



Internal Control Functions

All businesses can benefit from thoughtful construction and proper operation of their internal control system. This is the set of processes aimed at providing reasonable assurance that:

- daily operations are carried out effectively
- resources are used efficiently
- financial reporting is reliable, and
- the organisation complies with applicable laws and regulations.

Cddb bank, acknowledges the importance of internal controls and strives to meet or exceed the requirements of the relevant Central Bank Directive of July 2014 on *“Governance and Management Arrangements in Credit Institutions”*.

While not explicitly mentioned in the Directive, modern day internal control frameworks are organised along the so-called *“three lines of defence”*. **The first line** is formed by the management and staff who carry out day-to-day operations and are hence best suited to take ownership for and manage risks in the first place. **The second line** is tasked with providing the first line with the necessary tools and support, monitoring the first line’s effectiveness in implementing the risk and control framework, and also helping to ensure consistency of definitions and measurement of risk. **The third line** of defence provides independent assurance, i.e. assesses how effectively the first two lines are operating, and issues recommendations for improvement.

The second and third lines of defence are collectively referred to as *“Internal Control Functions”*. In the case of banks they are made up of **Compliance, Risk Management, Information Security, and Internal Audit** respectively. Their roles and responsibilities are outlined further below. Common features shared by all Internal Control Functions include:

- 1) **Independence** - For Internal Control Functions to work effectively they need to operate independently, e.g. without interference from executive management. This is safeguarded through among others a direct reporting line to the Management Body, which is also responsible for the appointment and removal of the Heads of Internal Control Functions. Moreover, Internal Control Functions are organisationally independent from each other and the business and support units they monitor and do not carry out any duties other than those required by their mandate.
- 2) **Accountability** – Internal Control Functions report at least quarterly to the Management Body, and annually to the Central Bank.

Cddb bank’s **Compliance Function** reports to the Board’s Audit Committee. It is responsible for identifying laws and regulations relevant to the operation of the Bank and overseeing establishment of the necessary processes and documentation aimed at ongoing observance of their provisions. Examples of such legislation include anti-money laundering, and data protection.

The **Risk Management Function** reports to the Board's Risk Management Committee. Its work is divided between the four categories of risk recognised in Banking regulations, namely credit, market, liquidity, and operational risk. The Function assists the Board in setting the risk appetite of the organisation, based on which exposure and other limits are defined for quantifiable risks. Adherence to these internally set as well as regulatory limits is routinely monitored and deviations investigated and if need be escalated. The Function is also responsible for among other things designing and performing stress tests of Cdbbank's capital adequacy and liquidity, and for assessing the adequacy of loan provisions.

Cdbbank's **Information Security Function** is housed under Risk Management. Its mission is to provide advice on the design and to monitor proper operation of the framework for protecting Cdbbank's information assets stored electronically or in paper form. Logical security tools include the setting up of firewalls, use of data encryption, controlling user access rights, etc. Physical security involves restricting and controlling access to premises and network terminals.

The **Internal Audit Function** reports directly to the Board's Audit Committee. Its field work comprises onsite reviews of Cdbbank's key activities to assess the adequacy and proper operation of internal controls in the particular area. The schedule of such visits is determined by a risk-based annual audit plan. The Function issues reports with recommendations which line management is obligated to address. Implementation progress is routinely monitored and reported.