



THE FIVE 2020 GOALS FOR MICROFINANCE
INSTITUTIONS SERIES

GOAL #3

**Regulatory Compliance and
Operational Audit**

Cloud Computing Strengthening Management and Compliance of Microfinance Institutions

Ensuring an effective compliance audit process for Microfinance Institutions

The ever-changing regulatory environment puts increasing pressure on financial institutions of all types to meet the requirements imposed by the regulators across jurisdictions. “Banks will need to show not only that they are in compliance, but that they are **in control**. The emphasis needs to shift from curing breaches to anticipating **where risks may arise** and preventing them from occurring.”¹

With the emergence of financial technologies that swept the financial services industry, Microfinance Institutions realised the benefits digitalisation can bring to make regulatory compliance a seamless process. However, despite the widespread usage of digital solutions, some Microfinance Institutions are still grappling with legacy technology. The unscalability and inefficiency of legacy systems expose Microfinance Institutions to a wide range of security risks and vulnerabilities, hindering them from complying with the regulator requirements.

Regulatory compliance in financial service industry is not only important to avoid legal punishment but also to sustain the business operations and remain competitive in the market.

“A **compliance audit** is a comprehensive review of an organization's adherence to regulatory guidelines. **Audit reports** evaluate the strength and thoroughness of compliance preparations, security policies, user access controls and risk management procedures over the course of a compliance audit.”² How can digital solutions hold the key to seamless compliance and risk management?

Compliance challenges facing Microfinance Institutions

Cumbersome, inefficient manual processes threaten the future of Microfinance Institutions

¹ [https://www.eylaw.com.hk/Publication/vwLUAssets/ey-global-regulatory-network-january-2016/\\$FILE/ey-global-regulatory-network-january-2016.pdf](https://www.eylaw.com.hk/Publication/vwLUAssets/ey-global-regulatory-network-january-2016/$FILE/ey-global-regulatory-network-january-2016.pdf)

² <https://searchcompliance.techtarget.com/definition/compliance-audit>

Microfinance Institutions, which operate in a challenging rural environment, are continuously struggling to streamline their processes in order to meet their compliance requirements. Relying on legacy banking systems impedes Microfinance Institutions' ability to improve their operations and internal controls, and thus fail to meet the compliance requirements.

Calculating risk has long been a manual process. As such, the infrastructure to cope with new demands for risk management is simply not in place. Firms are only just starting to realise that some level of automation is required to avoid falling behind.³

Relying on on-premise systems and manual processes are labour-intensive and time-consuming.

- Banks' staff spend a tremendous amount of time on manual processes.
- Audit team needs to **frequently travel** to visit each and every branch in order to conduct audits on-site.
- Time-consuming month-end consolidation (lengthy end-of-month processes at branches, long waiting at head office to consolidate data from all branches) and no real-time data available makes it challenging to generate financial reports for audits and regulatory compliance.
- Paper handling does not only consume time but also unfold risks of **data loss, damage and inaccuracies**.
- With no real-time insight to the portfolio's performance, it is difficult for Microfinance Institutions to anticipate and mitigate risks that may cause financial losses, legal or regulatory sanctions, or loss of reputation.

Manual compliance processes are a thing of the past



³ <https://www.worldfinance.com/strategy/top-five-regulatory-concerns-currently-facing-financial-institutions>

To address the above challenges, Microfinance Institutions are urged to go digital and embrace best practice for compliance. Financial technology automates manual processes and reduces redundant ones, while ensuring Microfinance Institutions are meeting the requirements and keeping all security risks at bay.

When the technology in use is cloud-based, Microfinance Institutions are granted access to real-time data and customised reports in line with their regulator's requirements.

Effective management of operational and compliance risks

Security and privacy are crucial aspects of any financial institution's core business. It's essential that Microfinance Institutions are running at the highest level of security at all times. Digital solutions offer Microfinance Institutions flexibility, yet a greater control over their portfolios through real-time monitoring of operations across all branches.

Mitigating internal and external risks of fraud

Building robust internal controls

"An effective system of internal control is a critical component of a bank or financial institution's management and a foundation for its safe and sound operation."⁴ Microfinance Institutions of all sizes should opt for a cloud-based systems that allow for establishing robust internal controls to mitigate internal and external risks of fraud. With your core banking system, you should be able to:

Foster transparency at all organisational levels: Access to files should not be limited to those handling the clients or loan files. Your system should enable you to create common rights through "user groups" to ensure transparency and consistency of user rights across roles.

Define data access controls: Access to data should be customisable according to the specific needs of the business and roles within the bank. While files should only be accessible to those with the appropriate user rights, the core banking system should be flexible to allow the customisation of user rights based on the organisational structure and not only on individuals of groups of users. For example, a branch manager can only exercise his/her user rights within the assigned branch and not on other branches, assuring that users only perform action or view information within their geographical area of responsibility.

Secure user management with easily-configurable password policy: Inflexible password policy configuration engenders higher risks of system intrusion. Digital solutions enable financial institutions to tailor the strength of passwords by using industry best practices to minimise the likelihood of security breaches.

⁴ <https://www.findevgateway.org/sites/default/files/mfg-en-paper-the-internal-control-and-internal-audit-regulations-2004-2004.pdf>

Monitoring and controlling operations through automating audit trails

Automating **audit trails** is another way to monitor and control operations within a financial institution. Audit trails are key indicators of good internal controls as they “contain all the relevant details associated with a transaction, from the time, date and user information associated with the transaction to the more detailed financial data and reporting information an auditor may need.”⁵ The system can generate a report that is specifically designed for auditing purposes.

Consolidating real-time and compliant reports in a few clicks

Regulators enforce audit and financial reporting transparency on all financial institutions. Microfinance Institutions need to equip themselves with resilient systems to meet the expectations of both customers and regulators. Modern software solutions offer auditable reports in real-time in line with financial regulations. Among the features to aim for when choosing a core banking system is a dynamic reporting platform that enable Microfinance Institutions to **sort out, filter data, and create custom and standard reports** to meet the specifications and format required by their regulatory authority. This reduces the time and costs associated with data capture and compliance. Access to real-time data established with regulatory principles enables Microfinance Institutions to generate reports and build templates based on their specific needs.

Ensuring compliance while improving efficiency with fully digitalised loan workflow management

Enabling maker-checker control to reduce frauds

Automated processes prevent unnecessary delays and inevitable human errors. Digitalised loan origination significantly helps loan officers to **screen applications** and **assess risks** in order to prepare the proposal for the decision makers – all in one place. Cloud solutions offers a fully digitalised loan workflow that supports financial institutions to set up the approval process in alignment with industry best practices – the four-eyes principles.

The four-eyes principle means that a certain activity, i.e. a decision, transaction, etc., must be approved by at least two people. This controlling mechanism is used to facilitate delegation of authority and increase transparency. This approach not only ensures the efficiency of processes by enabling fast decision-making while ensuring **effective control and monitoring**, but also brings about cultural change. Staff members are able to perform these processes irrespective whether they are at Headquarters or in the field.⁶

⁵ <https://insights.diligent.com/audit-reporting/the-importance-of-audit-trails-for-business-security-and-compliance>

⁶ <https://www.unido.org/overview/member-states/change-management/faq/what-four-eyes-principle>

A maker-checker process in the system helps organisations strengthen their online controls, manage fraud risks, and protect employees from making unintended errors or deviating from the process with records

Ensuring a seamless auditing process

A cloud-based core banking system that is catered to the specific needs of Microfinance Institutions should offer a comprehensive, all-in-one solutions to **digitalise and streamline all loan workflow steps** from loan application to disbursement.

Issuing a loan incorporates a series of steps from capturing loan applications, to processing and evaluating their applications and documentations, **assessing any potential risks** and then finally either approving or rejecting the loan. With the proper cloud-based solution, all these steps are performed within the system, where all documents related to any specific loan or client can be uploaded and are accessible to employees with the appropriate user rights. There's no need to physically transfer the paper-based documents required for credit committees to conduct their reviews.

With a fully digitalised workflow, financial institutions are enabled to speed up the approval process and mitigate risks caused by poor document management in separate locations through direct online access to all documentation.

Microfinance Institutions access to data in real-time enhances collaboration, transparency while easing the auditing process and compliance with regulatory requirements.

Conclusion

Manual processes and paper handling will no longer hamper Microfinance Institutions' compliance with regulations. With a cloud-based banking system, there is no need to keep clients' data and loan files in paper form in various locations. All files are stored in the system and backed up by the technology provider to mitigate any risks of data corruption, damage and loss while ensuring all data is available to you during the auditing process.

Digital banking solutions offer insights into the portfolio's performance — at all times. Knowing and controlling financial data in real-time empower leaders of Microfinance Institutions to make smart business decisions on the spot, while counter-actions can still be taken in the case of anticipated risks.

The right technology partner delivers services that are catered to the specific needs of Microfinance Institutions in alignment with regulatory requirements. Microfinance Institutions equipped with a fully digitalised platform can now overcome the barriers preventing them from conducting seamless audit and compliance with regulators' requirements, while improving transparency and operational efficiency.

About Oradian

Oradian is a financial inclusion company serving financial institutions in remote, hard-to-reach communities. Using insights from our community of customers, Oradian builds a cloud-based core banking system that financial institutions plug into to access best practice and efficiency. Their global community is made up of over 80 financial institutions in 12 countries serving over 4 million end-clients.