supervision bodies shall evaluate the systems, organization and efficiency of internal control in banks and banking groups.

(2) Banking supervision bodies and the head of the internal audit unit shall periodically hold discussions and consultations on the banking risks inherent, the measures to be taken and the relations with external auditors.

**Article 28.** (1) the head of the internal audit unit shall immediately notify the Banking Supervision Department at the Bulgarian National Bank of established violations or malpractices in the bank's management that have led or may lead to material damages.

(2) Banks and banking groups shall submit to the banking supervision bodies the annual reports on the activity of the internal audit, and by request, reports on conducted examinations and other control actions.

### **Additional Provisions**

§ 1. ‘Risk matrix’ shall be a table for evaluating risks identified at the bank where each risk is assessed with view to its probability of occurrence and the degree of impact on the bank’s financial state.

§ 2. ‘Standards for the Professional Practice of Internal Auditing’ shall be the standards issued by the Institute of Internal Auditors, Altamonte Springs, Florida, the USA.

### **Transitional and Final Provisions**

§ 3. This Ordinance is issued on the grounds of Article 59 in connection with § 12 of the transitional and Final provisions of the Law on Banks, and is adopted by Resolution No. 100 of 26 November 2003 of the Governing Council of the Bulgarian National Bank.

§ 4. This Ordinance shall repeal Ordinance No. 10 of 3 June 1993 on the Internal Control in Banks (Darjaven Vestnik, issue 51 of 1993).

§ 5. Banks shall bring their activity in line with the requirements of this Ordinance within six months after its enforcement.

## **Ordinance on Amendment of Ordinance No. 10 of 2003 on the Internal Control in Banks**

(Published in the Darjaven Vestnik, issue 102 of 19 December 2006)

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### **Final Provision**

§ 2. This Ordinance is issued on the grounds of § 13 of the Transitional and Final Provisions of the Law on Credit Institutions, and is adopted by Resolution No. 151 of 30 November 2006 of the Governing Council of the Bulgarian National Bank and comes into force as from the effective date of the Law on Credit Institutions.