

**TERMS OF REFERENCE
INTERNAL AUDIT SERVICES**

Swabalamban Laghubitta Bittiya Sanstha Ltd.
Central Office: Kamalpokhari, Kathmandu, Nepal
Class “D” National Level Microfinance Financial Institution

Financial Year: **[FY 2083/84]**
Document reference: **[Ref. No.]**
Date:

1. Introduction

1.1 The Institution

Swabalamban Laghubitta Bittiya Sanstha Ltd. (herein after “the Institution”) is a Class “D” national level retail microfinance financial institution licensed by Nepal Rastra Bank. It provides microcredit, savings, micro-insurance and remittance services to deprived and low-income households through a group-guarantee model, operating from a central office in Kathmandu through a network of area offices and branch offices across the country.

Particular	Detail
Registered name	Swabalamban Laghubitta Bittiya Sanstha Ltd.
Legal form and class	Public limited company; Class “D” national level retail microfinance financial institution

As per Rule 61 (kha) of Bank and Financial Institutions Act, 2073, the accounts and record of the Institution is required to be audited by the Internal Auditor.. Therefore, the Institution seeks the services of registered auditors to carry out the internal audit for the Fiscal Year 2083/84.

1.2 Purpose of this Terms of Reference

The purpose of internal audit is to enhance and protect organizational value by providing independent and objective risk-based assurance, advice and insights to management and the governing body concerning the adequacy and effectiveness of the Institution’s arrangements for governance, risk management, control and securing value for money as well as to submit an Audit Report of factual findings on the financial transactions

2. Legal and Regulatory Basis

The assignment shall be governed by the following framework, as amended and in force from time to time. Any circular, directive or guideline issued during the engagement period shall be reflected promptly in the work programme.

2.1 Legislation and Directives

- Nepal Rastra Bank Act, 2058, and the Unified Directives issued to Class “D” licensed institutions thereunder, as revised;

- Bank and Financial Institutions Act, 2073, in particular the provisions governing board committees and the audit committee;
- Companies Act, 2063, in particular sections 164 and 165 concerning the audit committee;
- Asset (Money) Laundering Prevention Act, 2064 and the Rules made thereunder;
- Income Tax Act, 2058, Value Added Tax Act, 2052, Labour Act, 2074 and Contribution Based Social Security Act, 2074, to the extent of the Institution's compliance obligations;
- Securities Act, 2063 and the disclosure requirements applicable to a listed company.

Of the NRB Unified Directives, those of principal relevance are Directive No. 2 (loan classification and provisioning), No. 3 (limits on loans and advances), No. 4 (accounting policy and financial statements), No. 5 (risk management), No. 6 (corporate governance), No. 12 (cash reserve and liquidity), No. 18 (AML/CFT) and No. 19 (financial consumer protection). The remaining directives apply to the extent relevant to the areas under review.

2.2 Mandatory requirements of the assignment

NRB Unified Directive No. 6/082, Clause 2, imposes the following requirements, which are binding on the design and execution of this assignment:

- **Frequency of coverage.** The internal audit of all branch offices including that of Head Office to be completed at least once in every year.
- **Professional certification.** Where the internal audit is outsourced, the Institution shall appoint a person or firm holding the relevant professional certification, and shall designate one of its own officers as the contact officer for the assignment.
- **Direct quarterly reporting.** The Internal Auditor shall report directly to the Audit Committee at least once in every quarter.
- **Disclosure of manpower and man-days.** Each such report shall state the details of the manpower engaged in the internal audit and the man-days taken to complete the work.
- **Independence from statutory audit.** A person or firm appointed to perform the internal audit, and the partners and employees of that firm, shall not be involved in the statutory audit of the Institution; and the converse applies equally.

- **System audit.** A national level institution shall cause a system audit to be carried out at least once in every three years. This is a separate engagement and lies outside the scope of this Terms of Reference.

2.3 Professional standards

The assignment shall be performed in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of Nepal, the Nepal Standards on Auditing to the extent relevant to an internal audit engagement, and the International Standards for the Professional Practice of Internal Auditing as guidance. Financial records shall be tested against Nepal Financial Reporting Standards.

3. Specific Objectives

The overall objective is to provide the Board of Directors, through the Audit Committee, with independent and objective assurance on the adequacy and effectiveness of the Institution's internal control, risk management and governance processes, and on the reliability of its financial and regulatory reporting. The specific objectives are to:

- Assess whether the internal control system at branch, area office and central office level is adequately designed and operating effectively in practice;
- Verify compliance with the Unified Directives, the applicable legislation, and the Institution's own approved policies, by-laws and procedures;
- Evaluate the quality of the loan portfolio, including client eligibility, group and centre discipline, appraisal, disbursement, utilization, classification, provisioning and recovery;
- Verify the integrity of savings and deposit records, the protection of member funds, the safeguarding of cash and other assets, and the reliability of accounting records at each unit;
- Assess the effectiveness of the AML/CFT framework as applied at the point of client onboarding and transaction;
- Identify indicators of fraud, misappropriation, ghost lending or manipulation of records, and escalate them without delay;
- Evaluate the adequacy of measures adopted to manage credit, operational, liquidity, market and interest rate risk;

- Follow up observations raised in previous internal audit, statutory audit and Nepal Rastra Bank inspection reports, and recommend practical, prioritized corrective action.

4. Scope of Work

4.1 Coverage and frequency

The assignment covers the entire office network of the Institution. The auditable universe comprises every branch office, every area office, and the central office together with its departments, as they stand from time to time.

Auditable unit	Minimum frequency	Basis
Branch offices- 145	Once in every year*	Directive No. 6/082, clause 2
Area offices-9	Once in every year	Supervisory tier over branch offices
Central office and departments--1	Once in every year	Quarterly reporting to the Audit Committee

*or more frequently as per risk grading of the Branch.

The Institution shall furnish the Internal Auditor with the current list of offices at the commencement of each cycle, and shall give notice of any office opened, relocated, merged or closed during the engagement period. The auditable universe shall be adjusted accordingly and the scope varied in the manner provided in the Clause 11.3.

Frequency stated above is a minimum. The Audit Committee may direct additional visits to units assessed as high risk.

4.2 Branch and area office audit

At each branch office the Internal Auditor shall cover, at a minimum, the following areas:

- **Credit operations** - member and group eligibility against target-group criteria; group formation and centre discipline; loan appraisal, approval authority and documentation; lending limits, collateral proportion and geographical restriction; multiple-borrowing checks; loan utilization verification; classification, ageing and provisioning; rescheduling and restructuring; interest computation; write-off and recovery; and direct confirmation of balances with members.

- **Savings and deposits** - verification of member ledgers against passbooks and the core banking system; product terms and interest rates; dormant and unclaimed accounts; withdrawal authorization; and reconciliation with the general ledger.
- **Cash, bank and vault** - surprise physical verification of cash on the date of visit; vault limits, insurance and dual custody; cash movement and remittance in transit; bank reconciliation; and controls over cash collected at centre meetings.
- **Centre-level verification** - attendance at a sample of centre meetings; direct verification of balances, instalments and charges with members; and identification of proxy members, ghost borrowers, and lending to staff relatives.
- **AML / CFT** - customer due diligence and know your customer documentation at onboarding; enhanced due diligence and screening for politically exposed persons; threshold and suspicious transaction reporting; currency of KYC updation; and staff awareness. This forms an integral module of every branch audit.
- **Human resource, administration and general controls** - attendance and leave records; segregation of duties between appraisal, disbursement, collection and recording; job rotation and mandatory leave; staff advances; procurement and expense authorization; fixed asset verification; system user access and password discipline; and premises security and insurance.
- **Client protection and grievance handling** - transparent disclosure of interest rates and charges; the grievance register and timeliness of redress; utilisation of the Client Protection Fund; and the absence of coercive or improper recovery practices.
- **Risk management commentary** - every unit report shall contain a specific commentary on the adequacy of the measures adopted at that unit to manage credit, operational, liquidity, market and interest rate risk, as Directive No. 5/082 requires.
- **Staff Scoring related with Audit Remarks** - after obtaining audit remarks such remarks must be link with each staff and score the staff individually.

At each area office the Internal Auditor shall additionally cover the supervisory function performed over its branches, loan approvals sanctioned within delegated authority, fund transfers between the area office, its branches and the central office, consolidation of branch returns, staff deployment and performance monitoring, recovery monitoring and escalation, and follow-up on prior audit and inspection observations raised at its branches.

The Internal Auditor shall:

- express an independent professional opinion with regard to efficiency, effectiveness and economy of the Institution's operation.
- ascertain and evaluate the adequacy and effectiveness of the financial management and internal control framework.
- identify the areas of improvement, if any.
- provide the management recommendations with timely on financial management aspects of the Institution to enable timely corrective actions, as per needed.
- ensure compliance with policies, laws, financial norms, procedures, guidelines, etc. as applicable.
- ascertain the integrity and reliability of financial and other information provided to management, including that is used in decision making.
- provide an internal audit report with suggestions and assurance on the proper asset management as well as arrangements for risk management, control and good governance.

4.3 Central office audit

The central office shall be audited quarterly on a departmental and thematic basis, covering:

- **Governance and compliance** - minutes of the Board and its committees and the implementation of their decisions; constitution and functioning of each committee against Directive No. 6/082; code of conduct and self-declaration obligations; restrictions on loans to directors, significant shareholders, the chief executive officer, the auditor, staff and related persons; related party transactions; and the annual corporate governance report.
- **Financial reporting and regulatory returns** - general ledger and inter-office reconciliations; consolidation of branch and area office returns; compliance with NFRS and the prescribed statutory formats; capital fund computation and capital adequacy; statistical returns to Nepal Rastra Bank; and appropriation and utilization of the statutory funds.

- **Borrowings, Treasury, liquidity and investment** - cash reserve and statutory liquidity compliance; borrowings, their terms, servicing and covenant compliance; investments against the approved policy and regulatory restrictions; and the maturity profile and liquidity gap.
- **Information technology and central operations** - user access administration and periodic review of access rights; change management, data backup, restoration testing and business continuity arrangements; integrity of interest, provisioning and ageing routines configured within the system; and controls over digital channels and interfaces with payment service providers. This is a review of controls surrounding the information system and is not the System Audit referred to in clause 2.2.
- **Human resource and payroll** - payroll, statutory deductions, social security contributions and tax withholding; recruitment, promotion and placement against the Employee Service By-laws; expenditure on staff training against the prescribed minimum; and remuneration of the chief executive officer and officer-level staff.
- **Other area as instructed by Audit committee or the Board**

4.4 Follow-up of prior observations

Each report shall carry forward and report the status of observations raised in earlier internal audit reports, in the statutory auditor's report and long form audit report, and in Nepal Rastra Bank inspection reports, classified as resolved, partially resolved or outstanding, with the age of each outstanding item.

4.5 Certification work

The Unified Directives require the internal auditor to certify the monthly and quarter-end capital fund statements, and the quarterly financial statements before publication. The Institution shall specify, before commencement, whether these certifications fall within the scope of this assignment.

4.6 Exclusions

The following lie outside the scope of this assignment: the statutory audit of the Institution and any opinion on its financial statements; tax representation or proceedings before any authority; any executive or management function, including the design, implementation or operation of controls, the approval of transactions or the maintenance

of accounting records; investigation into a specific allegation of fraud beyond the escalation obligation in clause 6.4; and valuation, actuarial or other specialist opinion.

5. Approach and Methodology

5.1 Risk-based approach

The assignment shall be executed on a risk-based basis. While every branch office is visited at least once in every year as the directive requires, the depth of testing, the size of samples and the time allotted at each unit shall be calibrated to an assessed risk score. The Internal Auditor shall prepare, and update annually, a risk assessment matrix for each unit having regard to portfolio size and concentration, portfolio at risk and non-performing loan trends, volume of cash handled, the severity of prior audit and inspection findings, staff turnover, the control maturity of the unit, and any complaint or exception flagged by management.

5.2 Conduct of the work

The Internal Auditor shall prepare an annual audit plan, risk matrix and audit calendar for the approval of the Audit Committee, and unit-wise audit programmes and checklists covering each area in clause 4. Analytical procedures shall be performed on system-generated data before each field cycle so that field effort is directed to genuine exceptions rather than to routine verification. Provisional findings shall be discussed with the unit in-charge before the team departs, and the management response recorded.

5.3 Sampling and documentation

Sample sizes shall be determined by reference to the population and the assessed risk at each unit, shall be documented in the working papers, and shall in no case be so small as to prevent a conclusion being drawn. The basis of selection shall be stated in each report. The Internal Auditor shall maintain complete working papers supporting every observation, retained for the period required by the Institute of Chartered Accountants of Nepal and in any event for not less than five years, and shall make them available to the Audit Committee, the statutory auditor and Nepal Rastra Bank on request.

6. Deliverables and Reporting

6.1 Deliverables

Deliverable	Timing	Addressed to
Annual audit plan, risk matrix and audit calendar	Within 30 days of appointment, and annually thereafter	Audit Committee, for approval
Audit programmes and checklists	Before commencement of the first cycle	Audit Committee, for approval
Branch and area office audit report	Within 30 days of completion of the visit	Unit concerned and Head of Internal Audit
Central office report	Within 30 days of completion of the quarterly review	Head of Internal Audit
Consolidated quarterly report	Within 30 days of the end of each quarter	Audit Committee, directly
Draft summary report	Within 30 days of the end of each quarter	Audit Committee and Board of Directors
Annual summary report	Within 45 days of the financial year end	Audit Committee and Board of Directors
Special or exception report	Immediately on identification	Audit Committee and Chief Executive Officer

6.2 Contents of the quarterly report

The consolidated quarterly report shall be submitted directly to the Audit Committee and shall contain, at a minimum:

- an executive summary of significant findings and the overall assessment of the control environment;
- the details of the manpower engaged and the man-days taken during the quarter, as Directive No. 6/082 requires;
- the units audited against the approved calendar and the reasons for any deviation;
- observations classified by severity, each stating the condition, the criteria breached, the cause, the effect and the recommendation;
- the management response with agreed timeline and responsible officer;
- the commentary on adequacy of risk management;
- the status of prior period observations with ageing;

- the status of Nepal Rastra Bank inspection and statutory audit observations;
- a summary of regulatory non-compliance identified, with the provision concerned identified;
- and trend analysis distinguishing systemic from isolated weaknesses.

6.3 Severity classification

Rating	Criteria	Expected response
High	Regulatory breach, suspected fraud or misappropriation, material misstatement, or a control failure exposing the Institution to significant loss	Immediate escalation; corrective action within 15 days
Medium	Control weakness with potential for loss or non-compliance if not corrected; repeated procedural lapse	Corrective action within 30 days
Low	Procedural or documentation lapse with limited exposure	Corrective action within 60 days

6.4 Language, format and escalation

Reports shall be issued in **English/Nepali language**, in both electronic and signed hard copy, in a format agreed with the Audit Committee before the first cycle and not thereafter varied without its consent.

Where the Internal Auditor identifies suspected fraud, misappropriation of member funds, forgery, wilful concealment, or any matter requiring the immediate attention of the Board, it shall report the matter forthwith in writing to the Coordinator of the Audit Committee and the Chief Executive Officer, without waiting for the quarterly cycle. Where the matter involves a member of senior management, the report shall be made to the Coordinator of the Audit Committee alone.

7. Reporting Line and Governance

The Internal Auditor shall report functionally and directly to the Audit Committee, which is constituted under a non-executive director as coordinator with the head of the internal audit department as member secretary, and which meets at least once in every quarter. The Internal Auditor shall have direct and unrestricted access to the Audit Committee,

shall attend its quarterly meetings and present its report in person, and shall be entitled to communicate with its Coordinator without the presence of management where the circumstances require.

The Institution shall designate one of its officers as the contact officer for the assignment, as Directive No. 6/082 requires. The contact officer shall coordinate access, information and logistics, but shall not direct or restrict the scope, timing or extent of the work. Contact officer designated.

Day-to-day administrative liaison shall be with the head of the internal audit department. Administrative reporting shall not in any circumstance override the functional reporting line to the Audit Committee.

8. Composition, eligibility and Qualification of the Internal Audit Team

The institution requires eligible service provider (SP) to conduct Internal Audit of Audit Universe as mentioned in Clause 4 having following eligibility criteria:

1. The service provider (SP) must have Firm Registration Certificate issued by the Institute of Chartered Accountants of Nepal, VAT Registration Certificate and Tax Clearance Certificate for the F/Y 2080/081
2. The service provider (SP) should be a Chartered Accountant firm particularly a partnership firm
3. Be a registered firm as per the prevailing law and be in service for 10 years.
4. The assignment shall be led by a Fellow Chartered Accountant (FCA), the engagement partner who is a member of the Institute of Chartered Accountants of Nepal (ICAN) holding a valid certificate of practice.
5. The engagement partner shall be personally responsible for the quality of the work and shall sign every report issued to the Audit Committee.
6. The firm shall have prior experience of conducting at least 2 internal audit and 1 statutory audit of Micro finance institutions.
7. The team shall meet at least the following requirements:

Position	Minimum requirement
Engagement partner	Member of the Institute of Chartered Accountants of Nepal holding a valid certificate of practice; not less than 10 years of post-qualification experience, including demonstrable experience of internal audit or risk-based audit of Class “D” microfinance financial institutions or other banks and financial institutions in Nepal (at least two financial institutions)
Supporting partner or engagement manager	Member of the Institute of Chartered Accountants of Nepal; not less than 5 years of experience in at least two banking or microfinance sector
Quality control reviewer	A partner or senior person independent of the field execution, responsible for review of every report before issue
Field team leaders	Member of the Institute of Chartered Accountants of Nepal with not less than 3 years of field audit experience in at least 2 microfinance institutions
Field team members	Semi-qualified or personnel trained in microfinance operations, group lending methodology and the applicable Unified Directives

Field teams shall ordinarily comprise not fewer than two members, each led by a qualified or semi-qualified team leader under the supervision of the responsible partner. However, based on the high risk and portfolio, at least 50% of the branches must be audited by the team lead by a qualified auditor. Central office reviews shall be attended by not fewer than four members. The Internal Auditor shall deploy a sufficient number of concurrent field teams to complete the annual cycle within the year, and shall state the deployment plan and the identity of team leaders in the annual audit plan.

The engagement partner and supporting partners shall not be substituted without the prior written consent of the Audit Committee. Any change in team leaders shall be notified to the Institution, with adequate handover so that continuity of knowledge is preserved. Field personnel shall be rotated between units across cycles, so that the same unit is not audited by the same team leader in two consecutive years. All personnel deployed shall carry identification issued by the Internal Auditor and shall observe the Institution’s security, conduct and data handling requirements while at its premises.

9. Obligations of the Institution

- Provide, before commencement, the memorandum and articles of association, all approved policies and by-laws, the organization structure, delegation of authority, product manuals and the previous three years’ audited financial statements;

- Provide previous internal audit reports, statutory audit and long form audit reports, and all Nepal Rastra Bank inspection reports and correspondence, together with the Institution's responses;
- Grant unrestricted access to all records, personnel, premises and assets at every office, and to the minutes of the Board and its committees;
- Provide read-only access to the core banking system and data extracts in a usable electronic format, so that analytical procedures may be performed; where such access cannot be granted, provide the equivalent reports, the consequent limitation being recorded in the report;
- Designate the contact officer, communicate the approved audit calendar to all offices, give notice of any change in the office network, and instruct all staff to extend cooperation without delay;
- Provide a written management response to each report within 30 days of receipt, and convene the Audit Committee at least once in every quarter to consider the report.

The design, implementation and maintenance of an adequate internal control system, the prevention and detection of fraud, and compliance with all applicable laws and directives remain the responsibility of the management and the Board of Directors. The work of the Internal Auditor supplements, and does not relieve management of, that responsibility.

10. Obligations of the Internal Auditor

- Perform the assignment with the professional competence, due care and diligence expected of a firm of Chartered Accountants, and in accordance with the standards in clause 2.3;
- Complete the audit of every branch office, area office and the central office within the approved calendar, and in any event within the minimum frequency in clause 4.1;
- Deploy and maintain a team meeting the requirements of clause 8 throughout the engagement;
- Submit each deliverable within the timeline in clause 6.1 and attend every quarterly meeting of the Audit Committee;
- Maintain complete working papers as required by clause 5.3;
- Notify the Institution immediately of any circumstance affecting independence;
- Deliver, on completion or termination, all reports for work completed and a written hand-over of the status of open observations.

11. Independence, Confidentiality and Duration

11.1 Independence and conflict of interest

The Internal Auditor shall satisfy the following conditions at the time of appointment and shall maintain them throughout the engagement: that neither it nor any of its partners or employees is engaged in the statutory audit of the Institution; that no partner, nor any member of the undivided family of a partner, holds shares in the Institution; that no partner or employee holds any office or financial interest in the Institution or in any entity in which the Institution has an interest; and that it has no business relationship with the Institution other than this engagement. A written declaration of independence shall be furnished at commencement and annually thereafter. Any circumstance giving rise, or which might reasonably be perceived to give rise, to a conflict of interest shall be disclosed forthwith.

11.2 Confidentiality and data protection

The Internal Auditor and every partner and employee engaged on the assignment shall keep confidential all information concerning the Institution and its members obtained in the course of the work, shall use it solely for the purposes of the assignment, and shall not disclose it to any third party except where required by law, by Nepal Rastra Bank or by the Institute of Chartered Accountants of Nepal. This obligation survives termination. Member data extracted for analytical procedures shall be held on controlled systems, shall not be transferred outside Nepal, and shall be securely destroyed on completion, with a certificate of destruction furnished to the Institution.

11.3 Duration and variation in scope

The engagement shall be for one financial year of FY 2083-84 and can be renewed by mutual agreement and subject to the approval of the Board of Directors on the recommendation of the Audit Committee. The Audit Committee shall review performance at the end of each year against the timeliness of deliverables, completeness of coverage against the approved calendar, the quality and usefulness of findings, and the responsiveness of the engagement team.

Where the office network changes during the engagement period, or where the Audit Committee requires additional visits to high-risk units or a special review, the scope and the corresponding effort shall be varied by written agreement between the parties before the additional work is undertaken.