

**PRAKAS**  
**ON**  
**THE INTERNAL CONTROL OF BANK AND FINANCIAL INSTITUTIONS**

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**CHAPTER I**  
**GENERAL PROVISIONS**

**Article 1: Principles**

1.1 Although the responsibility for safe and sound operations and abiding by applying laws and regulations relies essentially with management of the banking and financial institutions hereinafter called “ Institutions” , the establishment of an adequate internal control system shall be considered as an effective means to:

- (a) Support management in the exercise of its responsibilities;
- (b) Allow for early identification, assessment and management of risk, and
- (c) Support risk-awareness and responsiveness in implementation of corrective actions.

1.2 The internal control system shall also be considered in light of the volumes and complexity of the activity, corporate group structure, establishments (domestic and abroad), and of the various types of risk to which they are exposed. The internal control system shall be commensurate to such activities’ and operations’ complexities, adequately staffed and provided with appropriate other resources required for effectiveness purposes, such as, but not limited to, management information systems and contingency planning and testing.

1.3 An effective internal control system shall also aims at promoting the sense of individual responsibilities and shall be supported by clear and well understood accountability rules throughout the entire organization. Such accountability rules shall be effectively supported by clear reporting lines to management, senior management and to the Board of Directors or equivalent executive body. The accountability rules should also be tailored in a way that effectively supports the arrangement made for delegating authorities and making sure that beneficiaries of delegated authorities are clearly aware of checks and controls involved by such delegations throughout the entire chain of management and command.

1.4 For the purposes of this Prakas, the Internal Control System shall notably-but not limited to include the followings;

- (i) A control system for operations and internal control procedures;
- (ii) The organization of accounting and information processing systems;
- (iii) Risk and result measurement systems;
- (iv) Risk identification, measurement and monitoring systems as well as the risk control systems supporting corrective actions;
- (v) Segregation of duties, prevention from conflict of interest situations and resolution policies and procedures;
- (vi) Compliance policies, procedures and processes;
- (vii) Documentation and information system; and
- (viii) A system for the monitoring positions and flows of cash and securities.

1.5 Where applicable, the Internal Control System shall be set up at a consolidated level and effectively support risk identification, measurement, monitoring and control at such

consolidated level. Responsibilities, reporting lines and accountabilities shall be established subsequently in order to fully and clearly support the effectiveness of the consolidated Internal Control System.

## **Article 2: General Objectives**

The purpose of the overall Internal Control System is to provide optimal conditions in terms of security, reliability and comprehensiveness for:

- 2.1 Ensuring that the institution's operations, organization and internal procedures comply with relevant laws and regulations, customary business practices and ethics and the business strategy determined by the executive body;
- 2.2 Ensuring strict compliance with decision-making procedures and risk-taking policies and procedure, whatever the kind of risks involved, and with the management standards set forth or approved by the executive body. Such policies and procedures shall notably take the form of authorized and prohibited activities and transactions as well as limits applying to the different types of risks;
- 2.3 Ensuring the quality of financial and accounting information, whether destined for the executive and decision-making bodies, for the supervisory authorities or for general public disclosure;
- 2.4 Verifying the conditions in which such information is assessed, recorded, stored and made available, in particular by ensuring that the Audit Trail Systems and Procedures are effective and allow for retrieving legal documentation or accounting supporting documents at the origin of the elementary entries into the accounting and into the risk management information systems;
- 2.5 Through periodic assessments and reviews, ensuring for quality and appropriateness of information and communication systems within the organization at both, individual and, where applicable, consolidated levels, and towards the authorities and the external auditors.

## **Article 3: Definitions**

For the purposes of this Prakas, following definitions shall be strictly considered:

- **“Audit Committee”**: A Committee that should be set up by the Executive Body to assist it in the exercise of its functions. The Executive Body shall determine its membership, tasks, operating procedures and the conditions in which the External Auditors, the Internal Auditor and any other person belonging to the organization shall be involved in its work.

The Audit Committee shall be chaired by an independent Board or Executive Body member who shall not be directly in charge of risk-taking activities or business development areas.

Under the responsibility of the decision-making body, the Audit Committee shall notably be in charge of following tasks:

- (a) Ensuring that the financial and risk-related information is clear and assessing the relevance of the accounting and valuation methods used for the establishment of the individual and, where applicable, consolidated accounts and financial statements;

- (b) Assessing the quality of internal control procedures, in particular whether the systems for measuring, monitoring and controlling risks are consistent, and recommending further action where appropriate;
- (c) Following up on effective corrective actions' implementation, notably by tracking pending and outstanding recommendations issued by Internal Audit and further supporting the work of Internal Audit.
- **“New Products / New Activities”**: For the purposes of this regulation, New Products / New Activities shall be viewed as any transaction, new service, new equity participation, new outsourcing decision, or whatsoever that would involve changes, upgrades, IT developments, legal aspects, compliance and risk assessments, consumer protection, material policy, procedural, processing and organizational changes, accounting entries and charter of accounts upgrades and changes ect. which if not appropriately performed could result in unidentified operational, legal-compliance, or any type of risk for the institution. Such risk need to be assessed prior to taking on such new products and activities by all functions involved- operational, support as well as control functions and, where necessary, appropriate measures taken to adequately process, control, monitor, manage and, where deemed necessary, mitigate the risks involved by such new activities and products.
  - **“Executive Body”**: executive body refers either to the Board of Directors for Corporate entities where executive responsibilities only rely with the Board of Directors or the Executive Board for corporate entities where a Supervisory Board has been established.
  - **“Supervisory risk-profile assessment”**: Comprehensive analysis of a covered institution's condition based on all the data and information made available to the supervisory authority in charge. Such assessment aims at evaluating all the risks carried by a covered entity ( solvency, liquidity, credit/counterparty, market and interest rate, notably) and, but not limited to, the quality of internal controls, risk, business and funding concentration issues, insufficient ability to withstand adverse business or market development, risk management organization and effectiveness, staffing, segregation of duties, potential for conflicts of interest, independence of “key” functions, effectiveness of reporting lines, IT infrastructures and processes, Management Information Systems, Corporate Governance, Shareholders' support, Contingency Planning, procedures and effectiveness of back-up solutions supported by periodic testing.
  - **“Consolidated risk-profile assessment”**: Supervisory risk-profile assessment performed at a consolidated level by the National Bank of Cambodia acting as a consolidated supervisor. When and where applicable, such a risk-profile assessment shall also be performed at the level of a financial conglomerate.
  - **“Credit/counterparty risk”**: the risk incurred in the event of default of counterparty or of counterparties deemed to constitute a “single beneficiary” in the sense of the definition set forth in the Prakas on Asset Classification and Provisioning in Banking and Financial Institution. Such risk shall be considered globally for both on balance sheet positions and off-balance sheet commitments and contingencies.
  - **“Market risks”**: any exposure to financial losses due to changes of assets' prices in the money, capital and financial markets. Market risks encompass interest rate risk, foreign exchange currency risk, equity risk and commodity risk.

- **“Overall interest-rate risk”**: the risk incurred by banking book transactions accounted for on-balance as well as off-balance in the event of interest-rate fluctuations due to imbalances between funding and lending terms. Such overall interest-rate risk directly impacts the institution’s net interest margin which shall be adequately monitored and managed alongside with the overall liquidity condition by a dedicated Committee, such as an Asset and Liability Committee (ALCO). Banking Book refers to items for which interest income and interest expense are accounted for on an accrual basis. Interest rate risk involving price changes for tradable instruments, due to implementation of mark-to-market or fair value, shall be considered market risk.
- **“Liquidity risk”**: the risk that, in a given market situation, the institution might not be able to fulfill its obligations or will not be able to unwind or offset a position with the consequence that it might be considered as being defaulting by other market participants, Liquidity risk shall be considered for cash, in domestic and foreign exchange currencies, as well as for any other tradable or listed asset the Institution is trading in.
- **“Settlement risk” / “delivery risk”**: The risk that settlement in a payment system will not take place as expected. The risk incurred during the time when the payment or delivery order for a financial instrument that has been sold/ purchased can no longer be unilaterally cancelled and the final receipt of the corresponding cash or financial instrument.
- **“Operational risk”**: the risk incurred by an inadequacy or a failure attributable to internal procedures, personnel, internal systems or to external events.
- **“Legal risk”**: the risk of litigation with any counterparty caused by any lack of clarity, inaccuracy or deficiencies whatsoever that may be attributed to the institution in the course of its operations, Legal risk is a sub-category of operational risks involved by operations.
- **“Intermediation risk”**: the risk that a principal or counterparty will default in a transaction involving financial instruments for which a reporting institution has guaranteed final settlement or delivery.
- **“Business continuity plan”**: a set of measures and procedures designed to ensure according to various crisis scenarios including severe shocks or adverse conditions, the continuation of essential services for the institution, where appropriate and temporarily in a degraded mode, but with the aim of resuming normal operations as soon as possible. Such business continuity plan might be broken down into several “contingency plans” such as, but not limited to “liquidity contingency planning”, “Information Technologies and Systems contingency planning and backups” or “Crisis management planning”
- **“Non-compliance risk”**: risk of judicial, administrative or disciplinary sanction(s), of significant financial losses or loss of reputation arising from the failure to comply with the prevailing laws and regulations, professional and ethical standards, specific regulations issued by market authorities, relating to banking and financial activities and with policies and instructions issued by the decision-making body.
- **“Outsourced activities”**: activities for which the reporting institution entrusts the provision of essential services to third parties by ways of sub-contracting such activities and services on a permanent and habitual basis. Essential activities and services shall be understood as the ones for which the failure to deliver timely by the sub-contractors would result in disruptions in the normal operations of the

reporting institution and could have significant impacts on the institutions ability to fulfill its obligations or reputation.

- **“Concentration risk”**: risk arising either directly or indirectly, from risk exposures to the same counterparty, groups or related counterparties, to the same issuer of securities, to the same economic sector, geographic region, country, to a given type of asset or collateral category or due to significant exposure to a counterparty with which significant risk mitigation transactions were transacted.
- **“Whistle blowing procedure”**: any procedure aimed at addressing a real or potential conflict of interest situation or compliance issue arising in the course of normal operations by setting up adequate and independent reporting lines and establishing individual protection rules aimed at benefitting to staff members acting in good faith and in the institution’s overall interest.

## CHAPTER II

### ORGANIZATION OF INTERNAL CONTROL SYSTEM

#### **Article 4: Board and Senior Management Responsibilities**

4.1 Its is the Board’s responsibility to establish the general framework for an appropriate Internal Control System that complies with the provisions of the present Prakas. The Internal Control policies aimed at establishing an effective Internal Control System shall be approved by the Board and periodically assessed and, if required by circumstances, revised.

4.2 The Board shall notably establish the Board level committees, designate their members, and clearly define their missions and the conditions under which their chairs shall report to Board. Despite of other committees foreseen in Prakas on Governance in Banks and Financial Institutions, The Board shall consider establishing other dedicated Committee(s) where deemed appropriate due to complexity and size of operations and organization with the aim of prudent risk taking and risk management objectives.

4.3 The Internal Control policies shall also foresee the conditions under which new activities, new services or new financial participations can be undertaken. Such preliminary risk assessments and evaluation processes aim at ensuring the adequacy and capacity of Internal Control System, Risk Management processes, Accounting and Reporting function and Compliance procedures prior to undertaking such new activities and participations shall be performed under the responsibility of senior management and discussed in a New Activities and Products Committee (NAP Committee).

The assessments performed and the corresponding recommendations made to the Board shall be formalized. All Committees’ minutes shall be filed and made available without any restriction to the Supervisory Authority, Internal Audit and External Auditors at their request.

Where such recommendations foresee preliminary conditions to be fulfilled or testing period, the Internal Control policies shall foresee procedures aimed at assessing effectiveness prior undertaking new activities, offering new services, performing the planned investments through financial participations or establishment of subsidiaries. For the latter, consolidated Internal Control procedures and risk management processes shall be established. More specifically, potential impacts on financial condition, liquidity and solvency management shall be prudently assessed and require the Board’s attention.

4.4 As a general principle, Board level committee dealing with Internal Control, Audit, New Activities and Products, Risk Management and Remuneration shall be chaired by independent board member(s) that are not involved in daily operation, business development or administration. Committees' organization and chairing shall always be considered in light of potential conflicts of interests and shall be set up in a way aimed at informing timely and effectively the Board and at supporting knowledgeable decision making.

4.5 The Board shall also establish risk taking policies that shall be reviewed in light of financial condition of the institution and, where applicable, group or financial conglomerate, and market developments. Such policies shall notably establish the prohibited activities, risk tolerance and aversion principles, essentially in the form of minimum liquidity and solvency buffers, overall risk concentration limits and policies aimed at dealing with crisis situations (contingency planning). Such policies shall be periodically reassessed and the compliance function shall provide the Board with assessment aimed at ensuring that such policies are clearly understood and fully adhered to.

4.6 The Board shall be responsible for provision of adequate and qualified resources to fill in the positions to be established in order to carry out permanent and periodic controls. Such resource shall be commensurate it size and complexity of business as well as to the organization and corporate structure. The Board shall also ensure that Internal Audit can operate independently by 1) being staffed adequately, 2) being given full access to information and data required to carry out its missions throughout the entire organization, and 3) being provided with appropriate IT, management information system' accesses, training, methodological and audit planning resources.

#### **Article 5: Internal Control System: permanent and periodic controls**

5.1 The overall organization and policies related to the Internal Control System shall be approved by the Board of Directors or its equivalent. Such Internal Control System shall encompass both, permanent controls and a periodic control function.

5.2 The permanent controls shall be established and designed in order to control on an ongoing basis;

- (i) Compliance with prevailing laws and regulations, professional and ethical standards, specific regulations issued by market authorities, relating to banking and financial activities and with policies and instructions issued by the decision-making body;
- (ii) Existence and effectiveness of procedures and processes aimed at avoiding or, where applicable, at resolving conflict of interest situation;
- (iii) Approval, security and validation of completed transactions in light of existing policies, procedures and processes related to authorities, to segregation of duties and to independence of decision and reviews; and
- (iv) Effective implementation of specific internal policies and procedures related to the identification, measurement, limitation and monitoring of all types of risk associated with activities and transactions carried out by the Institution.

5.3 The permanent controls shall be carried out, with appropriate qualitative and quantitative resources and supported by appropriate information systems, either by:

- (i) Appropriate hierarchic level in the organization with clear control responsibilities that do not conflict with other operational responsibilities, or
- (ii) Dedicated staff assigned exclusively to permanent control tasks and reporting directly or indirectly, but independently, to an independent Board member or equivalent; or
- (iii) Staff in charge of operational responsibilities but which responsibilities are not conflicting with control missions clearly segregated from the operational tasks; or
- (iv) Any combination of the three previous solutions deemed appropriate to the nature, complexity and volumes of risks involved by the daily operations and considering the organizational set-up of the Institution.

5.4 Periodic controls shall be carried out by Internal Audit that shall be independent from permanent control functions and from operational areas. In addition, Internal Audit shall not be in charge of missions that could result in conflict or interest situations that would or could hamper the independence of its assessments. The head of Internal Audit shall report to the chair of the Audit Committee.

5.5 Designation of head of Internal Audit and of head of the Compliance function should be request for prior approval from the National Bank of Cambodia. Such reports shall be accompanied by a CV of the position' holders and by a detailed description of education, professional background, experience acquired and other relevant document. The NBC might notify its objection to such designation within 15 working days from reception of the fully designation documents. The National Bank of Cambodia shall be directly entitled to liaise with head of Internal Audit and head of the compliance function and to forward its requests to them. Dismissal or removal of head of Internal Audit and of Head of Compliance shall be notified to the National Bank of Cambodia without delay; such decisions shall be duly motivated and clearly reported to the National Bank of Cambodia.

5.6 For Groups and financial conglomerates, the individuals in charge of Internal Audit and of Compliance at a consolidated level shall be subject to the reports foresee by paragraph 5.5 above. In addition, such reports shall be supported by organization charts, internal policies and procedures allowing for a clear understanding of the reporting lines and the relationships with the other officers in charge appointed in the different entities belonging to the group or to the conglomerate.

### **CHAPTER III**

#### **OUTSOURCED ACTIVITIES AND SERVICES**

##### **Article 6: Outsourced activities other than Internal Audit**

6.1 Outsourced activities defined in article 3 of the present Prakas shall:

- (i) Be subject to compliance checks ensuring that such outsourcing is not prohibited by any legal or regulatory provision or by a Board's policy;
- (ii) Be subject of a written agreement between the outside service provider and the institution;
- (iii) Be performed within the framework of a formal policy for controlling outside service providers framed by the outsourcing institution.

- 6.2 In their relations with their outside providers, institutions shall ensure that the providers:
- (a) Commit to a level of quality that corresponds to normal operation of the service and, should an incident occur, leads to use contingency procedures and mechanisms aimed at resuming service provision within to the institution acceptable delay;
  - (b) Implement emergency mechanisms in the event of serious difficulty affecting continuity of service, or ensure that their own continuity plan takes account of a scenario in which its is impossible for the outside service provider to resume service provision to the institution;
  - (c) Are not able to impose a substantial modification of the service they provide without the outsourcing institution's prior consent and under a reasonable delay that would be require to take alternative measures;
  - (d) Comply with the procedures defined by the institution related to the organization and implementation of control of the services they provide;
  - (e) Allow them access, whenever necessary, on-site where relevant, to all information about the services provided to them, in compliance with disclosure requirements established;
  - (f) Report to them regularly on the way in which the outsourced activities are performed and on their financial condition; and
  - (g) Give access to the National Bank of Cambodia's on-site examination team to any information deemed necessary for the performance of its assignment, including, where and when required, controls and interviews on-site at the service provider's operations premises.

6.3 Based on its risk-assessments, Internal Audit shall perform periodic audit reviews focusing on or encompassing outsourced activities and services. The frequency of such audit reviews shall be commensurate to the risks involved for the institution. Notably, compliance with the provision set forth above shall be specifically assessed as well as existence, consistency and effectiveness of emergency mechanisms and contingency planning.

#### **Article 7: Outsourcing of Internal Audit**

7.1 For smaller institutions that belong to banking or a financial group, the Board might consider outsourcing Internal Audit under its responsibility. However, Internal Audit shall neither be outsourced to the firm in charge of External Audit nor to an affiliate of such firm.

Prior to outsourcing Internal Audit to specialize firm or to a parent's company audit department the institutions shall require the National Bank of Cambodia's authority. Such request shall be supported by all required and useful information and data deemed necessary in order to make a knowledgeable decision.

7.2 When deciding upon outsourcing Internal Audit, Board member in charge shall ensure that:

- a) Service provided will be appropriate in light of the institution's activities, organization and business complexity;
- b) Audit reviews performed will be carried out in accordance with the best market standards and by professionals with the required education, skills and experience;

- c) allocated budget will be sufficient to comply with all the principles set forth in this Prakas, notably to ensure for effective independence of audit reviews, assessments and recommendations, and
- d) That the availabilities of the service provider will be sufficient to cover all functional and operational areas, in accordance with a comprehensive audit planning that covers all the risk areas as required by the identified priorities and by the provisions set forth in this Prakas on the comprehensive audit cycle and coverage.

7.3 In addition, all requirements set forth in article 6, above, related to outsourced activities shall be strictly complied with since Internal Audit shall be considered as an essential activity in the sense of the definition provided in article 3. Notably, alternative solution(s) shall be considered by adequate contingency planning to percent from any disruption or delays in the fulfillment of the audit planning under the responsibility of the independent Board member in charge.

## **CHAPTER IV**

### **COMPLIANCE**

#### **Article 8: Appointment and responsibilities of Compliance Officer**

8.1 The organization of the Compliance function shall be approved by the Board and appropriate to support effective fulfillment of missions and responsibilities in light of size, complexity, network, participations of organization and risks involved by business carried out. The compliance function shall be placed under a responsibility of a Compliance Officer who is not involved in business operations to prevent from potential conflicts of interests. The Compliance Officer shall report to an independent Board member in charge.

8.2 The designation, dismissal, removal or resignation of the Compliance Officer shall be reported to the National Bank of Cambodia, under the conditions set forth in article 5, paragraphs 5.5 and 5.6.

8.3 Manager and staff in charge of permanent controls related to AML/CFT and to “Know Your Customer” shall be placed under the direct authority of the Compliance Officer. Depending on the organization of the overall Compliance function, policies and procedures shall fully support the Compliance officer’s cooperation with other individuals and areas involved in Compliance controls, such as, but not limited to, Finance and Reporting, Accounting and Legal Departments. The “whistle blowing” procedure foreseen in article 11 shall systematically lead to involve the Compliance Officer.

#### **Article 9: Compliance control system**

9-1 The Compliance control system shall be established and organized in accordance with policies to be approved by the Board, and supported by appropriate and effective procedures and processes under the responsibility of the Compliance Officer referred to in article 8.

9.2 Institutions shall provide all staff members involved in compliance controls with adequate training in procedures for controlling compliance, adapted to the operations and controls they perform.

9.3 The Compliance control system and procedures shall be designed to prevent from non-compliance risk as defined in article 3 and to address swiftly any potential compliance issue or concern. With regard to this general objective, institutions shall notably establish procedures and processes for assessing compliance, including:

- Procedures for systematic prior approval, including a written notice from the compliance officer or a person duly authorized by the compliance officer for this purpose, for new products, activities, undertakings or material changes to existing products and services; and
- procedures for controlling completed transactions

9.4 Institutions shall establish, as part of the compliance control system, a monitoring system operating on a regular basis and as often as possible of any changes to the rules and regulations applying to their operations and, in that context, aimed at immediately informing all staff members concerned.

## **CHAPTER V**

### **CONFLICT OF INTEREST: PREVENTION AND RESOLUTION**

#### **Article 10: Prevention procedures and mechanisms**

10.1 Institutions shall establish procedures and mechanism aimed at preventing conflict of interest situations. Such procedures and mechanisms shall notably rely on clearly established rules and principles such as, independence of controls, segregation of duties, adequate delegations and accountability, reconciliation processes or refraining from establishing negative incentives in the form of bonuses that could prove detrimental to prudent risk selection and management, position taking, control over asset quality, liquidity and solvency condition.

10.2 Policies aimed at preventing from potential conflict of interest situations shall be approved by Board and periodically reassessed. When necessary, such policies shall be reviewed and improved in light of such periodic assessments.

10.3 The Compliance function shall ensure that policies and procedures are effectively complied with and bring any observed breach or issue to the independent Board member's attention, in writing. The underlying facts shall be documented and corrective actions recommended. Implementation of corrective actions required shall be considered without delay.

#### **Article 11: "Whistle Blowing" procedure**

11.1 Institutions shall establish " Whistle Blowing" procedures that meet the definition set forth in article 3. Such procedures shall involve the Compliance Officer who shall handle the reports confidentially, inform the independent Board member and take appropriate action to resolve the issue.

11.2 The "Whistle Blowing" procedure and processes shall be made known to staff. In addition, staff shall be clearly informed that activation of such procedure is protective but requires acting in good faith.

## CHAPTER VI

### INTERNAL AUDIT

#### **Article 12: Organization of Internal Audit**

12.1 Internal Audit shall be placed under the responsibility of an Internal Auditor appointed in accordance with the provisions and requirements set forth in article 5, paragraphs 5.5 and 5.6. Head of Internal Audit shall be fully independent, report to an independent Board member and shall not be in charge of any permanent controls or operational tasks. Notably, Head of Internal Audit shall not be in charge of the Compliance function; therefore, Head of Internal Audit shall not be in charge of the compliance function; therefore, Head of Internal Audit cannot be simultaneously the institution's Compliance Officer.

12.2 Where Internal Audit is outsourced the conditions under which such outsourcing is performed shall comply with the requirements established in article 7, and the principles set forth under this Chapter.

12.3 The Internal Audit function shall be appropriately staffed, both numerically and qualitatively by considering size and complexity of business and organization. Where applicable and appropriate, reporting lines, performance appraisals, staffing, training and audit methodologies and procedures shall be considered at a group's level.

#### **Article 13: Objectives of the Internal Audit Function**

13.1 Internal Audit's mission is to carry out periodic and comprehensive audit reviews and investigations aimed at providing the Board and management with documented assessments and recommendation on:

- the effectiveness of risk identification, measurement, monitoring, management, limitation and, where applicable, mitigation procedures and processes;
- the effectiveness of the internal control procedures and processes and appropriateness of processes established to prevent from conflict of interest situations or, when applicable, to resolve them in a prudent manner; and
- the adequacy and effectiveness of Compliance controls and the full adherence to the policies issued by the Board.

13.2 The audit reviews shall be planned on a yearly basis and prioritized in light of the risk assessments performed by Internal Audit. The risk areas and priorities shall be documented and supported by an appropriate risk assessment methodology that shall be presented to and approved upon by the Board or by the Audit Committee. The audit review shall be planned and carried out during an audit cycle that shall be as short as possible and allow for the coverage of all risk areas identified in the organization. Over an audit cycle, no risk area shall remain unaudited. In addition, highly risky areas shall be audited several times over a complete audit cycle.

13.3 All material audit issues and concerns shall be clearly documented and accompanied by recommendations to Board and management aimed at addressing them effectively and

without undue delays. Effective implementation of recommended corrective actions shall be subject to a tracking mechanism and supported, where demand appropriate, by follow up mission aimed at assessing effectiveness of such corrective actions. Pending audit recommendations shall be periodically, and at least twice a year, reported to independent Board member whom the Internal Auditor reports to and, at Audit Committee's chair request, to the Audit Committee members.

#### **Article 14: Audit Resources, methodologies and procedures**

14.1 Internal Audit shall be adequately staffed to carry out the audit cycle effectively. Internal Auditor shall also be provided with a budget, which under his /her responsibility, shall allow for covering all expenses related to specific audit training, business travels and outsourcing incurred by its missions.

14.2 Adequacy of staffing and specialized audit profiles shall be periodically assessed in light of business growth, complexity and volumes of transactions, corporate structure and organization, technologies implemented and subsequent risks involved. Such assessments shall be formalized and provided to the independent Board member.

14.3 Risk assessments and audit reviews shall be performed in accordance to the prevailing professional standards and shall, where appropriate, be reviewed in light of best practices. Such assessments and reviews shall be supported by written audit methodologies, procedures and manuals. Access to such documents and methodologies shall be granted, at request, to Board, Audit Committee members, External Auditors and Banking Supervisory Authority.

### **CHAPTER VII**

#### **RISK MANAGEMENT POLICIES, PROCEDURES AND PROCESSES**

#### **Article 15: Responsibilities of the Board and of management**

15.1 The Board shall establish risk management policies addressing the different material types of risks incurred by the activities, complexity and size of the organization. Permanent adherence to these policies shall be part of the controls carried out by the Compliance function. These policies shall be part of the institution's documentation system addressed under Chapter X.

15.2 Management shall be responsible for the establishment of procedures and for the effective implementation of appropriate processes aimed at identifying, measuring, monitoring, limiting, management and, where applicable, mitigating the risks involved by the institution's operations and organization. Such procedures and processes shall be periodically assessed and reviewed in light of best practices, market developments and new undertakings. Adequacy of specific and applicable procedures and processes shall be systematically reassessed prior to undertaking new activities, new participations and offering new products and services to the customers and market counterparts.

#### **Article 16 : Effectiveness of procedures, processes and management information systems**

16.1 Procedures, processes and management information systems shall be designed and established in accordance with the principles set forth by the Board in the relevant policies. Such procedures, processes and information systems shall be subject to compliance

assessments and, where required, reviewed subsequently.

16.2 To be effective, risk management procedures, processes and information systems shall:

- a) Allow for risk identification and accurate measurement or evaluation;
- b) support decision making in light of sensitivity of such risks carried by the institution notably, but not limited, to adverse market developments, deterioration of debtor's or counterparty's financial condition, and more generally, attention required by prudent management objectives;
- c) Allow for consolidation of such risks in order to identify, monitor and effectively manage risk concentration issues;
- d) Be designed and implemented in a way that fully supports responsibilities and accountability in light of authorities, delegations and limits applicable; and
- e) Alerting hierarchic levels and Board of limit breaches or overstepped authorities and delegations in a way deemed appropriate to take prompt corrective actions when so required by circumstances.

16.3 Effectiveness and adequacy of risk management procedures, processes and information systems shall be periodically reassessed under the responsibility of senior management and, independently, by Internal Audit. Where applicable, such procedures, processes and information systems shall support effective risk management at a consolidated level.

16.4 Adequacy of risk management procedures, processes and information systems shall be systematically reassessed prior to undertaking new activities, new participations and offering new products and services to the customers and market counterparts.

16.5 Risk management procedures, processes and information systems' documentation shall be up to date and part of the documentation system referred to under Chapter X below.

## **CHAPTER VIII**

### **ACCOUNTING AND INFORMATION SYSTEMS**

#### **Article 17: Compliance with legal and regulatory standards, documentation**

17.1 Institutions shall comply with legal and regulatory standards applying to accounting, financial reporting and financial disclosure. Adequate controls shall be established in order to assess effective compliance with such standards. Where options can be considered, such options shall be discussed and approved upon by the Audit Committee in a prudential perspective, duly documented and strictly adhered to.

17.2 Institutions shall establish and maintain an adequate documentation on the charter of account implemented, on the accounting entries to be performed for recording transactions and events generating accounting entries and on the accounting information system implemented.

## **Article 18: Effective audit trail procedures and processes**

18.1 Regarding the information disclosed in the balance sheet, off-balance sheet, income statement and notes to financial statements, the organization of the accounting processes shall foresee a set of procedures and processes, known as audit trail, making it possible to:

- a) Reconstruct operations in chronological order;
- b) Support all information with original documents from which it must be possible to trace an operation directly back to the summary document, and vice versa;
- c) Account for changes in balances from one closing date to the next one, by preserving effective records of movements that affect such accounting balances.

18.2 Effectiveness of audit trail shall be periodically tested and assessed.

## **Article 19: Inventories of assets held by initiations on behalf of customers and third parties**

19.1 Institutions shall establish procedures and keep accurate records showing inventories, inflows and outflows of assets held on behalf of customers and third parties that are not their properties and, therefore, not included in their individual accounts and reports.

19.2 With regards to such assets, a distinction shall be made between assets held on deposit and assets held as collateral for a commitment given for a specific purpose or by virtue of a standing agreement in favor of the depositors.

## **Article 20: Independent controls, segregation of duties and periodic reconciliations**

20.1 Institutions shall implement procedures and processes supporting effectively segregation of duties, independent controls and periodic reconciliations aimed at safeguarding their assets and at identifying rapidly any significant discrepancy.

20.2 Such procedures and processes shall notably establish a clear segregation of duties and functions involving institution's commitments, paying away funds and accounting for the institution's assets and liabilities. Such processes shall be periodically reconciled and reassessed.

20.3 Such procedures and processes shall notably foresee control lists, reconciliation of accounts, checks and balances (dual controls, independent validation of accounting entries, double signature or any equivalent built-in in process supported the accounting system), exhaustive review of assets accounted for in inventories and information to be provided to management on the results. Any discrepancy shall be swiftly investigated, documented and prudently addressed. Where required, impacts of such discrepancies shall be immediately taken into consideration for their consequences on reported income and net worth that shall be corrected consequently.

## CHAPTER IX

### RISK AND RESULT MEASURING SYSTEMS AND CONTROLS

#### **Article 21: Effectiveness of risk and result measuring systems and controls**

21.1 Institutions shall establish risk analysis and risk measurement systems that are suited to the nature and volumes of their transactions as well as to the complexity of their activities. Such systems shall allow for timely and reliable assessment of the different types of risk they are exposed to, in particular credit risk, liquidity risk, overall interest rate risk and settlement risk.

21.2 Where applicable, such systems shall be designed and established to support consolidated risk analysis and measurement at a consolidated level. Such systems shall notably allow for an appropriate identification and monitoring of risk concentration and for supporting timely and effective risk management decision making.

21.3 Such systems and supporting procedures shall be subject to regular internal reviews aimed at ensuring that they remain comprehensive and proportionate to the nature, scale and complexity of activities carried out, organization and corporate structures involved.

#### **Article 22: Permanent control processes to ensure compliance with regulatory requirements or limitations**

The risk and result measuring systems and controls established by institutions shall allow for permanent monitoring for regulatory requirements or limitations. Any identified breach shall be immediately addressed and reported to the Head of Compliance. Such reports shall document the origins of the breach and the corrective actions implemented to address the non compliance risk involved. Such corrective actions shall also aim at preventing from repeated breaches and at reviewing the existing controls if assessed inappropriate or ineffective.

## CHAPTER X

### DOCUMENTATION SYSTEM

#### **Article 23: Policies, procedures, authorities, delegations and reports**

23.1 Institutions shall formalize and regularly reassess and update their policies, procedures, authorities and delegations, organization, information system, activities, corporate governance and corporate structure, if consolidated or consolidating entry.

23.2 Authorities and delegations shall be clearly documented and made available to all parties involved, beneficiaries, risk management and control functions, including compliance. The information system of the institution and, where applicable, of the group, shall allow for ensuring that all interested parties be clearly informed of such internal decision making rules. There shall also be adequate control processes established in order to ensure that authorities and delegations are not overstepped or misused.

23.3 Policies and procedures shall be made available to management and staff in writing; where required, implementation of such policies and procedures shall be supported by appropriate training. Such policies and procedures shall undergo compliance checks prior to their insurance and effective implementation. Such policies and procedures shall clearly

address the processes implemented with the aim of ensuring for segregation of duties, independence of controls and prevention or resolution of potential conflicts of interests.

23.4 Institutions shall notably establish, under the conditions set forth in paragraphs 23.1 to 23.3 above, and regularly assess and update documents aimed at supporting the effective operations of the overall internal control system in line with the policies established by the Board in these matters. Such documents that should be made available to all parties involved shall notably include:

- a) a description of the various levels or responsibility,
- b) a presentation of the functions and positions established as well as the resources allocated to such functions and positions,
- c) a discussion of the reporting lines and mechanism aimed at ensuring independence, absence of conflict or interest situations and effectiveness,
- d) a description of the risk measurement systems and processes. Where applicable, specific risk measurement methodologies, such as, but not limited to, statistical risk measures, replacement cost, mark-to-market, shall be documented and approved independently from business operations,
- e) a description of risk monitoring systems implemented for the surveillance of the risk described under article 3 of this Prakas, of the corresponding control systems, of the required corrective actions, if any, an alerts to be immediately brought to the Board's attention.

#### **Article 24: Organization of information and documentation system**

24.1 The institution's information system shall ensure that any significant decision or significant matter related to business, operations and organization be duly documented in a way that effectively supports tracking and facilitates access.

24.2 The institution's information system shall also support appropriate information dissemination system throughout the organization. Such dissemination shall notably be paid particular care to for matters related to internal control issues and, more specifically, to compliance requirements and provisions.

24.3 The contingency plans and related procedures shall be part of the institution's documentation system. Where applicable, such contingency plans and procedures shall be clearly articulated with the ones established on a group's level and with the procedures referred to in article 6, paragraph 6.3, for outsourced activities and services.

24.4 All policies, procedures, authorities, delegations, reports and minutes shall be made available, at their request, to Internal Audit, compliance, Banking Supervision and External Auditors for the purposes of their missions.

#### **Article 25: Annual report on the organization and effectiveness of the Internal Control System**

25.1 Institutions shall establish an annual report that describes the organization of the Internal Control System and the corresponding policies, procedures and mechanism. Such

report shall also assess the effectiveness of the Internal Control System in light of business growth and diversification and of changes occurred in the institution.

25.2 Where applicable, such report shall also discuss the articulation of such internal controls with the policies and organization established at a consolidated level.

25.3 The report shall be established under the responsibility of an independent Board member and shall be discussed by Audit Committee. Where deemed appropriate or necessary, corrective actions or improvements should be recommended to the Board.

25.4 The annual report shall be issued, under the signature of the independent Board member in charge, to the National Bank of Cambodia, no later than March 31 of the following year.

## CHAPTER XI

### CONTINGENCY PLAN AND TESTING

#### **Article 26: Requirement for contingency planning**

26.1 Institutions are required to perform periodic risk assessments in order to identify material risk exposures, risk concentration issues, significant sensitivity to adverse events and developments that could result in severe disruptions, such as failures to pay or to deliver timely for the fulfillment of their obligations, major compliance issues or systems' breakdown.

26.2 Such periodic assessments shall lead to establish emergency management and decision making processes aimed at dealing with crisis situations, notably by addressing plausible adverse scenarios that might have to be coped with under tight time constraints. The policies addressing crisis situations, contingency planning and testing, communication to the authorities and to the public shall be approved by the Board and implemented under the responsibility of clearly designated Board member (s)

26.3 Institutions are required to establish a Business Continuity Plan as defined in article 3 above that is commensurate to the risk identified on help of the periodic assessments referred to in paragraph 26.2, above. At a minimum, such Business Continuity Planning and procedures shall address contingency funding and emergency liquidity management as well as back-up solutions and processes aimed at coping with Information Technologies' failures.

26.4 Contingency plans and processes shall be periodically reassessed in light of business and market developments, complexity of organization and technologies involved, adequacy of downgraded substitution procedures and processes, minimum requirements for effectiveness of daily risk management and control and, more generally, by considering the impacts of potential foreseeable contingencies in terms of compliance and reputation risks.

## CHAPTER XII

### SANCTIONS, INCREASED SOLVENCY REQUIREMENTS

#### **Article 27: Sanctions in case of non-compliance or ineffective Internal Controls**

Non Compliance with and violations of the provisions set forth in this Prakas shall lead the National Bank of Cambodia to issue sanctions against the contravening institutions, according to its powers and the principles established in the Law on Banking and Financial Institutions. In addition, Such violations and insufficiencies and their potential impacts on the overall Institution's risk profile assessment shall be taken into consideration by the Banking Supervisory Authority at both individual and consolidated levels.

#### **Article 28: Increased Solvency requirements**

28.1 Due to severe insufficiencies in Risk Management processes or , more generally, in their Internal Control Systems, the National Bank of Cambodia might consider increased solvency requirements against those institutions that present a higher risk profile due to such insufficiencies.

28.2 Increased solvency requirement shall notably be issued against Institutions that did not implement the required corrective actions after a supervisory injunction.

28.3 Increased solvency requirements shall not exceed thirty (30) percent of the minimum solvency ratio and shall not be lifted without the Supervisory Authority being fully satisfied with the effectiveness of the corrective actions implemented. At the current regulatory minimum solvency level of 15% (fifteen percent), the maximum solvency requirements would be 19.5% (nineteen pint five percent).

28.4 Increased solvency requirements shall be notified in writing to the contravening Institution as well as the lifting of such prudential supervisory measure.

## CHAPTER XIII

### TRANSITIONAL PROVISIONS

#### **Article 29: Effective Implementation of the present Prakas**

Banking and financial Institutions shall fully comply with the provisions and requirements set forth in the Prakas no later than 1 July 2011. Effective implementation shall be supported by the performance of an overall assessment of the Institutions' exiting Internal Control Systems and by the identification of steps to be taken in order to achieve compliance.

#### **Article 30: Assessment and Action Plan**

30.1 Based on the required assessment, Banking and Financial Institutions shall identify the areas such as policies, procedures, processes, organizational framework, management information system etc., where actions need to be taken to comply with the regulatory provisions set forth in this Prakas and establish an action plan detailed the steps to taken and the additional means to be allocated to do so

30.2 Where applicable, the action plan shall address the actions to be taken to comply at a consolidated level.

30.3 The action plan will be detailed and supported by flow-charts, organization charts, job descriptions, committees' terms of reference, policies and procedures as well as budgetary elements aimed at supporting its effective implementation no later than 31 March 2010.

30.4 A copy of the action plan and evidence documents mentioned under paragraph 30.3 or any other additional information material deemed useful to the National Bank of Cambodia, no later than 31 March 2010. Late transmission of such action plan shall be subject to sanctions.

## **CHAPTER XIV**

### **FINAL PROVISIONS**

#### **Article 31:**

The General Directorate, the General Secretariat, the General Inspection, the General Cahier, and all Banking and Financial Institutions under the National Bank of Cambodia's supervisory authority shall strictly implement this Prakas.

#### **Article 32:**

The present Prakas shall take effect from this signing date.

Phnom Penh, 28 September 2010

**The Governor**

Signed and sealed: **Chea Chanto**