



HNB

Trg hrvatskih velikana 3, 10002 Zagreb
tel.: 01 45 64 555 / faks: 01 46 10 551, 45 50 726, 46 10 591
teleks: 22 569 / www.hnb.hr / mb 3269817

**Decision
on the internal controls system**

Pursuant to Article 105, paragraph (3) of the Credit Institutions Act (Official Gazette 159/2013) and Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

Decision on the internal controls system

1 GENERAL PROVISIONS

Subject matter and scope

Article 1

(1) This Decision prescribes in detail:

- 1) the content of internal acts for each control function;
- 2) the criteria that have to be met by persons carrying out the control functions;
- 3) the content and the dynamics of the control function reports and the persons to whom the reports are to be delivered;
- 4) the scope and the manner of operation of each individual control function; and
- 5) the manner in which a credit institution's management board examines the adequacy and efficiency of the control functions in accordance with Article 41, paragraph (5) of the Credit Institutions Act.

(2) The provisions of this Decision shall apply to credit institutions which have their head offices in the Republic of Croatia and are authorised by the Croatian National Bank.

(3) The provisions of this Decision shall apply *mutatis mutandis* to branches of third-country credit institutions authorised by the Croatian National Bank to establish branches of third-country credit institutions.

(4) A credit institution shall apply the provisions of this Decision on an individual basis and on a consolidated basis, in accordance with Part One, Title II of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27. 6. 2013, hereinafter referred to as 'Regulation (EU) No 575/2013').

2 INTERNAL CONTROLS SYSTEM

Internal controls system

Article 2

(1) A credit institution shall establish and implement an effective internal controls system in all areas of operation in accordance with the provisions of Article 104 of the Credit Institutions Act.

(2) All employees, particularly the senior management, the management board and the supervisory board of a credit institution shall participate in an appropriate manner in the establishment and implementation of the internal controls system.

(3) Internal controls, including administrative and accounting procedures referred to in Article 104, paragraph (2), item (6) of the Credit Institutions Act, shall in particular relate to:

- 1) the calculation and review of capital requirements for risks;
- 2) the identification and monitoring of large exposures, changes in large exposures and examination of compliance of large exposures with the policies of the credit institution pertaining to the relevant type of exposure;
- 3) the keeping of business books, other business documentation and records, evaluation of assets and liabilities and the preparation, disclosure and delivery of annual financial statements in accordance with the applicable regulations and professional standards;
- 4) the processes ensuring timeliness, validity and accuracy of publicly disclosed information;
- 5) management, logical and physical controls within the information system;
- 6) control procedures verifying the accuracy of data and information needed for supervision on a consolidated basis;
- 7) the reporting system and supervisory procedures for intra-group transaction monitoring;
- 8) the reporting to supervisory and other bodies in accordance with the relevant regulations; and
- 9) the estimation of the effects of outsourcing of business activities on the internal controls system.

3 CONTROL FUNCTIONS

Control functions

Article 3

(1) A credit institution shall set up control functions in accordance with the provisions of Articles 105 and 106 of the Credit Institutions Act.

(2) A credit institution shall have in place a work methodology for each control function.

(3) The internal audit function shall have in place an audit programme for each area to be covered by audit.

(4) A credit institution's management board shall periodically, and on an annual basis at a minimum, verify the adequacy of the procedures and the efficiency of the control functions, document its conclusions and notify the supervisory board thereof.

(5) In the procedure of examining the adequacy of procedures and efficiency of control functions, a credit institution's management board shall take into account as a minimum:

- 1) work methodology of each individual control function;

- 2) the execution of the work plan of each individual control function;
- 3) the number of employees included in the execution of each individual control function;
- 4) the structure and the content of each individual control function report;
- 5) the findings of each individual control function during the period that is being examined for adequacy and efficiency of an individual control function;
- 6) the risk profile of the credit institution;
- 7) business and risk management strategies; and
- 8) other criteria and documentation which it estimates to have an effect on the adequacy of the procedures and efficiency of individual control functions.

Bylaw on the control function

Article 4

(1) A credit institution shall regulate the work of control functions by means of an internal bylaw, in accordance with the provisions of Article 105, paragraph (2) of the Credit Institutions Act.

(2) A credit institution shall, by means of an internal bylaw, lay down for each control function, at a minimum:

- 1) the objectives, scope and mode of operation of a control function;
- 2) the organisational structure and the role of the control function;
- 3) the position of the control function within a credit institution;
- 4) the measures ensuring the independence and objectivity of each control function;
- 5) the authorities, responsibilities and relationships with other organisational units;
- 6) mutual relationships with other control functions;
- 7) the duties and responsibilities of the person responsible for the operation of each control function as a whole;
- 8) the measures for ensuring and monitoring professional qualification, adequate expertise and experience of the persons responsible for carrying out control functions;
- 9) the manner and the procedures used to examine and monitor the quality of the services provided by service providers, in accordance with the provisions of relevant regulations governing outsourcing of credit institution's business activities, where applicable;
- 10) the right of access to all the relevant data, information and applications necessary to carry out the activities;
- 11) the manner of cooperation with external auditors and supervisors, respectively; and
- 12) the reporting system.

Persons carrying out control functions

Article 5

(1) A credit institution shall ensure that it has an adequate number of staff to carry out the activities of each control function, in accordance with the provisions of Article 107 of the Credit Institutions Act.

(2) A credit institution shall employ on a full time basis at least one person who has attained the title of auditor or internal auditor in accordance with the law governing audits or the rules and a

programme of a professional organisation competent for professional education of internal auditors to carry out internal audits.

(3) A credit institution shall ensure the necessary resources and funding in the financial plan for the execution of the annual plan of each control function and provide regular professional education and training of the persons responsible for carrying out the control function activities.

Control function work plan

Article 6

(1) A credit institution shall periodically, and at a minimum once a year, identify and assess the risks to which it is or might be exposed, including the risks arising from the macroeconomic environment in which the credit institution operates and document any such risks.

(2) Based on the assessment of risks referred to in paragraph (1) of this Article, each control function shall prepare an annual control function work plan.

(3) A credit institution's management board, subject to the prior approval of the relevant committee set up by the supervisory board and/or of the supervisory board, shall adopt each control function work plan.

(4) The annual control function work plan shall include at a minimum:

- 1) a list of all the planned activities of the control function;
- 2) a list of risks and business areas to be covered by control;
- 3) the period during which the planned activities and controls shall be carried out.

(5) The control function, on the basis of its annual work plan, shall adopt an operational work plan for each risk and each planned area of work of the control function.

(6) A credit institution's management board shall ensure that the person responsible for the work of each control function is notified about planned organisational changes, projects, new products and other initiatives, to ensure that this person can identify in advance and assess all the risks to which a credit institution might be exposed as a result of such changes.

Control function activities

Article 7

(1) Control functions shall ensure that a credit institution operates in accordance with risk management rules, strategies and policies, including those for the management of risks arising from the macroeconomic environment in which the credit institution operates.

(2) A credit institution shall, within its risk control function, ensure the carrying out of the following activities at a minimum:

- 1) risk analysis which includes the identification, measurement and assessment of risks to which the credit institution is or might be exposed in its operation;

- 2) monitoring all significant risks to which the credit institution is exposed;
- 3) implementing stress testing;
- 4) verifying the application and efficiency of the methods and procedures for the management of risks to which it is or might be exposed, including the risks arising from the macroeconomic environment;
- 5) examining and evaluating the adequacy and efficiency of internal controls in the risk management process;
- 6) assessing the adequacy of the risk management methodology and the extent to which it is well documented;
- 7) participating in the risk management strategy and policy development and review;
- 8) participating in the development and application of risk management methods and models and supervision of their functioning;
- 9) making proposals and recommendations for adequate risk management;
- 10) analysing, monitoring and reporting on the adequacy of the credit institution's internal capital, and reviewing the strategies and procedures for the assessment of the required internal capital;
- 11) analysing the risks of new products or new markets;
- 12) reporting on risk management to the management board, supervisory board, and the relevant committee set up by the supervisory board;
- 13) reporting on its work to the management board, supervisory board, and the relevant committee set up by the supervisory board; and
- 14) making other verifications necessary for adequate risk control.

(3) A credit institution shall, within its compliance function, ensure the carrying out of the following activities at a minimum:

- 1) identifying and assessing the compliance risk to which the credit institution is or might be exposed;
- 2) advising the management board and other responsible persons on the manner of implementation of relevant laws, standards and rules, and providing them with information on new developments in these areas;
- 3) assessing the effects that amendments to relevant regulations will have on the operation of a credit institution;
- 4) verifying compliance of new products or new procedures with relevant regulations as well as amendments to such regulations; and
- 5) providing advice as regards the preparation of training programmes related to compliance.

(4) A credit institution shall, within its internal audit function, ensure the carrying out of the following activities at a minimum:

- 1) examining and evaluating the adequacy and efficiency of the internal controls system;
- 2) assessing the application and efficiency of risk management procedures and risk assessment methodologies;
- 3) assessing the efficiency and reliability of the compliance and risk control functions;
- 4) assessing management reporting systems;

- 5) assessing the accuracy and reliability of the accounting records system and financial statements;
- 6) assessing strategies and procedures in place for internal capital adequacy assessment;
- 7) information system audit;
- 8) verifying the reliability of the reporting system and timeliness and accuracy of the reports prescribed by the Credit Institutions Act, regulations adopted under that Act and other regulations;
- 9) assessing the methods of asset protection;
- 10) assessing data collection systems and the validity of publicly disclosed information in accordance with Title XIV of the Credit Institutions Act;
- 11) making other assessments as prescribed by the Credit Institutions Act and regulations adopted under that Act; and
- 12) all other activities necessary to achieve internal audit objectives.

(5) Each control function shall carry out its activities in accordance with regulations, and professional rules, principles and standards.

Control function reports

Article 8

(1) The control functions shall prepare:

- 1) operational reports; and
- 2) control function work reports.

(2) The control functions shall prepare the reports referred to in paragraph (1), item (1) of this Article in accordance with the activities they carry out and the established operational work plans.

(3) The reports referred to in paragraph (1), item (1) of this Article shall be submitted to the management board member responsible for the area covered by audit, control or work activity carried out as well as to responsible persons of the organisational part of the credit institution in the jurisdiction of which is the area of business operation covered by control, audit or work activity carried out.

(4) Where a person responsible for the operation of an individual control function deems it necessary, he/she may submit the reports referred to in paragraph (1), item (1) of this Article to all members of the credit institution's management board and/or to the supervisory and/or other relevant committee set up by the supervisory board.

(5) The reports referred to in paragraph (1), item (1) of this Article shall, depending on the control function activities, contain at a minimum:

- 1) the subject and the scope of the activities, controls and audits carried out;
- 2) illegalities and incidents of non-compliance with the credit institution's policies and procedures identified in the course of carrying out the control function activities;
- 3) deficiencies and weaknesses in the operation and risk management identified in the course of carrying out the control function activities;

- 4) an assessment of the adequacy and efficiency of the internal controls system in individual areas of operations;
- 5) an assessment of the adequacy and efficacy of risk management and information on risk exposure;
- 6) proposals, recommendations and time limits for the elimination of the identified illegalities, irregularities, deficiencies and weaknesses;
- 7) the persons responsible for the implementation of proposals, recommendations and measures;
- 8) information on the status of implementation of the proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses;
- 9) a completed verification of the compliance of new products and procedures with regulations, internal bylaws, standards and codes, and the assessment of their effects on the credit institution's risk exposures; and
- 10) an assessment of the credit institution's compliance with regulations, internal bylaws, standards and codes.

(6) The control function shall regularly monitor the status of implementation of the given proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses referred to in paragraph (6), item (8) of this Article.

Control function work reports

Article 9

(1) The control function work reports referred to in Article 8, paragraph (1), item (2) shall, depending on the control function activities, contain at a minimum:

- 1) a report on the realisation of the annual work plan;
- 2) a list of all the planned work activities carried out;
- 3) a list of all the extraordinary work activities carried out;
- 4) a list of planned but not executed work activities, specifying the reasons for the non-execution;
- 5) a summary of the most important facts identified during controls, audits and other work activities carried out;
- 6) a general assessment of the adequacy and efficiency of the internal controls system in the areas covered by control or audit;
- 7) a general assessment of the adequacy and efficacy of the system for the management of individual risks or risks in a credit institution; and
- 8) a report on the implementation of proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses identified in the course of controls or audits and the reasons for their non-execution.

(2) The internal audit function shall deliver the report referred to in paragraph (1) of this Article to the management board and the audit committee or other relevant committee set up by the supervisory board on a quarterly basis and to the credit institution's supervisory board on a semi-annual basis and to the Croatian National Bank on an annual basis.

(3) The compliance function and the risk control function shall deliver the report referred to in paragraph (1) of this Article on a semi-annual basis to a credit institution's management board and supervisory board and annually to the Croatian National Bank.

(4) Each control function work report shall be signed by the person responsible for the work of an individual control function.

(7) A credit institution shall deliver the control function work report to the Croatian National Bank by 31 March of the current year for the previous year.

4 TRANSITIONAL AND FINAL PROVISIONS

Cessation of the effect of the previous Decision

Article 10

As of the date of entry into force of this Decision, the Decision on the internal controls system (Official Gazette 69/2013) shall cease to have effect.

Entry into force

Article 11

This Decision shall enter into force on the eighth day after the day of its publication in the Official Gazette.

No.:
Zagreb,

Croatian National Bank
Governor

Boris Vujčić