**CLARIFYING MEMO**

**ON**

**POWERS AND RESPONSIBILITIES OF MEMBERS OF THE**

**BOARD OF DIRECTORS OF SAUDI COMMERCIAL BANKS CONTENTS**

**INTRODUCTION**

The modern concept of the responsibility of company directors is very wide. The public company is now much more in the limelight and no longer can it concern itself exclusively with the interests of its shareholders. There are groups such as employees, consumers, and others, who have important stake in the company and whose interests are increasingly being taken into account; the State itself is getting more and more active in protecting and furthering the public interest. The directors who are the custodians of the company and are jointly the repository of all its powers (not vesting specifically in general meeting) are supposed to resolve the conflicts of interests of all concerned groups and not just to serve the interest of their own constituency, namely, the shareholders, to the detriment of others. The responsibility of bank directors is all the greater in this regard as bank's business, it is now universally acknowledged, is vested with a high degree of public interest. The scheme of banking legislation in the Kingdom takes this fully into account and places considerable emphasis on the protection of the interests of the depositors and creditors.

As in other countries, the powers and responsibilities of the directors of joint stock companies in the Kingdom are both of statutory and contractual nature conferred and governed by the Company Law as well as by the corporate by-laws such as the company's memorandum and articles of association. Then, in the case of the banking company, there are also the provisions of the Banking Control Law, which have a direct bearing on the Bank's relationship with its directors, on the directors’ conduct, and on their Ultimate responsibility for the bank's non-fulfillment of legal requirements and contravention of regulations. A recapitulation of these legal and contractual obligations will help bring out in proper relief the areas of a bank's operations on which its directors' attention needs to be focused.

**THE COMPANY LAW**

The main provisions of the Company Law (Royal Decree No. M/6 of 1385) pertaining to directors are contained in Articles 66 to 82, which deal with the administrations of joint stock companies. According to Article 66, joint stock companies are to be administered by a Board of Directors the members of which shall be appointed by the ordinary general assembly, which has also the power to terminate their membership. Articles 68 requires that a director must own at least 200 shares of the company and that these shares must be deposited within 30 days of his appointment with one of the banks designated for this purpose by the Minister of Commerce. Such shares shall be assigned to secure the  director's liability and shall remain non-transferable until the end of the period fixed for admissibility of law suits against directors provided for in Article 77 for their responsibility for errors resulting in damages to shareholders or until such law suit is decided. Article 69 provides that a member of the Board of Directors may not have any direct or indirect interest in the operations and contracts of the company except by permission of the ordinary general assembly to be renewed every year or except for operations concluded through public tender in which the Board member submits the lowest bid. A Board member must advise the Board of any personal interest which he may have in the operations and contracts concluded for the company's account and he should not take part in the vote on the resolution passed in this matter. Further, the Chairman of the board is required to report to the ordinary general assembly the operations and contracts in which any member of the Board has a personal interest and this is to be accompanied by a special report  from the auditor. Article 70 prevents a Board member from participating in any operation, which might compete with the company, or trade in any branch of activity performed by it, without the permission of the ordinary general assembly. According to Article 71, joint stock companies are not allowed to grant cash loans of any kind to their directors or to guarantee the loans they conclude with other parties. This requirement is not applicable to banks but they are in this connection subject to the separate provisions of the Banking Control Law, which will be described later. The provision for maintaining secrecy is contained in Article 72, which prohibits directors from revealing to the shareholders outside the meeting of the general assembly or to other parties secret information, which they obtain in the course of performing their duties. Subject to the powers vested in the general assembly, Article 73 entrusts the Board with ample powers to administer the company and to delegate power to perform any particular function to one or more of its members. However, the same Article places certain restrictions on the Board's powers. It may not extend loans for a term exceeding three years, nor sell or mortgage the companies' properties or business, nor exempt the company' s debtors from their obligations unless authorized to do so by the company's articles and regulations and in accordance with the conditions laid down therein, or unless the ordinary general assembly authorizes. Article 74 requires the Board to give in its report to the ordinary general assembly a comprehensive statement of all payments made to and benefits enjoyed by Board members during the financial year. While the acts performed by the Board bind the company (Article 75), members of the Board are jointly responsible for compensating the company, the shareholders or others for any damage resulting from their mismanaging the affairs of the company, or contravening the provisions of the Company Law or of the company's regulations, members opposing the Board's resolution in question and recording their opposition explicitly in the minutes not being held responsible (Article 76). The procedure for instituting legal proceedings against members of the Board for errors resulting in damage to shareholders is laid down in Articles 77 and 78.

**THE BANKING CONTROL LAW**

While the Company Law governs the constitution and functioning of companies in general, the Banking Control Law constitutes the supervisory framework under which banks operate: The need for special legislation to regulate banking arises from the unusually high degree of public interest involved in it. Unlike other businesses that rest in varying degrees on their own shareholders' money, banks deal principally with other people's money. They are the custodians of the savings of the community. It is the large body of depositors who entrust to them the funds, which they lend to these who need them. The primary objective of Banking Control Law is to protect the interest of those depositors. Bank directors would do well to acquaint themselves with the principal provisions of this law as it is specifically stated in Article 24 that they shall be responsible within their jurisdiction for any contravention of this law or of the rules and decisions issued under it. The most important provision which is directly related to directors is the one concerning bank's advances to them. Article 9 forbids banks to grant unsecured advances to (a) members of their Board of Directors or their auditors, or to (b) concerns other than Joint-stock companies in which any of their directors or auditors is a

partner or manager or has a direct financial interest, or to ( c ) persons or concerns (others than joint-stock companies) in the case of which any of their directors or auditors is a guarantor. This prohibition also applies to issuing guarantees or incurring any other financial liability without security in respect of directors or auditors or their concerns. Article 12 requires that no person shall be a director of more than one bank and further that no person shall without prior written approval of the Agency be elected as a director or appointed a manager of any bank if he occupied a similar position in a banking concern that was wound up, or if he was removed from a similar post in any banking establishment. Article 22 empowers the Agency to take, with the approval of the Minister of Finance and National Economy, various actions in case the Agency finds that a bank has failed to comply with the provisions of the Banking Control Law or of any regulation issued under it or if a Bank adopts a policy that might seriously affect its solvency or liquidity. Suspension or removal of any director or officer of the bank is among the actions the Agency is empowered to take under this clause.

**THE CORPORATE BY-LAWS : ARTICLES OF ASSOCIATION**

In addition to the relevant statutory provisions of the Company Law and the Banking Control Law, which have been explained above, there are detailed provisions pertaining to directors' powers and responsibilities in the Banks' Articles of Association which constitute the by-laws or the constitutional framework under which the banks operate. The Articles in question are in pursuance of the Company Law provisions and in fact reiterate, elucidate and supplement these provisions. The Memorandum and Articles of the Saudi-foreign joint venture banks established (by conversion of foreign banks into Saudi-Companies) in recent years are more or less of a standard pattern evolved in the course of negotiations between the different banks' founders and the Agency at the time of the conversion of the various foreign banks into Saudi joint ventures. Of these, there are many Articles, which embody principles and regulations of general applicability, which all banks in the Kingdom have, or will have, to adhere to. There is, for example, the Article which lists the events on which the office of director shall be vacated. According to this, in addition to the conclusion of his term or upon resignation, the director's office is vacated upon his attaining the age of 70 years unless the General Meeting decides otherwise, or if he becomes disqualified from holding office under any law in force in the Kingdom, or if he is found to be of unsound mind or if he is convicted of an offence involving dishonesty, fraud or moral turpitude or if he becomes bankrupt or makes any arrangement or compounds with his creditors, or if he is removed from his office by a resolution passed by the General Meeting by a majority of two-thirds in case such removal is not requested by the Board, and by a simple majority in case the removal is requested by the Board. Similarly, there is a general Article defining Board powers. It states that the Board shall be vested with full powers to manage the business of the Company and supervise its affairs and that in the discharge of its duties, it shall exercise all such powers, and do all such acts and things as the Company is by its articles and Memorandum of association or otherwise authorized to exercise and do except for acts specifically required to be done by the Company in the General meeting. It further states that the Board is empowered to make loans for terms exceeding 3 years, to buy, sell and mortgage real estate, to release the Company's debtors from their obligations to compromise and to accept arbitration, and that the Board may delegate any of its powers to the Managing Director, another director or to any of the Company's officers or employees for such period and subject to such conditions as the Board may think fit. Remuneration of members of the Board and the attendance fee payable to them is fixed in an Article which also requires that the Board shall give in its Annual Report to the Ordinary General Meeting a detailed statement of all the amounts paid to the directors in the financial year as remuneration. Out-of-pocket expenses and any advantages in cash or in kind including any amounts paid for technical, administrative or consultation services. In another Article it is reiterated that any director who is personally interested directly or indirectly in any matter or proposal before the Board or the Executive committee shall disclose the nature of his interest in the matter and shall take no part in any deliberations or resolutions relating to that matter. In yet another Article, it is laid down that the proceedings and resolutions of the Board shall be written in minutes to be circulated among all Board members and signed by the Chairman and Secretary after having been approved by the Board and that these minutes shall be recorded in a Special Register and signed by both the Chairman and the Secretary.

The Articles also provide for appointment of an Executive Committee consisting normally of 5 Directors, including the Managing Director, who is to chair its meetings. The powers of the Executive Committee are to be determined by the Board and these powers are to be exercised subject to such directions and restrictions as the Board may prescribe. It cannot alter any decision taken or rules laid down by the Board. It is required to meet at least once a month, and its resolutions are supposed to be passed unanimously unless there is a difference in which case a majority of those present and represented is required. The minutes of its proceedings and resolutions must be circulated among all directors. Functioning as a sort of a mini board, exercising many of the Board's powers during the interval between Board meetings, the Executive committee has within the range of its powers the same responsibilities which the Board has and its members are therefore subject to the same disciplines to which they are subject as Board members.

The Articles of Association of the recently Saudiized banks have also, provision for a Managing Director to be selected from amongst the directors representing the foreign bank. His powers and responsibilities as Chief Executive Officer are specified in detail in one Article, which states that he shall be entrusted with the day-to-day business of the banking company. It is however clearly stated in this Article that the responsibilities being entrusted to the Managing Director shall be subject to the provision which vests the Board with full powers to manage the banking company's business and to supervise its affairs. In other words, it is for the Board to set limits within which the Managing Director is to carry out his functions and exercise his powers, particularly in respect of advances and investments, for the Board cannot escape responsibility if the bank's affairs are mismanaged. The Technical Management Agreement concluded with the participating foreign banks, it may be noted, provides that the Managing Director shall administer the Bank and conduct its business according to the regulations, policies and decisions of the Board or Executive Committee. For that purpose, he shall have such powers as the Board may from time to time determine. The Technical Management Agreement, it may not be out of place to mention here, has as provided for in the Articles of Association been entered into by the Banking Company with the foreign bank concerned entrusting it with the technical management of the Bank for a specified period, the term "Technical Management" having been defined in the Agreement to mean the nomination of the Managing Director, the provision of necessary staff and techniques of banking business, the general guidance of the bank’s activities and the training of the Saudi staff. These Agreements are renewable for such further periods and on such terms and conditions as may be mutually approved by both parties.

The directors' duties and responsibilities being very wide, it is difficult to pinpoint what they have to see and what they can ignore. They have to delegate sufficient powers to the professional management to enable it to conduct the Bank's business efficiently. And yet they have to oversee what the management is doing. They have to lay down the policies which the management is to follow and execute, and they have to find out from time to time how these policies are implemented and with what results. They have at the same time to set limits to the management's discretion so that large and important transactions have to be approved by them. The principal areas on which their attention needs to be focused are indicated below with suggestions as to how to proceed.

**ASSETS AND LIABILITIES**

An extract of the consolidated General Ledger of the Bank or a consolidated statement of assets and liabilities is the principal source through which the Bank's position can be gauged and its progress watched. Detailed statement of assets and liabilities which would in fact constitute the detailed balance sheet should be presented to the Board on a regular periodical basis, say monthly, giving with each statement a short review and comparative analysis, or at least an explanation of all material variations from the previous month's figures. A comparative study of this statement and the questions it may raise will give the directors a quick appraisal of the Bank's position and progress. The important questions the statement could answer or raise could be the following: (All these questions may not necessarily pertain to each statement, some may be raised only occasionally at quarterly or half yearly reviews.)

Are deposits growing or falling?

What is the relative position of demand deposits?

(current accounts and other cost-free deposits)

and time deposits (savings and fixed deposits)?

What is the average cost of commission-bearing deposit?

What is the position of large deposits (which exceed 2% of total deposits)?

How many? How much is their aggregate balance?

Which branches have the best deposit mobilization record?

What is the capital-deposit ratio and how much penal reserves are kept with SAMA if deposits exceed fifteen times paid up capital and reserves?

What is the position of borrowings (net amount due to banks)?

What are the constituents of Other Liabilities and is there any material change?

What is the position of Contingent liabilities

(liabilities for which the bank may become liable in future, such as letters of Credit issued and outstanding exceeding cash margin, Acceptances executed and endorsed Guarantees issued, law suits pending against bank, etc.)? Is there adequate provision for potential and estimated losses?

What is the liquidity position of the Bank and is there any shortfall in the maintenance of statutory and liquid reserves as required in Article 7 of the Banking Control Law?

What is the ratio of liquid assets (cash, balances with SAMA, balances with other banks on demand, call and short-term) to deposits? to deposits and borrowings?

What is the comparative position of advances (total) and of the credit-deposit ratio?

Is credit portfolio nearing prudent limits (roughly 60% of deposits) or extending beyond it and if so why?

Is the bad and doubtful debts reserve adequate?

Is there a material change in the composition of investments?

What is the position of other assets?

Is Suspense Account outstanding (where some expenses are temporarily parked) large or increasing?

**LOANS AND ADVANCES**

The Bank's lending operations constitute by far its most important activity as it is the principal source of earning and on it depends largely the Bank's financial soundness and viability. The commission charged on loans is often the largest source of a bank's income. At the same time the greater or most substantial portion of deposits and borrowings is employed in loans and, as such, the bank's capacity to meet its liabilities is largely dependent on the recoverability of its advances. So every loan operation involves balancing of the profit consideration with the requirements of prudence. A responsible bank management will never sacrifice prudence for profit. The broad policy objective of the Board of Directors in the matter of loans and advances should be that.

**(a) The loan portfolio is not over-extended**

Normally advances should not exceed 60% of total deposits but there are no hard and fast rules. There are many factors that have to be taken into account, such as the composition of deposits and the stability of the deposit base, the composition and liquidity of advances, the general economic situation, the official monetary and credit policy, etc. What is important is that should it be considered necessary or advisable to exceed the suggested norm, the position need to be put under close and constant scrutiny and should not be allowed to continue indefinitely.

**(b) There is no undue concentration of credit**

Adequate risk diversification is a basic principle of sound banking. A line of credit to an individual firm or obligor which is large in relation to the bank's capital structure is obviously a concentration of credit. It exposes the bank unduly to the fate of a single borrower. It is to protect the banks against this risk that the Banking Control Law prohibits granting credit facility to any person (natural or juristic) for amounts exceeding 25 percent of the Bank's paid-up capital and reserves. In special circumstances the Agency may allow this percentage to be increased to 50 percent. It  is however to be borne in mind that even if four loans are granted up to the permissible limit of 25 percent each, the entire capital and reserves of the Bank maybe deemed to have been locked in just four accounts. The larger the number of such accounts, the greater is the Bank's risk exposure. The Board cannot view such a situation with equanimity. Similarly, the Board should aim at avoidance of other types of concentrations, as for example, lending too heavily to one industry or one line of business, or against the same kind of collateral. Such concentrations would expose the Bank unduly to any adverse change in the prospects or cyclical downturns of a particular industry or business or security. The wider is the distribution and diversification of the Bank's credit in terms of the loan amounts, sectors of economic activity, types of collateral and geographical dispersal, the better for the Bank and for the society it seeks to serve.

**(c) There is a reasonable degree of matching between loan and liability patterns**

Too often banks have succumbed to the temptations of borrowing short and lending long and too often has this turned out to be the recipe for disaster. A prudent bank management is always conscious of the risks involved in the mismatching of assets and liabilities and would therefore arrange its loan portfolio with an eye on the maturity pattern of its liabilities.

A heavy reliance on inter-bank borrowings (which are usually repayable on call or on very short term) for funding normal loan operations would be highly ill-advised. Similarly, if the larger proportion of deposits is in current accounts and thus repayable on demand, extending medium-term loans on any significant scale would be inadvisable. Loans for short-term (say from 6 months to one year) which commercial banks usually provide can be a disguise for long-term facilities through successive renewals or rollovers. Such concealment of long-term facilities is to be avoided. Facilities can of course be renewed provided each renewal is applied for, examined properly and decided on merits; the behavior of the account is the most convenient guide; if no hard core develops, and if there have been genuine repayments, the facility can really be treated as short-term and can be renewed from time to time if there are no other adverse factors.

**(d) The loans are sanctioned after the due consideration and according to proper procedure**

Giving a temporary overdraft for a minor amount to an account-holder is something that a Bank Manager, if authorized, may do on trust basis, but granting an overdraft or loan for a material amount for any length of time must invariably be on the basis of a prescribed discipline. Credit investigation is a most essential requirement of loan operation and every Bank is supposed to organize a proper and efficient system for collecting and maintaining credit information on borrowers. This information has to be adequate, in sufficient detail, properly filed and reviewed and updated regularly. The Borrower must apply on the Bank's standard loan application form, must mention in it the purpose for which the loan is required and, the source of repayment, and must provide all necessary information and supporting data including latest and preceding financial statements. While collateral and security have an important bearing and must be given due importance, the ability of the borrower to service his debt remains the primary measure of the risk of the loan.

This implies that the borrower must have earnings or liquid assets sufficient to meet commission payments and must be in a position to reduce and liquidate the principal within the given period. It is for the bank to determine that the purpose for which the loan is to be given is genuine, that the business has reasonable prospects of success, that the borrower is credit-worthy, and that the collateral offered is sound and has sufficient margin. In the case of loans for large amounts and longer terms the financial analysis and feasibility examinations will have to be more sophisticated and thorough so that the Bank does not enter into commitments which entail more than normal risk. The loan sanctioning procedure should provide for Loan Committee at the head office and if necessary at the branch or regional control level so that all loan proposals are considered, discussed and appraised in the fullest possible detail by a group of senior officials before sanction. Discretionary sanctioning powers, which are to be given to staff, should better be exercised through such a committee rather than on individual basis. Proposals for loans to be sanctioned by the Executive Committee or by the Board should be put up to these bodies after being screened by the Head Office Loan Committee and with its recommendations. What is important for the Directors is to satisfy themselves that the Bank's loan operations are governed strictly by prescribed disciplines and are not conducted on the basis of the whims of sanctioning officials and authorities. It is also necessary that the Board itself lays down or approves the procedure for sanction or loans and establishment of credit lines, defining clearly the powers and responsibilities of the Branch manager, the Loan Committees. the Managing Director, the Executive Committee and the Board itself in this regard. It is also necessary that the respective discretionary powers be never allowed to be exceeded.

**(e) The Board keeps a close watch over loan operations**

A reporting system, which enables the Board to watch the trends and behavior of the Bank’s loan portfolio, is a basic ingredient of Board supervision. While large lines of credit should be approved by the Board itself (or by the Executive Committee, if necessary), and the Board should consider carefully all the relevant data and policy issues before according its approval, a monthly statement of all loans sanctioned in the course of each month by the Managing Director and other Bank officials in their respective discretionary powers should be submitted to the Board giving important particulars of each loan including past behavior in case of its extension, renewal or increase of an earlier facility. If the number of loans being sanctioned is very large, the Board may like to exempt small loans (Say Rls 50,000) from detailed reporting requirement. And may allow these loans to be reported only on consolidated basis. Another statement, which the Board should obtain on regular basis, is that of overdue advances. All such accounts should be reported periodically, giving in each case along with other particulars the period for which the loan is overdue, the actions taken to get the outstanding adjusted and the position of the security. All delinquent advances, defaults of longer duration, say of more than 6 months or one year, should be under constant scrutiny of the Board, should be discussed by it case by case so that it satisfies itself that the management is taking all possible actions for recovery. Minutes of the Board meeting in which such advances are discussed should record these discussions in detail. Review and examination of defaults and delinquencies in the loan portfolio should also provide the Board with an opportunity to consider whether there is any thing wrong with the Bank’s loaning policy, whether due care is not being taken in sanctioning loans, whether post-sanction control and supervision of credit lines is lacking, and to take in the light of these considerations suitable remedial action.

In the case of bad and doubtful debts the Board would be well advised to follow a very cautious and conservative policy, writing off promptly advances that are irrecoverable and making adequate provision for advances the recovery of which is improbable and in which the risk of ultimate loss is high. The power to write off or make provision for any loan, should be vested exclusively in the Board. The Managing Director's or the General manager's recommendation has of course to be taken into consideration but it is only for the Board to decide. The Auditors' observations have to be given due weight but the Board would do well not to wait for its Auditors to ask for write off or provision. It is of course to be remembered that for every loss that accrues or is likely to accrue to the Bank, the management is answerable to the Board and the Board is answerable to the shareholders. If the losses are large and have any bearing on the solvency of the bank, the accountability to the wider body of depositors and creditors cannot be escaped.

**GUARANTEES AND OTHER CONTINGENT LIABILITIES**

A contingent liability is a liability that may or may not arise, a debt contingent on an uncertain event and thus constituting a future unascertained obligation. A guarantee is defined as a promise to answer for the debt, default or miscarriage of another person if that person fails to meet his obligations. As the guarantor becomes liable only if the principal debtor fails to pay, the guarantee is treated as a contingent liability. No payment

being involved in issuing a guarantee, banks are sometimes prone to take it lightly and may issue guarantees without due consideration and safeguards and in disregard of their capacity to take losses as measured by their free capital and reserves. The risk is all the greater in the existing circumstances when issuing contract guarantees for clients is an important feature of banking services in the Kingdom and guarantees are being issued in large numbers and for large amounts. 1t is therefore all the more necessary to remember that every guarantee has in it the potential to become an actual liability. As a loan can become bad due to the failure of the borrower to repay, so a guarantee can be enforced on the failure of the principal debtor to meet his obligations. Before agreeing to his request to give the guarantee the bank has to satisfy itself that he is and will be in a position to meet his obligations, that in the case of contract guarantees he has the capacity and the means to complete the project, and that his credit and continuing solvency are beyond doubt. In short, guarantees need to be subjected to the same sort of disciplines that have earlier been suggested for loans and advances and sanction of guarantee limits are as much a concern of bank directors as loan limits are. Guarantees should normally be issued against proper collateral unless there are very sound reasons for giving clean facility. The account of all guarantees issued and outstanding should be properly maintained and in no case should a guarantee be issued without passing necessary entries in the appropriate contra accounts. The total outstanding guarantee commitment should have some relevance to the loan portfolio and should not be disproportionate to the bank's capital and reserves. It is also to be noted that the Banking Control Law, as many other countries' banking regulatory system, treats guarantee at par with loan for purposes of credit diversification requirements.

The provision of Article 8 according to which no bank can extend a credit facility to, or incur any financial liability in respect of, any party for amounts aggregating more than 25 per cent of the Bank's paid up capital and reserves, specifically includes guarantees. This means that if, for example, a party is given a loan and other facilities for amount equaling 20% of the Bank's paid up capital and reserves, guarantees on account of that party can be issued only for the residual part of the ceiling, i.e. 5 percent. It is further to be noted that this provision does not exempt guarantees issued against any other bank's counter-guarantee. The inter-bank and inter-branch transactions exempted from this provision do not extend to transactions with third parties.

Letters of credit, acceptances on behalf of customers, and other transactions of this nature which involve varying degree of risk of contingent liabilities turning into actual liabilities require certain precautions and safeguards. As with loans and guarantees, the Board and Executive, Committee have to be satisfied that these facilities are extended after due consideration and approval taking into account the party's total liabilities to the Bank, its overall worth and commitments, its past behavior and future prospects, general market conditions, cash margin and collateral, and SAMA's directives and instructions.

**INVESTMENT**

In conducting its investment policy the Board has always to remember that a commercial bank is different from an insurance company, a pension fund, an investment bank or a development finance agency. The liability structure of the bank is a fundamental constraint, which should never be lost sight of. Considerations of safety and liquidity should be given overriding importance, the investment portfolio should consist only of high quality papers and should be fairly diversified to hedge the various risks. Determination of the investment-deposit ratio is the Board's prerogative, depending of course on the liquidity requirements of the monetary and supervisory authorities, the generally accepted norm of high quality banks in the community and the breadth and conditions of, the market. In the absence of a local gilt-edged securities market a ratio higher than 20 percent would appear hazardous.

It would be better if the Board retains with itself or delegates only to  the executive Committee the authority for purchase and sale of investments, and as such, all authorizations by the Board or Executive Committee for purchase or sale should be noted in the minutes before execution. If authority is to be delegated to the Managing Director or General Manager, it should be specific, limited and under strict guidelines. All transactions under delegated authority should be reported to the Board, approved by it and noted in minutes.

Detailed statement and analysis of investment should be presented to the Board at periodical intervals, say quarterly, and on this basis all investment should be reviewed by the Board. Investment of marginal or speculative nature and investments in which loss is accruing or probable should receive Board's special consideration. The Board should also ensure that credit information is maintained on unquoted securities and that this information is adequate, reliable and current. Losses in the book value of investments should be promptly provided for but unrealized gains should not be taken into profit.

The restrictions the Banking Control Law places on certain types of investments should always be borne in mind. These are recapitulated here for directors’ convenience. According to para 3 of Article 10, Banks cannot purchase without the Agency's approval stocks and shares of any bank conducting its business in the Kingdom. Para 4 of the same article prevents them from owning stocks of any other joint-stock company incorporated in the Kingdom in excess of 10 per cent of the paid-up capital of such a company and that also on condition that the nominal value of these shares does not exceed 20 per cent of the Bank's own paid -up capital and reserves; these limits can only be increased by the Agency. Para 5 of the article contains the Prohibition on Banks from acquiring or leasing real estate except in so far as may be necessary for the purpose of conducting its banking business, housing of its employees or for their recreation. Real estate acquired in satisfaction of debt and not required by the bank for its own use has to be disposed of within 3 years. As an exception to these provisions, and in special circumstances, the bank may with the Agency's approval acquire real estate up to value not exceeding 20 percent of its paid up capital and reserves. According to para (c) of Article 11, banks are precluded from acquiring shares in a company established outside the Kingdom except after the written approval of the Agency and on the conditions it prescribes.

**INCOME AND EXPENDITURES**

It is not only the annual financial statement and profit and loss account of the bank that the directors are concerned with. They have to keep themselves informed of the trends and developments in the bank's income and expenditure accounts throughout the year to exercise proper financial control over management, to seek ways of increasing earnings and economizing expenditure, to prevent waste and to check misuse of authority. A healthy growth in earning capacity is necessary not only to give a fair return to stock holders but also to provide for future losses, to build up reserves and to expand steadily the bank's capital base. The board should therefore obtain a detailed monthly statement of income and expenditure in which all current operating income and all current operating expenditure, earned, incurred and accrued during the month, should be reported under their various heads. The usual segregation of operating income is: Commission on Loan, Commission and Dividend on Investments, Service Charges, Commission and Fees on foreign exchange operations. The principal segregation of operating expenditure are: Commission on Deposits, Commission on Borrowings, Salaries and Fees, Rent, Repairs and Depreciation on Property and Other Expenses. Non-recurring income including gains and recoveries, and non-recurring expenditure including losses and charge-offs should be shown separately under appropriate heads. A comparative study of the statement with the

statements of the previous months will reveal the trends and enable the Board to seek explanation of significant variations. The Board may ask for more detailed analysis of expense accounts and look more closely into them. The Board has also to satisfy itself that delegated powers of expenditure have strictly been abided by, that expenditure for larger amounts and for purposes not covered in delegation are invariably referred to the Board (or the Executive Committee, as the case may be) for sanction, that income has not been over-accrued, that there has been no failure to accrue expenses, and that expenses to be charged off have not been capitalized or hidden into any asset account. Internal and external audits can be of great help in detecting and bringing out irregularities:

**RECORDS, BOOK-KEEPING AND INTERNAL AUDIT**

Adequacy of records, adherence to sounds accounting principles and procedures and maintenance of effective internal safeguards are among the principal pillars on which a durable bank structure rests. If these pillars erode, the structure is sure one day to collapse. It is therefore the inescapable obligation of directors to see that the bank's foundations do not weaken. Mechanization of accounts and use of computers have considerably facilitated the task, and services of leading accounting firms and consultants can well be requisitioned to introduce a modern accounting and book-keeping system or to review, improve and streamline the system already in vogue. But no system, it is to be remembered, can be a substitute for vigilance, and if vigilance is missing in the organs of

power even the best of systems would atrophy and would fail to prevent fraud, forgeries, embezzlement and defalcations. So the directors should first satisfy themselves that a proper accounting and book-keeping system with all the usual built-in safeguards is being followed, and that the necessary procedures for safe maintenance and handling of valuable records, security forms and documents specimen signatures, investment securities, loan collateral and cash have been adopted. They should then ensure that all the prescribed procedures are being strictly adhered to and all the instructions for the day to day working of the system are being meticulously followed. In this context the utility and importance of an efficient system of internal audit cannot be over re-emphasized. Auditors constitute the eyes and ears of management. The whole range of the bank's operations should be subject to their scrutiny and it is for them to detect and report irregularities, departures from prescribed procedure, non-compliance with Head Office instructions and contraventions of legal provisions and SAMA directives. The internal audit department should be directly under the Managing Director, and the Board and the Executive Committee should obtain from it periodical reports on its activities and observations and on the actions taken on its findings. It is however to be noted that an audit set-up is only an instrument of Head Office control and supervision, it cannot be a substitute for it. If there is laxity and incompetence at the controlling level, internal audit cannot do much to set things right. The Board should give equal importance to external audit, which should in fact constitute a means of checking whether the internal audit system is functioning properly. The external auditor's reports should invariably be considered by the Board in great detail and with utmost seriousness.

**CONCLUSIONS**

It is not the purpose of this handbook to lay down a code of behavior or to be a complete guide for action. It only seeks to highlight the main legal provisions which apply to bank directors, to draw their attention to the principal areas of their responsibility, to discuss briefly some policy issues involved and some advisable courses of action and to offer some suggestions as to how a conscientious directorate would like to discharge its responsibility. Bank's business has great diversity and every director is likely to come across a wide variety of issues and problems during his tenure of office. As long as he is conscious of his fiduciary duty, takes his responsibility seriously and gives due weight to fundamentals, he would be dealing with all these issues and problems in the best interests

of the bank and of all the groups that have vital stake in it. It is evident that if high standards of conduct and morality are to be set for the bank's management and staff, the directors have themselves to measure up to those standards in their individual and collective actions. They have in particular to observe strictly in letter and in spirit all the provisions of law designed to regulate conflicts of interest between the bank and its directors. Their attention has already been drawn to these provisions in the earlier section of this handbook. Another point they need always to keep in mind and which has not so far been dealt with is that of staff recruitment and training. This is a subject of the highest importance as the quality of any institution is in the final analysis an image of the quality of its staff. Without a full cader of qualified, trained and competent Saudi staff, the Bank cannot be considered to rest on secure foundations and to be in a position to fulfill the aspirations of the government and people of the Kingdom. Finally, directors would do well to remember that the bank is not only a profit-earning enterprise but has also some social objectives to serve. Unless the bank creates goodwill in the community in which it operates by rendering it cheap and efficient service, by helping people of small means to establish their businesses, industries and professions, and by participating in promotional and nation-building activities, its foundation will remain unstable and its prospects uncertain.