

# BAHRAIN ISLAMIC BANK (B.S.C)

## INTERNAL AUDIT CHARTER

### INTERNAL AUDIT

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بنك البحرين الإسلامي



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## Board Approval

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## 1 Introduction

1.1. The Internal Audit Charter (the “Charter”) defines and describes the principles and basic operational concepts of the Internal Audit within Bahrain Islamic Bank B.S.C. (the “Bank”), a subsidiary of National Bank of Bahrain B.S.C. (the “Group”). In addition the Charter also defines the set of principles and rules which Auditors must adhere to when performing their roles.

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

1.3. The Charter is in compliance with the current legal and regulatory framework.

1.4. 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 Division (IAD) or auditing practices which necessitate amendments to the Charter. The Audit Committee’s (“AC”) recommendation for Board approval will be sought for any amendments to the Charter.

## 2 Definitions

### 2.1 Internal Audit

2.1.1 Internal auditing is defined as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It assists an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

### 2.2 Role of Internal Audit

2.2.1 The internal audit activity is established by the AC and its roles and responsibilities are defined by the AC as part of their oversight role.

### 2.3 Internal Audit Charter

2.3.1 The Internal Audit Charter is a formal document that defines the authority, scope of work, and responsibility of IAD. The charter establishes the IAD’s position, power and responsibilities within the organization; authorizes access to records, personnel, and physical properties relevant to the performance of engagements.

## 3 Mission of Internal Audit

3.1 Perform all and any types of audit to all units, local and cross-border activities and third parties who provide substantial (critical) services to the Bank, in order to form a reasonable, objective and independent opinion about the adequacy and the effectiveness of the Internal Control System (the “ICS”) of the Bank.

3.2. Provide objective assurance, as defined, through the AC to the Board of Directors of the Bank with regards to the results of the assessment of the adequacy and effectiveness of the Bank.

3.3. Perform any other activity that is specifically required by the legal and regulatory framework.

3.4. Assess the ICS based on criteria deriving from international standards and best practices.

## 4 Internal Audit Authority

4.1. The IAD, with strict accountability for confidentiality and safeguarding records and information, is authorized full, free, and unrestricted access to any and all of Bank records, physical properties, and personnel pertinent to carrying out any engagement.

4.2 All employees are requested to assist the internal audit activity in fulfilling its roles and responsibilities. Restriction to these accesses imposed by any employee or management of the Bank, which prevents the IAD from performing its duties, will be reported immediately to the Chief Executive Officer (the “CEO”) and to the AC, based on circumstances as determined by the Chief Internal Audit Officer (the “CIAO”).

4.3. The IAD will also have free and unrestricted access to the Board. The CIAO will have direct access to the AC and the Group IAD and will communicate directly to the Chairperson of the AC and the Group CIAO, any matter that is believed to be of sufficient magnitude and importance to require immediate attention of the AC and the Group IAD.

## 5 Operational Structure

5.1. The IAD operates as a single pool comprised of auditors. The CIAO is responsible for setting up the strategy and ensuring the smooth operation of the IAD, in accordance with the legal and regulatory framework and the international best practices.

5.2. The CIAO is supported by Auditors. Auditors are allocated to audit teams according to audit requirements and time constraints of specific audit engagements. Participation of experts (internal or external) may be sought whenever this is deemed necessary and only following approval by the AC with regard to the associated cost.

5.3 The IAD has an annual budget, which is executed under the supervision of the AC, always in accordance with the established procedures regarding the request for proposals, selection process and invoice settlement.

## 6 Independence

6.1. The internal audit in the Bank is a permanent function. The AC of the Board in coordination with the Bank's executive management will ensure that appropriate measures are taken, including providing appropriate resources and staffing to ensure that internal audit achieves its objectives and that the Bank can continuously rely on an adequate internal audit function.

6.2. The CIAO will report functionally to the AC of the Board and administratively (i.e. day to day operations) to the CEO and the Group CIAO.

6.3. The IAD will have no direct operational responsibility or authority over any of the activities that are subject to audit. Accordingly, it will not develop nor install systems or procedures, prepare records, or engage in any other activity that would normally be audited and be independent from every day internal control process in order to be able to carry out its assignments with objectivity and impartiality.

## 7 Impartiality

7.1 The internal audit should be objective and impartial when it performs its assignment and should be free from bias and interference.

7.2 Internal audit should avoid any conflict of interest.

7.3 Whenever practical, staff assignments within internal audit should be rotated periodically.

7.4 Internally recruited auditors should not audit activities or functions they performed in the last two years.

7.5 The internal audit should not be involved in the operations of the Bank or in selecting or implementing internal control measures to avoid impairment of its judgmental independence.

7.6 In cases where audit opinion is requested, say, for an important new risky activity or system, the auditors will only give comments and should not be made responsible for the development and introduction of any measure as such tasks will remain the responsibility of management. The internal audit can audit such activities and subsequent internal audit reports can contain recommendations relating to deficiencies and weaknesses and suggestions for improvement.

7.7 Internal auditors will exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors will make a balanced assessment of all the relevant circumstances and not be unduly influenced by their own interests or by others in forming judgments.

7.8 Annually, the Chief Internal Audit Officer will confirm to the Audit Committee, his/her independency and organizational independence of the Internal Audit activity.

## 8 Audit Methodology

8.1. The audit methodology applied by the IAD is in compliance with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors and the Auditing and governance standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

## 9 Scope of Internal Audit

9.1 The scope of coverage for the internal audit will consider the whole Bank's universe/activities. Audit planning is performed based on risk assessment for multi years audit plan. The audit centers which comprise the audit universe of the Bank are assessed and prioritized for audit according to their risk profile.

9.2 The scope of internal audit will include the examination and evaluation of the appropriateness and effectiveness of risk management, internal control and governance processes and the manner in which assigned responsibilities are fulfilled by the various branches and departments in the Bank.

9.3 Internal Audit activities include investigating whistleblowing cases as per the requirement of the whistleblowing policy (whenever referred to Internal Audit by the Chairperson of the Audit Committee).

9.4 The scope and objective of the internal audit will also cover, but not limited to, the following:

9.4.1 Review of the application and effectiveness of risk management procedures and risk assessment methodologies.

9.4.2 Review of the management and financial information systems, including the electronic information system and electronic banking services.

9.4.3 Review of the accuracy and reliability of the accounting records and financial reports.

9.4.4 Review of the Bank's system of assessing its capital in relation to its estimate of risk.

9.4.5 Testing of both transactions and functioning of specific internal control procedures.

9.4.6 Adherence to legal and regulatory requirements, code of conduct, the implementation of policies and procedures.

9.4.7 Testing of the integrity, reliability and timeliness of the regulatory reporting.

9.4.8 Carrying out of special investigations at the request of the Board or management, as appropriate.

9.4.9 Compliance with policies, procedures and risk controls.

9.5 Reliability and timeliness of financial and management information including electronic information systems.

9.6 Assess the independence of external auditors.

9.7 Performing consulting and advisory services related to governance, risk management and control as appropriate for the Bank. Any consulting and advisory services, if accepted, must be in-line with the Internal Audit standards and must not

compromise the auditor's independence.

## 10 Professionalism

10.1 The IAD will govern itself by adherence to;

10.1.1 The mandatory elements of The Institute of Internal Auditors' International Professional Practices Framework and guidance as applicable to guide the internal audit operations, including the Definition of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing (Standards), and the Core Principles for the Professional Practice of Internal Auditing. This guidance constitutes principles of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the internal audit activity's performance.

10.1.2 Auditing and Governance Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

10.1.3 The applicable regulations.

10.2 The internal audit activity will also adhere to the Bank's relevant policies and procedures and the internal audit activity's procedures manual.

10.3 All staff members of the internal audit should have sufficient and up-to-date knowledge of auditing techniques.

10.4 Professional competence of internal audit staff should be maintained through systematic training. Professional competence should be assessed taking into account the nature of the role and the auditor's capacity to collect, examine and evaluate information, and to communicate the findings properly given the growing technical complexity of the Bank's activities.

10.5 Whenever practicable, rotation of staff within the internal audit should be carried out periodically to reduce the negative impact of routine tasks that could affect the auditor's capacity for critical judgment. Also, where possible, the Chief Internal Audit Officer may explore the possibility of rotating members of the internal audit team to the Group NBB. Further, co-sourcing arrangements with the external audit firms can also be considered.

10.6 All internal audit staffs should sign and acknowledge an independence and objectivity confirmation declaration to the AC and the Group CIAO establishing the principles and rule of conduct covering the way the internal audit should be carried out.

## 11 Accountability of Chief Internal Audit Officer

11.1 Annually assess whether the authority and responsibility of internal audit as defined in the Charter, continue to be adequate to enable the internal audit activity to accomplish its objectives. The result of the periodic assessment should be communicated to Senior Management, the Group CIAO and the AC.

11.2 Ensure that the Internal Audit Charter is reviewed periodically and that the Charter is recommended by the AC for Board approval.

11.3 Ensure that Internal Audit complies where applicable with the International Standards document "Standards for the Professional Practice of Internal Auditing" and Auditing and Governance Standards issued by AAOIFI.

11.4 Establish and review on a regular basis the Audit Plan and the written Policies and Procedures for the internal audit staff.

11.5 Ensure continuous enhancement of professional competence and training of the audit staff and that the necessary resources are available.

11.6 Report to Senior Management, on the audit findings, agreed action and current status. Additionally, report to the Group CIAO and the AC on the same, further commenting regarding the assessment of the adequacy and effectiveness of the Internal Control System (ICS) as well as the achievement of internal audit objectives.

11.7 Support the AC in assessing the independence, accountability and effectiveness of the external auditors and in monitoring the rotation arrangements of audit partners according to regulatory requirement. Apart from the above, Internal Audit will provide adequate support to the AC in respect of additional requests that may be raised.

11.8 The CIAO must maintain adequate oversight and ensure that any outsourcing providers comply with the principles of the bank's Internal Audit Charter. To preserve independence, the CIAO must ensure that the outsourcing provider has not been previously engaged in a consulting engagement in the same area within the bank unless a one year "cooling-off" period has elapsed. Subsequently, those experts who participated in an Internal Audit engagement must not provide consulting services to a function of the bank they have audited within the previous 12 months. Additionally, the Bank must not outsource Internal Audit Activities to its own external audit firm.

## 12 The Internal Audit Plan

12.1 The CIAO will submit to the Group CIAO and the AC an internal audit plan for review and approval. The internal audit plan will consist of a work schedule as well as resource requirements to properly and efficiently execute and implement the plan.

12.2 The CIAO will communicate the impact of resource limitations and significant interim changes to senior management, the Group CIAO and the AC. The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the Board.

12.3 The CIAO will review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls.

12.4 Any significant deviation from the approved internal audit plan will be communicated to senior management, the Group CIAO and the AC through periodic activity reports.

## 13 Reporting and Monitoring

- 13.1 A written report will be prepared and issued by the CIAO or designee following the conclusion of each internal audit engagement and will be distributed as appropriate.
- 13.2 The internal audit report should include management's response and corrective action taken or to be taken in regard to the specific findings and recommendations.
- 13.3 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.
- 13.4 IAD will be responsible for appropriate follow-up on engagement findings and recommendations.
- 13.5 The CIAO will monthly report to the CEO and Group CIAO the status of pending internal audit recommendations.
- 13.6 The CIAO will keep the Chief Compliance Officer (the "CCO") informed of pending internal audit recommendations that are three months post issuance if high priority and nine months post issuance if medium or low priority.
- 13.7 The CIAO will report periodically to the AC regarding:
- 13.7.1 The IAD's purpose, authority, and responsibility.
  - 13.7.2 The IAD's plan and performance relative to its plan.
  - 13.7.3 The IAD's conformance with The IIA's Code of Ethics and Standards, and action plans to address any significant conformance issues.
  - 13.7.4 Significant risk exposures and control issues, including fraud risks, governance issues, and other matters requiring the attention of, or requested by, the AC and/or the Board.
  - 13.7.5 Results of audit engagements or other activities on a quarterly basis.
  - 13.7.6 Status of pending internal audit recommendations on a quarterly basis.
  - 13.7.7 Unjustified revisions to internal audit recommendations implementation dates.
  - 13.7.8 Resource adequacy.
  - 13.7.9 Any response to risk by management that may be unacceptable to the Bank.
- 13.8 The CIAO will report periodically to the Group CIAO regarding;
- 13.8.1 Status of pending internal audit recommendations on a monthly basis.
  - 13.8.2 The IAD's plan and performance relative to its plan.
  - 13.8.3 Results of audit engagements or other activities.
  - 13.8.4 Scope limitations.
  - 13.8.5 Significant risk exposures and control issues, including fraud risks, governance issues, and other matters requiring the attention of, or requested by, the AC and/or the Board.
  - 13.8.6 The IAD's conformance with the Standards and action plans to address any significant conformance issues.
  - 13.8.7 Resource adequacy.
  - 13.8.8 Any outsource/co-source arrangements.

## 14 Quality Assurance and Improvement Program

- 14.1 The IAD will maintain a quality assurance and improvement program that covers all aspects of the IAD.
- 14.2 The program will include an evaluation of the IAD's conformance with the Definition of Internal Auditing, the Standards, where applicable and applicable regulations and an evaluation of whether internal auditors apply The IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of the IAD and identify opportunities for improvement.
- 14.3 The CIAO will communicate to the Group CIAO and the AC on the IAD's quality assurance and improvement program including results of internal assessments (both ongoing and periodic) and external assessments in line with the Institute of Internal Auditors (IIA) and Central Bank of Bahrain (CBB) requirements conducted at least once every five years by a qualified independent assessor or assessment team from outside the Bank.

## 15 External Communication

- 15.1 Any kind of communication of the IAD, other than regulatory requirements, with third parties, external to the Bank, takes place only after appropriate authorization by the Chairperson of the AC or the CEO.

## 16 Access

- 16.1 Only AC, the Group CIAO, and the Central Bank of Bahrain (the "CBB") have unrestricted access to the audit files. Access to those files by any other individual is only permitted upon written approval by the Chairperson of the AC.

## 17 Approvals

- 17.1 The AC Charter will be approved by the Board. The AC will recommend the approval of this Charter to the Board and will approve the Three-Year Audit Plan. The detailed procedures and processes for the IAD will be approved by the AC and communicated to the relevant stakeholders.