

## INTERNAL AUDIT CHARTER

An Internal Audit Charter enhances the standing and authority of the internal audit function within the bank.

It establishes the following:

- The objectives and scope of internal audit function;
- The internal audit department's position within the organization, its powers, responsibilities and relations with other control functions; and
- The accountability of the head of internal audit department.

The Charter describes the mission, independence and objectivity, scope and responsibilities, authority, accountability and standards of the Internal Audit function.

The charter will be made available to all internal and external stakeholders.

The Internal Audit Charter will be reviewed annually or when there are material changes in the operation, the responsibilities, and the organizational structure of the internal audit function or auditing practices which necessitate amendments to the charter. The Committee approval will be sought for any amendments to the Charter.

### 1. Mission Statement

The mission of Internal Audit is to provide independent and objective assurance that the Bank's operations are conducted according to the highest standards by providing an independent, objective assurance function and by advising on best practice. Through a systematic and disciplined approach, Internal Audit helps the Bank accomplish its objectives by evaluating and improving the effectiveness of Risk Management, Control and Governance Processes.

### 2. Independence and Objectivity

- To ensure independence, Internal Audit is directly (functionally) responsible to the Audit Committee and administratively to the CEO of the bank. It reports regularly to the Audit and Corporate Governance Committee.
- To maintain objectivity, Internal Audit is not involved in day-to-day control procedures. Instead, each Department / Unit is responsible for its own internal control and efficiency.

### 3. Scope and Responsibilities

None of the bank's activities or entities – including branches, subsidiaries and outsourced activities are excluded from the internal department's scope of audit.

The scope of internal audit work includes, but is not restricted to, the review of risk management procedures, internal control systems, information systems and governance processes. This work also involves periodic testing of transactions, best practice reviews, special investigations, appraisals of regulatory requirements, and measures to help prevent and detect fraud.

To fulfill its responsibilities, Internal Audit shall:

- Identify and assess potential risks to the Bank's operations through ongoing collaboration with the controls functions in the Bank.
- Review the adequacy of controls established to ensure compliance with policies, plans, procedures, and business objectives.
- Assess the reliability and security of financial and management information and the systems and operations (in-house or outsourced) that produce this information.
- Assess the means of safeguarding assets.
- Review established procedures and systems and propose improvements.
- Appraise the use of resources with regard to economy, efficiency and effectiveness.
- Contribute to the development of projects, selected according to the risk involved; by confirming that the Bank's project methodology is followed and that, in particular, adequate controls are incorporated.
- Follow up recommendations to make sure that effective remedial action is taken.
- Carryout ad hoc appraisals, investigations, or reviews when deemed necessary or requested by the CEO / Audit and Corporate Governance Committee.

#### **4. Authority**

Internal Audit aims to promote effective controls at reasonable cost. To achieve this, Internal Audit is authorized, in the course of its activities, to:

- With strict accountability for confidentiality and safeguarding records and information, it is authorized, in full, to initiate direct communication with any member of staff, to examine any activity or entity of the bank, and to have full and unconditional access to any records, files, data and physical properties of the bank. This includes access to management information systems and records and the minutes of board and sub-board committee meetings and all consultative and decision-making committees.
- Require all the members of staff and Management to supply such information and explanations as may be needed within a reasonable period of time.
- The internal audit activity has free and unrestricted access to the Board, through direct access to the Audit Committee.

Heads of Department should inform Internal Audit without delay of any significant incident concerning security and/or compliance with regulations and procedures.

#### **5. Operational Structure**

The internal audit function operates as a single pool comprised of auditors. Head of Internal Audit is responsible for setting up the strategy and ensuring the smooth operation of the internal audit function, in accordance with the legal and regulatory framework and the international best practices.

The Head of Internal Audit is supported by auditors. Auditors are allocated to audit teams according to audit requirements and time constraints of specific audit engagements. The results

of the engagement are communicated to the audit manager in charge prior to issuance of the draft findings.

The draft findings are then issued to the relevant unit head, from whom responses to address the findings are sought. Management's response, provided by management of the audited area should include a timetable for anticipated completion of action to be taken and an explanation for any corrective action that will not be implemented; the head of internal audit must promptly inform the CEO and other related heads of functions about its findings. The internal audit activity will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until cleared.

The internal audit function has an annual budget, which is executed under the supervision of the Audit Committee, always in accordance with the established procedures.

## **6. Accountability**

Internal Audit shall develop, in liaison (if needed) with the Senior Management of the Bank an audit plan. The plan is based on risk model that identifies business risks, and on input from line managers. It provides information about the risk assessment, the current order of priority of audit projects and the manner in which they are carried out.

The plan shall be presented to the Audit and Corporate Governance Committee for approval. In case of need, adjustments could be made to the plan during the year and communicated to Audit and Corporate Governance Committee.

Internal Audit is responsible for planning; conducting, reporting and following up on audit projects included in the audit plan, and decides on the scope and timings of audits. The details of these processes are defined later in the Internal Audit Manual.

Audit field work shall be conducted in a professional and timely manner. Reporting of results will include an open process to agree on the facts and the validity of audit recommendations. A detailed audit report and a letter to the management will summarize the objectives and scope of the audit as well as observations and recommendations. In all cases, follow-up work will be undertaken to ensure adequate response to audit recommendations.

Internal Audit will submit an annual report to the Audit and Corporate Governance Committee and Management on the results of the audit work including significant risk exposures and control issues.

The head of internal audit will annually assess whether the authority and responsibility of the internal audit as defined in the Charter, continue to be adequate to enable to enforce the internal audit activity to accomplish its objectives. The result of the periodic assessment should be communicated to Senior Management and the Audit Committee.

## **7. Internal Audit Outsourcing**

In the case that appropriate expertise and skills cannot be ensured for the performance of an audit, audit work can be partially or fully assigned to third parties. The arrangement should receive in principle approval from the ACGC prior to undertaking the selection and risk assessment process. As per CBB directives, outsourcing arrangements cannot be made with the

external auditor; CBB regulations must be adhered to strictly in the case of engaging in any outsourced/co-sourced audit activity.

Criteria for outsourcing include the reputation of the outsourced firm and the professional accreditations of the outsourced team, including an assessment of their track record and experience. The criteria are further elaborated in the Internal Audit Manual.

In any case, the outsourced or co-sourced team should follow the Audit Department's manual and charter, CBB, and other relevant regulations.

This outsourcing/co-sourcing arrangement is considered material in nature as per CBB requirements. Prior to requesting approval, the selection of the arrangements should follow the Bank's internal tendering criteria. The outsourcing procedure should also follow the requirements delineated in the "Operational Risk Management" module of the CBB Rulebook, and the arrangement should ultimately be approved by the ACGC.

## **8. Consultancy/Advisory Services**

Internal audit is described as an "assurance and consulting activity". Consulting services are advisory in nature, and are generally performed based on a specific request. The nature and scope of the consulting engagement need to be agreed upon.

The internal audit department can provide consultancy services provided that the required resources and calibers are available and such services are monitored to determine the right balance between the two. In this regard, the internal audit function will monitor the services provided and report to the ACGC to manage the amount of consulting that Internal Audit does. Requests for consulting services, especially the major one related to projects or proposals, need to be communicated timely in order to be considered while preparing the audit plan.

In this regard, any consultancy services provided do not provide an assurance to the consulting function, nor does it preclude it from an audit as per the audit plan or through an unplanned audit.

Further details are presented in the internal audit manual.

## **9. Coordinating with External Third Parties**

The Internal Audit Department collaborates with supervisory bodies and external auditors of the Bank in order to ensure that audit needs are adequately covered and duplication of effort is minimized; all relevant internal audit reports should be provided to the external auditor, and the external auditor should be kept abreast of any significant matter that comes to the internal auditor's attention that affects the external audit, while the converse is also expected. The internal audit function also ensures adequate independence and objectivity with its dealings with the external auditor. Internal audit may also be useful in determining the nature, timing and extent of external audit procedures. Principles governing the internal audit department's relationship with the external auditor is further elaborated in the internal audit manual.

## 10. Standards

Internal Audit adheres to the standards of best professional practice, such as those published by the Institute of the Internal Auditors (IIA) and the Information Systems Audit and Control Association (ISACA) and relevant requirements of the Central Bank of Bahrain related to the Internal Audit function.

### 10.1 Organization Standards

- The bank shall have an internal audit function responsible for evaluating the adequacy, effectiveness and efficiency of its systems of controls and the quality of ongoing operations.
- The bank shall maintain an environment within which the auditor has freedom to act.
- The bank shall allocate sufficient resources to the internal audit function to enable it to conform to the standards of internal auditing.
- The bank shall require management to respond formally to adverse audit findings and to take appropriate corrective action.
- The bank's systems of control shall include measurement of audit effectiveness and efficiency.

### 10.2 Personal Standards

- An internal auditor shall have adequate technical training and proficiency.
- An internal auditor shall maintain a sufficiently independent state of mind to clearly demonstrate objectivity in matters affecting audit conclusions.
- An internal auditor shall respect the confidentiality of information acquired while performing the audit function.
- An internal auditor shall only engage in activities that do not conflict with the interests of the organization.
- An internal auditor shall adhere to conduct that enhances the professional stature of internal auditing.
- An internal auditor shall exercise due professional care in the performance of all duties and in the fulfillment of all responsibilities.

### 10.3 Performance Standards

- The internal auditor shall prepare a formal audit plan that covers all significant organizational activities over an appropriate cycle of time.
- The audit plan shall include an evaluation of controls within new systems and significant modifications to existing systems.
- Audit procedures shall provide sufficient and competent evidential matter to support conclusions regarding the adequacy, effectiveness and efficiency of the systems of control and the quality of ongoing operations.

- The organization of the audit function and related administrative practice shall provide for the proper supervision of persons performing audits and for the proper review of work performed.

#### **10.4 Communication Standards**

- The internal auditor shall prepare a formal report on the scope and results of each audit performed.
- Each audit report shall contain an opinion on the adequacy effectiveness and efficiency of the systems of control and the quality of ongoing operations; the degree of compliance with previously evaluated systems of control; or an explanation of why an opinion cannot be expressed. When an adverse opinion is expressed, the report shall contain a statement about the exposures that may exist in the absence of corrective action.
- The internal auditor shall communicate audit findings in a timely manner to the managers responsible for corrective action.
- At least once each year, the Head of Internal Audit shall prepare a log of audit activities to the Audit and Corporate Governance Committee and Executive Management. The detailed audit reports shall include an opinion of the overall condition of the organization's controls and operations related to the areas under audit.
- The head of internal audit must have formal regular communication with the CBB to (i) discuss the risk areas identified, (ii) understand the risk mitigation measures taken by the bank, and (iii) monitor the bank's response to weaknesses identified

At least two weeks prior to the prudential meeting date, all internal audit reports issued since the last prudential meeting must be submitted to the CBB supervisory point of contact.