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Regulatory Compliance and Operational Audit

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Cloud solutions strengthen management and regulatory compliance of rural banks

Ensuring an effective compliance audit process for rural banks

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 made a big impact on financial services, rural banks realised the benefits digitalisation can bring to make regulatory compliance a seamless process. However, despite the widespread usage of digital solutions, some rural banks are still grappling with legacy technology. Legacy systems expose rural banks 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 rural banks

Inefficient manual processes threaten the future of rural banks

Rural banks, which operate in challenging rural environments, are continuously struggling to streamline their processes in order to meet their compliance requirements. Relying on legacy banking systems impedes rural bank ability to improve their operations and internal controls, and thus fail to meet the compliance requirements.

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>

*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 is labour-intensive and time-consuming.

- Bank employees spend a tremendous amount of time on manual processes.
- Audit teams need to **frequently travel** to visit each and every branch in order to conduct audits on-site.
- Time-consuming month-end consolidation where the head office is waiting for data to consolidate from all branches. In the absence of real-time data available it becomes 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 **human error**.
- With no real-time insight to the portfolio's performance, it is difficult for rural banks 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

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

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



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

Effective management of operational and compliance risks

Security and privacy are crucial aspects of any financial institution's core business. It's essential that rural banks are running at the highest level of security at all times. Digital solutions offer rural banks flexibility, yet a greater control over their portfolios through real-time monitoring of operations across all branches. A proper digital solution should offer you the following features.

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 Rural banks 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. Through 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. Meanwhile, access should not be controlled through user rights only, but also through the organisation structure. 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. Therefore, files should only be accessible to those with the appropriate user rights. Access should not only be granted based on individual or groups but also based on the organisational structure. 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>

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

For instance in the Philippines, in 2020, the Bangko Sentral ng Pilipinas (BSP) called for publication of Balance Sheet (BS) and Consolidated Balance Sheet (CBS) in accordance with MORB. In addition to all the previously adopted accounting standards – The Philippine Financial Reporting Standards (PFRS)/Philippine Accounting Standards (PAS) – BSP is encouraging financial institutions to adopt digitalization and efficient digital systems as a primary reporting vehicle.

Regulators enforce audit and financial reporting transparency on all financial institutions. 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 which enable rural banks 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 rural banks 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.

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

*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*

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 rural banks should offer rural banks 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 a 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.

Rural banks access to data in real-time enhances collaboration and transparency while meeting compliance requirement.

Conclusion

Manual processes, paper handling and the ever-changing regulatory mandates will no longer hamper rural bank compliance. 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.

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

Digital banking solutions offer insights into the portfolio's performance — at all times. Knowing and controlling financial data in real-time empower leaders of rural banks 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 rural banks in alignment with regulatory requirements. Rural banks equipped with a fully digitalised platform can now overcome the barriers preventing them from conducting seamless audit and compliance with BSP 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. Feel free to contact them at knowdge@oradian.com.