THE INTERNAL CONTROL AND INTERNAL AUDIT REGULATIONS 2004

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THE BANKING AND FINANCIAL INSTITUTIONS ACT, 1991
(ACT NO. 12 OF 1991)

REGULATIONS

Made under section 51(1)

INTERNAL CONTROL AND INTERNAL AUDIT

PART I
PRELIMINARY

Short title

1. These regulations may be cited as the Internal Control and Internal Audit Regulations 2004.

Application

2. (1) These regulations shall apply to all banks and financial institutions.

(2) These regulations shall also apply to financial cooperative societies licensed by the Bank.

Other applicable regulations and guidelines

3. Banks and financial institutions must comply, on all matters not specifically addressed on these or other Regulations issued by the Bank, with regulations and guidelines issued by the following bodies in the stated order:

i) The National Board of Accountants and Auditors (NBAA).

ii) The Basel Committee for Banking Supervision.

iii) The International Federations of Accountants Committee (IFAC).

Interpretation

4. In these Regulations, unless the context requires otherwise-

"the Bank" means the Bank of Tanzania

"board of directors" is the collective group of individuals elected by the shareholders of a corporation to oversee the management of a financial institution. For the purposes of this Regulation, this term shall be applied to the management committee of a financial cooperative society.

"internal control" is the concerted action of the board of directors, senior management and all levels of personnel, designed to provide reasonable assurance regarding the achievement of objectives, the effectiveness and efficiency of operations and the reliability of financial reporting and compliance with applicable laws, regulations and internal policies.

"internal controls" are the policies and procedures established and implemented individually or with other policies or procedures, to manage and control a particular risk or business activity, or combination of risks or business activities, to which the company is exposed or in which it is engaged.

"internal auditing" is an independent, objective assurance and consulting activity, oriented to bring in a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

PART II
STATEMENT OF POLICY

System of internal control

5. An effective system of internal control is a critical component of a bank or financial institution's management and a foundation for its safe and sound operation.

Risk-based controls

6. Internal risk-based controls can help the bank or financial institution meet its goals and objectives, achieve long-term profitability targets, and maintain reliable financial and managerial reporting.

Internal audit function

7. Adequate internal controls within financial organizations must be supplemented by an effective internal audit function that independently evaluates the control systems within the organization.

Promotion of quality and independence of internal controls and internal audit

8. It is an objective of the Bank to ensure that an effective internal control system is present in all banks and financial institutions and that management takes appropriate corrective action in response to weaknesses identified in internal policies or procedures. The Bank has developed this internal control and internal audit framework in order to promote the quality and independence of the internal controls and the internal audit function of banks and financial institutions without impeding the development of new financial products and services.

PART III
ESTABLISHMENT OF AN INTERNAL CONTROL SYSTEM

Duty to establish an effective internal control system

9. All banks and financial institutions shall implement an effective system of internal controls that is consistent with the nature, complexity, and risk inherent in their on- and off-balance sheet activities and that is designed to respond to changes in the institution's environment and circumstances.The goals of the system of internal controls should be to reduce fraud, misappropiation and errors, and to mitigate other risks faced by the institution.

Objective and design of the internal control system

10. (1) The internal control system shall:

a) promote the efficiency and effectiveness of activities and measures that protect the institution from loss and the ability of every officer and employee work to achieve the organization's goals, without unintended or excessive cost or placing other interests before those of the organization;

b) ensure the reliability, completeness and timeliness of financial and management information, so that managers, directors, shareholders, depositors, creditors and supervisors can count on having reliable information for making decisions; and

c) ensure compliance with applicable laws and regulations.

(2) The internal control system shall be designed to identify the relative risks of each area of activity of the bank and financial institution and to help the bank or financial institution to focus appropriate amounts of time and resources on the higher risk issues.

PART IV
COMPONENTS OF THE INTERNAL CONTROL SYSTEM

Management oversight and the control culture

11. (1) Proper governance defines the character of the institution and promotes an appropriate organizational culture which provides the foundation for effective internal control. Proper governance is reflected in the exercise of the duties and responsibilities of the board of directors and the audit committee, the senior managers and the internal auditor.
(2) The board of directors and senior managers shall be responsible for promoting high ethical and integrity standards, and for establishing a culture within the organization that emphasizes and demonstrates to all levels of pesonnel the importance of internal controls. Senior managers shall ensure that all personnel understand their role in the internal controls process and shall be fully engaged in the process.

Risk recognition and assessment

12. (1) All material risks that could adversely affect the achievement of the institution's goals shall be recognized and continually assesssed. This assessment shall cover all risks facing the institution and the consolidated financial organization (including credit risk, country and transfer risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputational risk).
(2) Internal controls shall be reviewed at least annually to appropriately address any new or previously uncontrolled risk.

Control activities and segregation of duties

13. (1) Control activities shall be an integral part of the daily activities of an institution. Management shall establish an appropriate control structure, with control activities defined at every business level, including: top level reviews; appropriate activity controls for different departments or divisions; physical controls; checking for compliance with exposure limits and follow-up on non-compliance; a system of approvals and authorizations; and a system of verification and reconciliation.
(2) Duties shall be allocated appropriately and personnel must not be assigned conflicting responsibilities. Areas of potential conflicts shall be identified, minimized, and subject to careful, independent monitoring, particularly in those instances related to approval and disbursement of funds, customer and proprietory accounts, assessment and monitoring of loans and any other areas where

sugnificant conflicts of interest emerge and are not mitigated by other factors.

Information and communication

14. (1) Management shall collect, record and retain adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant for decision making. Information shall be reliable, timely, accessible and maintained in a consistent format.

(2) Reliable information systems shall be in place to cover all significant activities of the institution. These systems, including those that hold and use data in an electronic form, must be secure, monitored independently and supported by adequate contingency arrangements.

(3) Management shall maintain effective channels of communication to ensure that staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that other relevant information is communicated to the appropriate personnel.

Monitoring activities and correcting deficiencies

15. (1) The overall effectiveness of the institution's internal controls shall be monitored by management on an ongoing basis, through established procedures such as review and approval of ledger transactions and approval of exception reports.

(2) Monitoring of key risks shall be a part of the daily activities of all operational and business areas of the institution, including control areas and the internal audit. Internal rules shall establish clear lines of responsibility for each operational and business area.

(3) An effective and comprehensive internal audit of the internal control system shall be carried out by operationally independent, appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, shall report to the board of directors and communicate its findings to senior management either directly or through the audit committee.

(4) Periodic and separate reviews shall be performed by operational and business areas and internal control deficiencies shall be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies are required to be reported to senior management and to the board of directors.

(5) The minutes of board of directors' meetings shall record the decisions adopted concerning internal control deficiencies.

PART V
INTERNAL CONTROL RESPONSIBILITIES OF DIRECTORS AND SENIOR MANAGERS

Responsibilities of Directors

16. (1) Notwithstanding other duties established in laws and regulations, directors shall be responsible for providing direction, guidance and oversight to the bank or financial institution, and ensuring that the affairs of the entity are carried out in the best interest of the institution. Directors have a duty to act carefully in fulfilling the important task of directing and monitoring the activities of management, ensuring that the company's day-to-day operations are in the hands of qualified, honest and competent management.

(2) Specific internal control duties of directors shall be to:

a) Approve and review, on at least an annual basis, the overall business strategies and significant policies of the institution;

b) Understand the major risks run by the institution and set acceptable levels for these risks and ensure that senior management is monitoring the effectiveness of the internal control system.

c) Approve and review, on at least an annual basis, the manuals on organization and functions, on policies and procedures for every area of business, on risk management and control and any others necessary for carrying out the affairs of the institution.

d) Formally review, at least once a year, the internal control system and the audit function.

e) Be ultimately responsible for ensuring that an adquate and effective system of internal controls is established and maintained.

Responsibilities of senior managers

17. (1) The chief executive officer or general manager shall be ultimately responsible for the institution's organizational and procedural controls and to fulfill this responsibility by ensuring the integrity of internal controls and by having in place an effective management team that is characterized by a culture of control and that is accountable for the performace of its responsibilities.

(2) Specific internal control duties of the chief executive officer or general manager shall be to:

a) Implement strategies and policies approved by the board;
b) Develop processes that identify, measure, monitor and control risks incurred by the institution;
c) Maintain an organizational structure that clearly assigns responsibility, authority and reporting relationships;
d) Ensure that delegated responsibilities are effectively carried out; set appropriate internal control policies; and monitor the adequacy and effectiveness of the internal control system.

(3) The manual of organization and functions shall specify the responsibilities of each member of the management team of the bank or financial institution.

(4) Managers shall be responsible for ensuring that outsourced services of any kind are with reputable companies that themselves have an adequate internal control system. Contracts shall stipulate that external auditors, internal auditors and examiners of the Bank have access to any documentation or information source or system, that may be requested in the discharge of their respective functions.

Creation and responsibilities of the audit committee

18. (1) Banks and financial institutions shall set up a permanent audit committee composed of three to five non-executive directors who are independent of management and have a background compatible with their duties.

(2) The by-laws of the bank or financial institution shall establish the composition, authority and duties of the audit, including the duty to report to the entire board of directors at least every three months.

(3) The audit committee shall be entitled to call to its meetings any of the senior managers or the internal auditor, request access to any necessary data or records and order any investigation to be performed.

(4) The audit committee shall review and confirm the internal audit charter and the audit plan, as well as the resources required to implement the audit plan, in terms of personnel and material resources. It shall receive the activity reports and the summary of the significant internal auditor's individual recommendations and management' plans for their implementation.

(5) The audit committee shall recommend to the board of directors the appointment of the external auditor and review its terms of engagement. The work plan of the external auditor shall be subject to the audit committee's approval and the audit report

and management letter shall be presented and discussed with the audit committee.

(6) The audit committee shall review and be responsible for prompt action to ensure:

a) The appropriate functioning of the internal control system.

b) The planning, implementation and performance of activities of the internal auditor

c) That the planning of activities of external audits include a review of the nature, scope and opportunity of audit procedures.

d) That external and internal auditors' reports are adequately reviewed and management takes appropriate corrective action, particularly regarding any weaknesses of the internal control system.

e) That the risk areas of the instititution's operations be covered in the scope of the internal and external audits planning each year.

f) That financial information provided to management and external users is reliable and accurate.

g) That any material accounting or auditing concerns identified as a result of the external or internal audits are properly corrected.

h) That the institution complies with legal and regulatory provisions, its articles of association, charter and by-laws, and the rules established by the board of directors.

i) That external auditors maintain their independence at all times.

j) That internal controls and management performances correspond with the institution's needs

k) That the board of directors and the Bank are periodically informed about compliance with rules and regulations; internal control policies and procedures; identification of material internal control and internal audit problems; and an evaluation of the impact of corrective measures implemented by management.

PART VI
INTERNAL AUDITOR

Appointment of the internal auditor

19. (1) Banks and financial institutions shall appoint an internal auditor whose function is to permanently evaluate the effectiveness of the internal control system.
(2) The board of directors shall be responsible for ensuring the independence of the internal auditor and that sufficient human and material resources are available for the adequate performance of its functions and duties.
(3) The internal auditor shall report to the board of directors either directly or through the audit committee.
(4) The appointment of the internal auditor shall be advised to the Bank, with sufficient advance notice for the vetting process.
(5) The dismissal or resignation of the internal auditor and its causes shall be communicated to the Bank on the same day it is decided or the next working day at the latest.

Audit charter

20. (1) Banks and financial institutions shall have a written audit charter that enhances the standing and the authority of the internal audit function within the bank.
(2) The internal audit charter shall establish at least:
a) The objectives and scope of the internal audit function.
b) The internal auditor's position within the organization, its powers, responsibilities and relations with other control functions;
c) The accountability of the internal auditor.
(3) The charter shall be reviewed annually by the internal auditor. It shall be approved by the audit committee and subsequently confirmed by the board of directors as part of their supervisory role before the start of the financial year.
(4) The charter shall mandate the internal auditor with the right of initiative and authorizes it to have direct access to and communicate with any member or staff, to examine any activity of the institution, access any records, files or data of the institution, including management information and the minutes of all consultative and decision-making bodies, whenever relevant to the performance of its assignments.
(5) The charter shall establish the internal auditor's authority to communicate directly, and on his/her own initiative, to the board, the chairman of the board of directors, the members of the audit committee or the external auditors where appropriate or to the

Bank.
(6) The charter shall specify the terms and conditions to which the internal auditor can be called upon to provide advisory services or perform other special tasks.
(7) The charter shall establish a yearly independent review of the internal audit performance, which may be carried out by an independent party like an external auditor or by the audit committee.
(8) The charter shall be communicated throughout the financial institution and a copy be provided to the Bank.

Duties of the internal auditor

21. (1) The duties of the internal auditor shall include:
a) Examine and evaluate the adequacy and effectiveness of the internal control systems.
b) Review the application and effectiveness of risk management procedures and risk assessment methodologies.
c) Review the management and financial information systems, including the electronic information system.
d) Review the accuracy and reliability of the accounting records and financial reports.
e) Review the institution's system of assessing its capital in relation to its estimate of risk.
f) Appraise the economy and efficiency of the operations.
g) Review the systems established to ensure compliance with legal and regulatory requirements, codes of conduct and the implementation of policies and procedures.
h) Test the reliability and timeliness of the regulatory reporting.
i) Carry out special investigations.
(2) It is the responsibility of senior management that the internal audit department is kept fully informed of new developments, initiatives, products and operational changes to ensure that all associated risks are identified at an early stage.

Audit plan

22. (1) The internal auditor shall prepare an annual plan for the assignments to be performed during the next financial year and present it to the audit committee for review on or before March 30, and to the board of directors for review and approval not later than May 30. The minutes of the board's approval session shall be provided to the Bank not later than June 15.
(2) The annual audit plan shall include the timing and frequency of

planned internal audit work and it shall be based on an evaluation of internal controls and on a written assessment of material risks, updated yearly. The plan shall include a detail of the necessary resources in terms of personnel and other resources and shall specify the time devoted to training.
(3) The reports of the internal auditor shall be presented to the audit committee, containing the findings and recommendations as well as the responses of senior managers. The reports and working papers shall be kept for at least five years.
(4) The internal auditor shall follow up its recommendations to verify whether they are implemented. The status of the recommendations shall be communicated on a monthly basis to the audit committee and permanent coordination shall be maintained with senior managers.

Outsourcing of internal audit

23. (1) With the prior approval of the Bank, an internal audit outsoucing arrangement may be contracted between a bank or financial institution and a qualified professional.
(2) Regardless of the contractual stipulations, the audit committee and the board of directors shall remain ultimately responsible for ensuring that the system of internal control and the internal audit are adequate and operate effectively.
(3) All the conditions of this regulation remain applicable in the case where all internal audit activities are outsourced.

PART VII
SANCTIONS AND RISK CONTROL MEASURES

Sanctions

24. Without prejudice to the other penalties and actions prescribed by law, and unless otherwise required in these Regulations, the deliberate or negligent violation of any of the provisions hereof will attract one or more of the following sanctions:
(1) Imposition of fines on the directors, officers and employees responsible for the violation in such amounts as may be determined by the Bank to be appropriate or reasonable.
(2) Suspension from office of the defaulting director, officer or employee.
(3) Perpetual disqualification from holding any position or office in any bank or financial institution under the supervision of the Bank.

Risk control measure

25. Provisions for loan losses may be directed by the Bank in such amounts as may be determined appropriate or according to any regulation, to control the additional risk represented by weak or inadequate internal controls or internal audit.