

# **Internal Audit Charter**

## **Internal Audit Department**

## Table of Contents

|   |           |
|---|-----------|
| <b>1. INTRODUCTION AND BACKGROUND .....</b>                         | <b>3</b>  |
| <b>2. VISION .....</b>  | <b>3</b>  |
| <b>3. MISSION.....</b>  | <b>3</b>  |
| <b>4. INTERNAL AUDIT OBJECTIVES.....</b>                            | <b>3</b>  |
| <b>5. ACCOUNTABILITY .....</b>                                      | <b>4</b>  |
| <b>6. INDEPENDENCE &amp; OBJECTIVITY .....</b>                      | <b>5</b>  |
| <b>7. AUTHORITY .....</b>   | <b>6</b>  |
| <b>8. RESPONSIBILITY OF INTERNAL AUDIT DIVISION .....</b>           | <b>6</b>  |
| <b>9. SCOPE OF WORK .....</b>                                       | <b>6</b>  |
| <b>10. QUALITY ASSURANCE REVIEWS .....</b>                          | <b>9</b>  |
| <b>11. RESPONSIBILITIES OF BOARD OR BOARD AUDIT COMMITTEE .....</b> | <b>9</b>  |
| <b>12. RESPONSIBILITIES OF SENIOR MANAGEMENT.....</b>               | <b>9</b>  |
| <b>13. MANAGERS' RESPONSIBILITIES .....</b>                         | <b>10</b> |
| <b>14. THE THREE LINES OF DEFENCE MODEL.....</b>                    | <b>11</b> |
| <b>15. STANDARDS OF AUDIT PRACTICE.....</b>                         | <b>12</b> |
| <b>16. FRAUD RISK.....</b>  | <b>12</b> |
| <b>17. RELATIONS WITH RISK MANAGEMENT AND COMPLIANCE.....</b>       | <b>13</b> |
| <b>18. RELATIONS WITH EXTERNAL AUDITORS.....</b>                    | <b>13</b> |
| <b>19. REVIEW OF CHARTER .....</b>                                  | <b>13</b> |

## 1. Introduction and Background

The Internal Audit Charter (hereafter referred to as 'IA Charter' or the 'Charter') of Commercial Bank International PSC (hereafter referred to as 'CBI' or the 'Bank') describes the purpose, authority and responsibility of the Internal Audit Function (hereafter referred to as 'IA Function'), consistent with the Core Principles for the Professional Practice of Internal Auditing, Definition of Internal Auditing, the Code of Ethics and the International Standards for the Professional Practice of Internal Auditing (the Standards). This Charter establishes the internal audit activity's position within the organization. This Charter is also consistent with the following principles and regulations:

- Internal Control, Compliance and Internal Audit standard and regulation number 161/2018 dated 29 August 2018 issued by the Central Bank of UAE (CBUAE).
- Central Bank of UAE's Corporate Governance Regulations & Standards
- Basel Committee on Banking Supervision (BCBS) principles on Internal Audit Function in Banks

This Charter aims to define amongst other elements, the roles and responsibilities, authority, and reporting protocols of the IA Function.

As per CBUAE Regulations & Standards on Internal Control, Compliance & Internal Audit, the *"Internal Audit Function is an independent function that provides independent assurance to the Board of Directors and Senior Management on the quality and effectiveness of the Bank's internal control, risk management and governance systems and processes, thereby helping the Board and Senior Management protect their organization and its reputation"*.

The CBI Internal Audit Division is accountable to the Board Audit Committee and the Board of Directors on all matters related to the performance of its mandate as described in this Charter.

## 2. Vision

The IA Function at CBI aspires to provide a world class internal audit function with the highest standards of governance and professional excellence.

## 3. Mission

"To enhance and protect organizational value by providing stakeholders with risk-based, objective and reliable assurance, advice and insight."

## 4. Internal Audit Objectives

The Board is responsible for ensuring that CBI has an independent, permanent and effective internal audit function commensurate with the size, nature of operations and complexity of the bank.

Internal Audit is an independent appraisal function established to evaluate the adequacy and effectiveness of controls, systems and policies and procedures within the Bank.

The objective of Internal Audit is to assist the Board of Directors, Audit Committee and Senior Management in accomplishing their objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the bank's risk management, control, and

governance processes. Internal audit can also play a consulting role on occasion, when called upon to do so, without impacting on its independence.

The Internal Audit Division should independently evaluate the:

- 4.1. Review the business activities that are carried out by the respective departments within the organization and determine whether they are in accordance with the Bank's objectives, policies and procedures and relevant rules and regulations;
- 4.2. Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information;
- 4.3. Review and appraise the efficiency with which resources are employed; and
- 4.4. Review and evaluate governance and risk management processes.

## **5. Accountability**

The IA Function is accountable (through the Board Audit Committee) to the Board of Directors and will:

- 5.1. IA shall prepare an annual audit plan. The plan will be based on a risk model that identifies business risks and will include input from line managers as appropriate. It will provide information about the risk assessment, the current order of priority of audit assignments and how they are to be carried out;
- 5.2. The annual audit plan for the bank shall be presented by HIA to the board audit committee for approval. In case of need, adjustments may be made to the audit plan during the year. Any significant changes that impact the risk/frequency model need to be approved by the Audit committee;
- 5.3. Review the business activities that are carried out by the respective departments within the organization and determine whether they are in accordance with the CBI's objectives, policies and procedures and relevant rules and regulations;
- 5.4. Provide a periodic assessment on the adequacy and effectiveness of the Bank's processes for controlling its activities and managing its risks;
- 5.5. Report significant issues related to governance, risk management and internal control processes, including improvements to those processes;
- 5.6. Periodically provide information on the status and results of the audit plan and the sufficiency of the internal audit resources;
- 5.7. Coordinate with and provide overview of other control and monitoring functions (e.g. risk management, compliance and information security);
- 5.8. The above does not restrict IA from initiating any action and/or recommendation, including an unscheduled audit, where exceptions, emerging risks, process gaps, losses, near losses or other matters requiring timely preventive action, should they deems it necessary/appropriate;
- 5.9. Head of Internal Audit function must promptly report to the Central Bank violations of the Central Bank Law, regulations, instructions and any Matters of Significance. Head of internal audit making such reports in good faith shall not be considered to have breached any of his obligations; and

- 5.10. Uphold the internal audit charter that articulates the purpose, standing, scope and authority of the internal audit function within the bank in a manner that promotes an effective internal audit function.

## 6. Independence & Objectivity

The Internal Auditors should be free from any conflict of interest arising either from professional or personal relationships or other interests in CBI or related activity. In order to preserve its objectivity and independence, the Internal Audit function will have no direct operational responsibility or authority over any of the activities audited and will remain independent of the audited activities. Accordingly, IA function will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditor's judgment. However, it may, if deemed appropriate by the Audit Committee, or if requested by Senior Management, review systems under development or implementation and advise on appropriate controls without prejudicing its right to subsequently audit such systems.

The internal audit activity will remain free from interference by any element in the bank, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of a necessary independent and objective mental attitude. The Head of Internal Audit will disclose any such interference to the Audit Committee and discuss its implications.

To provide for the independence of the IA Function, its personnel report to the Head of Internal Audit, who reports functionally to the Audit Committee and administratively to the Chief Executive Officer (CEO) which ensures that HIA has the necessary independence, as well as authority, to exercise judgement, express opinions and make recommendations. Additionally, the compensation of employees in the internal audit function must be determined independently from the performance of the bank.

Examples of functional reporting to the Audit Committee would include the Audit Committee:

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the Head of Internal Audit on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the Head of Internal Audit;
- Approving the remuneration of the Head of Internal Audit; and
- Making appropriate inquiries of management and the Head of Internal Audit to determine whether there are inappropriate scope or resource limitations.

The Head of Internal Audit will confirm to the Audit Committee, at least annually, the organizational independence of the internal audit activity. If the Head of Internal Audit determines that independence or objectivity may be impaired in fact or appearance, the details of impairment will be disclosed to the Audit Committee or the appropriate.

## **7. Authority**

As per the CBUAE Regulations, the Internal Audit Function must have full access to and communication with any member of staff, as well full and unrestricted access to records, files or data of the Bank. The IA Function is authorized to:

- 7.1. Carry out a program of internal audit projects/ engagements, as necessary, to meet the objectives and purpose of the function;
- 7.2. Have unrestricted and unconditional access to all functions, records, physical property and personnel. This includes access to management information systems and records, as well as the agendas, papers and minutes of all committees and forums;
- 7.3. Have full and free access to the Audit Committee;
- 7.4. Request the assistance of the Audit Committee to enable the internal audit team to perform their duties properly;
- 7.5. Allocate resources, set frequencies, select subjects, determine scopes of work and apply the techniques required to achieve audit objectives; and
- 7.6. Obtain the necessary assistance of personnel in units of the Bank where they perform audits, as well as other specialized services from within or outside the Bank.

## **8. Responsibility of Internal Audit Division**

The Internal Audit Division has the following responsibilities:

- 8.1. Ensuring that the contents of this Charter are implemented within Internal Audit;
- 8.2. Develop a flexible audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by Management, and submit the audit plan to the Audit Committee for review and approval;
- 8.3. Implement the audit plan, as approved, including, as appropriate, any special tasks or projects requested by the Audit Committee / Senior Management;
- 8.4. Issue periodic reports to the Audit Committee and Management of the Bank, summarizing results of audit activities;
- 8.5. Keep the Audit Committee informed of emerging risks / trends and leading internal audit practices; and
- 8.6. Ensure the staff within the internal audit function are sufficient, competent and collectively have the appropriate experience to understand and evaluate all of the business activities, support and control functions of the bank.

The IA Function will prepare a budget for the Internal Audit department and submit the same to the Audit Committee for approval on an annual basis.

## **9. Scope of Work**

The scope of work of the IA Function is to provide reasonable assurance to the Audit Committee, the Board of Directors and Executive Management that the Bank's network of management, control and governance processes are adequate and functioning in a manner to ensure:

- 9.1. Risks (including emerging risks) are appropriately identified and managed;
- 9.2. The effectiveness and efficiency of CBI's operations;
- 9.3. Reliability and integrity of management and financial information processes, including the means to identify, measure, classify and report such information;
- 9.4. Adequacy, efficiency and alignment of internal control mechanisms and governance processes with the Bank's business;
- 9.5. Employee's actions are in compliance with Bank's policies and procedures and applicable laws and regulations in all material aspects;
- 9.6. Quality and continuous improvement are fostered in the organization's control processes.
- 9.7. Significant legislative or regulatory issues impacting the organization are recognized and addressed appropriately; and
- 9.8. Resources and assets are adequately protected.

Internal Audit may advise on:

- Improved accountability and transparency of decision-making;
- Bank's policies and procedures to ensure that these are current, practical and fit for purpose;
- Proactive advice on emerging issues / risks; and
- Perform evaluations of new or changing services, processes, operations and controls coincident with their development, implementation and / or expansion, as appropriate or upon request of the Audit Committee / Senior Management.

The IA Function's Scope of Work is detailed as follows:

#### **A. Audit Cycle and Plan**

Risk Assessment will be conducted on a periodic basis (once every 12 months) across the business, to ensure the audit universe stays up to date.

An Audit Plan will be prepared and presented to the Audit Committee for approval on a periodic basis (once every 12 months). Minor deviations to the Audit Plan will be within the remit of the Head of Internal Audit and any significant deviations from the approved plan will be discussed with the Audit Committee. Summary of deviations to the Audit Plan will be reported to the Audit Committee on an annual basis.

#### **B. Audit Universe**

The audit engagements as planned are based on an 'audit universe' which identifies all auditable areas, departments, processes and activities in the Bank and ranks them according to risk. This

approach aims to provide a comparison between the risk-profile of each auditable entity/ unit/ function within the Bank based on criteria such as strategic, financial, compliance, technology, and operational risk.

### **C. Risk-Based Internal Audit**

The IA Function shall establish risk-based plans to determine the priorities of internal audit are consistent with the Bank's goals. The internal audit activity's plan of engagements shall be based on a risk assessment, undertaken on a periodic basis. The input of Senior Management and the Board is considered in this process.

The IA Function may conduct any consulting engagements/ special tasks proposed by Management, the Audit Committee or the Board of Directors. Those engagements that have been accepted shall be included in the plan.

### **D. Reporting**

A written report will be prepared and issued by the Head of Internal Audit or designated personnel following the conclusion of each internal audit engagement and will be distributed as appropriate.

The internal audit report will include management's response and corrective action taken or to be taken in regard to the specific findings and recommendations. Management's response 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 final internal audit report will be communicated to the Audit Committee.

### **E. Monitoring Progress and Follow Up**

To ascertain that appropriate action is taken on reported findings, or that Management has assumed the risk of not taking the action, periodic follow up and monitoring will occur. A report of key outstanding audit issues will be presented to the Audit Committee on a periodic basis.

*Please refer to the IA Follow-up Guidelines for further details.*

### **F. Other Nature of Work**

Internal audit will provide assurance services and may provide consulting and advisory services to the Bank, as appropriate, on the improvement of governance, risk management and control processes to ensure that risk is managed effectively and efficiently throughout the Bank.

## **10. Quality Assurance Reviews**

### **Periodic Internal Assessment**

The Head of Internal Audit is responsible for providing periodically a Internal Audit Self-Assessment on the internal audit activity as regards its consistency with the Audit Charter (purpose, authority, responsibility) and performance relative to its plan.

### **External Assessment**

External assessments must be conducted in line with the IIA Standards at least once every five years by a qualified, independent reviewer or review team from outside the organization. The Head of Internal Audit must discuss with Audit Committee:

- The form and frequency of external assessments;
- The qualifications and independence of the external reviewer or review team, including any potential conflict of interest; and
- The Head of Internal Audit must communicate the results of the quality assurance and improvement program to Senior Management and Audit Committee.

## **11. Responsibilities of Board or Board Audit Committee**

As per the Central Bank Regulations, the Board is responsible for ensuring that the Bank must have an independent, permanent and effective Internal Audit Function commensurate with the size, nature of operations and complexity of its organization.

The oversight function of the Board Audit Committee includes reviewing and approving the Internal Audit Plan, its scope and the Budget for the Internal Audit Division. The plan should be based on a robust risk assessment (including inputs from Senior Management and the Board) and update at least annually (or more frequently to enable an ongoing real-time assessment of where significant risks lie).

As per the regulations, the Bank should have an in-house Internal Audit Division using their own staff. However, co-sourcing of certain internal audit activities (but not the function) on a limited and targeted basis can be used to provide access to specialized expertise and knowledge for an internal audit engagement where the expertise is not available in-house, or due to resource constraints. The Board remains ultimate responsible for the Internal Audit Division, regardless of whether certain internal audit activities are co-sourced.

## **12. Responsibilities of Senior Management**

The Senior Management are responsible for ensuring that the bank has an internal control framework that is adequate to establish a properly controlled operating environment for the conduct of its business, taking into account its risk profile.

Senior Management is responsible for developing an internal control framework that identifies, measures, monitors and controls all risks faced by the bank. As per the CBUAE Regulations,

Senior Management must inform the Internal Audit Division of new developments, initiatives, projects, products and operational changes and ensure that all associated risks, known and anticipated, are identified and communicated at an early stage.

The Senior Management assumes the responsibility for establishing a network of processes with the objective of facilitating smooth and efficient workflow within all functions of the bank and establishing operational controls in a manner which provides the Board of Directors reasonable assurance that:

- 11.1 Data and information published either internally or externally (including websites) is accurate, reliable, and timely.
- 11.2 The actions of Directors, Managers, and employees are in compliance with the bank's policies, standards, plans and procedures, and all relevant laws and regulations of the Central Bank of UAE and the Emirates Securities and Commodities Authority.
- 11.3 The Bank's resources (including its people, systems, data/information bases, and customer information) are adequately protected.
- 11.4 Resources are acquired and employed profitably laying special emphasis on adherence to quality and continuous improvement.
- 11.5 The Bank sets realistic plans, programs, goals, and objectives which are achievable.

Senior Management is *also* responsible for the oversight and implementation of the risk management framework including:

- 11.6 Providing full support to IA Function to assist Management in identifying gaps and major risk areas of the business;
- 11.7 Ensuring timely and effective resolution of internal audit recommendations.
- 11.8 Fostering awareness of the major aspects of risks that should be explicitly managed and accounted for; and
- 11.9 Informing IA Function in a timely manner of any potential or existing significant internal control matters (including any changes to the bank's overall governance framework), thefts, frauds, defalcations, unauthorized transactions, accounting breakdowns, major bad debts, etc.

Senior management must promptly notify the Central Bank of resignation of the Head of Internal Audit and the reasons thereof. Senior management must also promptly notify the when they become aware of a significant deviation from their Board-approved internal audit charter

### **13. Managers' Responsibilities**

Managers at all levels are responsible for executing the operational control established by the Senior Management. It is their responsibility to:

- 12.1 Identify and evaluate the exposures to loss or other inherent risks which relate to their particular sphere of operations.
- 12.2 Establish policies, plans, operating standards, or other measures to minimize and mitigate the risks associated with the identified risks.

- 12.3 Introduce process controls whereby all employees will carry out their duties and responsibilities in a manner that achieves the five control objectives outlined (11.1 to 11.5 above) by the Senior Management.
- 12.4 Ensure the effectiveness of the controlling processes and foster continuous improvement to these processes.

## 14. The Three Lines of Defence Model

In line with the Institute of Internal Auditors Position paper dated January 2013, the bank's business and process units, the control functions and the internal audit function comprise '**The Three lines of defence**' within the bank.

The *business and process units* are the *first line of defence* as they are expected to undertake risks within assigned limits of risk exposure and are responsible and accountable for identifying, assessing and controlling the risks of their businesses.

The *second line of defence* includes the control functions, such as *risk management, compliance, legal, and financial control*, which ensures that the risks in the business and process units have been appropriately identified and managed.

The *third line of defence* is the *internal audit function* that independently assesses the effectiveness of the processes created in the first and second lines of defence and provides assurance on these processes as well as value added recommendations to improve the process and promote best practice. As per the Central Bank regulations, the Internal Audit Function must report to the Board or the Board Audit Committee.

As per the CBUAE Regulations, the Board of Directors and Senior Management must respect and promote the independence of the Internal Audit Division by ensuring that Internal Audit reports are provided to the Board or the Board Audit Committee without Management filtering, and that the Internal Audit Division staff have direct access to the Board or the Board Audit Committee. The Central Bank may also request the Internal Audit reports.

To clarify, the responsibility for internal control does not transfer from one line of defence to the next line.



Source: The Institute of Internal Auditors

## 15. Standards of Audit Practice

The internal audit function will govern itself by adherence to The Institute of Internal Auditors' mandatory guidance, which includes the Core Principles for the Professional Practice of Internal Auditing, Definition of Internal Auditing, the Code of Ethics, and the Standards. This mandatory guidance constitutes the fundamental requirements for the professional practice of internal auditing and the principles against which to evaluate the effectiveness of the internal audit activity's performance.

The IA Function will develop a framework, methodology and infrastructure which meets the standard of professional practice as laid out by the Institute of Internal Auditors in their Professional Practices Framework. The IA Function will also adhere to the Code of Ethics, as prescribed by the Institute of Internal Auditors.

The Board of Directors and the Audit Committee require the IA Function to act professionally and ethically in discharging its role. The IA Function will adhere to the Bank's policy and procedures and adopt best standards and practices issued by professional bodies like the IIA, ISACA, etc. as applicable in delivering audit services.

## 16. Fraud Risk

The identification, prevention and investigation of fraud is a Senior Management responsibility. Fraud Prevention and Investigation Unit is primarily responsible for the conduct of fraud investigations including determining employee accountability.

The IA Function can undertake or participate in the investigation of incidents involving suspected fraudulent activities when mandated by the Board of Directors, Audit Committee or requested by the CEO. Amongst other issues, such investigations will also focus on identification of control gaps/process weaknesses and make appropriate recommendations.

## **17. Relations with Risk Management and Compliance**

In line with IIA standard number 2050, internal audit reports are shared with Risk Management & Compliance as is relevant. Likewise, Risk Management and Compliance also share their reports with Internal Audit.

## **18. Relations with External Auditors**

CBI's external auditors fulfil a statutory duty for which they are responsible to the Stakeholders. The IA Function will co-ordinate its activities with those of the external auditors, in order to obtain maximum assurance and to avoid duplication of audit effort.

The IA Function will carry out follow-ups on comments and recommendations contained in the External Audit reports.

## **19. Review of Charter**

The Head of Internal Audit must review the Internal Audit Charter on an annual basis and should present it to the Audit Committee for approval.

*\*This Internal Audit Charter should be read in conjunction with the CBI's Audit Committee Terms of Reference.*