



# **MCB BANK LIMITED**

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## **GLOBAL INTERNAL AUDIT POLICY**

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**VERSION: 6.0  
2023**

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## 1. DOCUMENT CONTROL SHEET

<b>Title of the Policy</b>	Global Internal Audit Policy
<b>Associated Key Risk(s)</b>	Operational / Legal / Reputational / Compliance / Financial risks
<b>Owner of the Policy</b>	Audit & Risk Assets Review (RAR) Group
<b>Applicability</b>	MCB Pakistan and Overseas Operations
<b>First Approval Date by Board of Directors</b>	February 20, 2019
<b>Last Approval Date by Board of Directors</b>	August 16, 2022
<b>Current Review Date</b>	August 02, 2023
<b>Next Review Date</b>	August 2024
<b>Periodicity for Review</b>	Annually or earlier as required
<b>Version of the Policy (Existing / New)</b>	5.0 (Existing) / 6.0 (New)
<b>Prepared By</b>	Audit & Risk Assets Review Group (A&RARG)
<b>Reviewed By</b>	Chief Internal Auditor (CIA)
<b>Recommended By</b>	Board Audit Committee (BAC)
<b>Approved By</b>	Board of Directors (BoD)

## 2. OVERVIEW & PURPOSE

- 2.1 The Global Internal Audit Policy Version 6.0 of MCB Bank Limited supersedes the Global Internal Audit Policy Version 5.0 which was approved by the Board of Directors (BoD) of the Bank in their meeting held on August 16, 2022.
- 2.2 In line with State Bank of Pakistan (SBP's) instructions on 'Governance Framework for Banks' Overseas Operations', a universal approach for formulation / alignment of policies has been adopted whereby this Policy / Charter shall be applicable to entire Bank i.e. both domestic and overseas operations.
- 2.3 The Internal Audit Function (IAF), being the third line of defense, is one of the fundamental components of overall governance framework in the Bank that works on behalf of Bank's Board of Directors to provide it an independent assurance on the adequacy and effectiveness of Bank's system of internal controls. IAF of the Bank is established in accordance with the requirements of the Listed Companies (Code of Corporate Governance) Regulations issued by SECP, as amended from time to time, which states that there shall be an internal audit function in every listed company. It is the responsibility of the Board of Directors of the Bank to maintain an independent internal audit function to primarily undertake the Internal Audit work throughout the Bank (covering its domestic as well as overseas operations including operations of its subsidiaries where there is no separate internal audit function). In MCB Bank Limited, internal audit function is performed by Audit & Risk Assets Review (Audit & RAR) Group. This Charter for Audit & RAR Group, inter alia, defines the purpose, authority, scope, organization, objective, roles and responsibilities of the Group as well as that of Management as envisaged by the Board of Directors in line with the requirements of State Bank of Pakistan (SBP's) Guidelines on Internal Audit Function<sup>1</sup> as well as those of Central Bank of Sri Lanka (CBSL), Central Bank of the United Arab Emirates (CBUAE), Central Bank of Bahrain (CBB) and other applicable legal / regulatory requirements issued by other authorities, if any.
- 2.4 In case of difference in the legal / regulatory requirements of Host and Home country (with respect to auditee), stringent of the two requirements will be followed. However, where there is a conflict in these requirements, matter will be referred to the concerned authority (ies) for advice.

## 3. DEFINITION OF INTERNAL AUDITING

- 3.1 Institute of Internal Auditor's International Professional Practices Framework (IPPF) defines internal auditing as follows:

*"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes".*

## 4. VISION OF AUDIT & RAR GROUP

- 4.1 To be a trusted internal audit service provider that adds value to the overall governance, risk management and control environment of the Bank.

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<sup>1</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

## 5. MISSION OF AUDIT & RAR GROUP [2]

- 5.1 The mission of Audit & RAR Group is to provide an independent, objective assurance and consulting / advisory services designed to add value and improve operations (both domestic and overseas) of MCB Bank Limited by adopting a systematic, disciplined approach to evaluate and further improve the quality, adequacy, effectiveness of its risk management, control and governance processes.

## 6. OBJECTIVES OF AUDIT & RAR GROUP [3]

- 6.1 The prime objective of Audit & RAR Group is to examine, evaluate and monitor whether the framework for Risk Management, Control and Governance Processes of MCB Bank Limited is adequate and functioning in a manner to ensure that:

- a. Risks, including those pertaining to Money Laundering (ML) / Terrorist Financing (TF) / Proliferation Financing (PF), are appropriately identified and managed;
- b. Financial, managerial and operating information is accurate, reliable and timely;
- c. Policies, standards, procedures and applicable laws, rules and regulations, including those related to Anti-Money Laundering (AML) / Combatting the Financing of Terrorism (CFT) / Countering Proliferation Financing (CPF), are complied with;
- d. Compliance with those policies, plans, procedures, laws, rules and regulations, which could have a significant impact on operations and reporting, is ensured by Bank's systems;
- e. Assets of MCB Bank Limited are adequately safeguarded; and
- f. Quality and continuous improvement are fostered into control processes.

- 6.2 The objectives of Audit & RAR Group also include advising and recommending improvements in internal controls (including internal controls over financial reporting) and risk management systems to Bank's senior management.

## 7. ORGANIZATION

### Independence & Line of Reporting

- 7.1 All employees within the Audit & RAR Group must maintain independence from the operational management and shall not have direct authority over any of the operational activities of the Bank. Personnel in Audit & RAR Group (including those posted at overseas jurisdictions) shall report through the chain of command to the Chief Internal Auditor (CIA). However, the Head(s) of Internal Audit in overseas jurisdictions shall administratively report to the respective Country Head.<sup>4</sup> The Chief Internal Auditor reports functionally to the Board Audit Committee (BAC) and administratively to the President / Chief Executive Officer (CEO) of the Bank.<sup>5(a&b)}</sup>

<sup>2</sup> SBP's Guidelines on Compliance Risk Management issued vide circular no. BPRD Circular No. 7 of 2017, Dated August 09, 2017.

<sup>3</sup> SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>4</sup> SBP's BPRD Circular No. 6 dated August 6, 2018 "Governance Framework for Bank Overseas' Operations".

<sup>5(a)</sup> Administrative reporting has been defined in SBP's Guidelines on Internal Audit Function as covering "matters like approval of leave, staff loans, advances and claims as per FI's approved policies. However, for CIA, any exceptions from these policies shall always be approved by the BAC".

<sup>5(b)</sup> Central Bank of Bahrain Rulebook - High-Level Controls (HC)-10.1 "Internal Audit".

## Performance Appraisal

- 7.2 The performance of Chief Internal Auditor shall be evaluated annually by Board Audit Committee against 'Key Performance Indicators' (KPIs) formulated by it. Board Audit Committee will also approve any performance-based bonuses, increments, promotion / demotion, cash awards or other financial and non-financial benefits to be given to Chief Internal Auditor on the basis of his performance evaluation.<sup>6</sup> However recommendation of Board's Human Resources & Remuneration Committee (HR&RC) may be sought by the Board Audit Committee / Board of Directors regarding compensation package of Chief Internal Auditor, keeping in view the institution-wide remuneration policy, formulated in terms of BPRD Circular No. 01 of 2017.
- 7.3 Performance appraisals of all internal audit personnel shall be carried out in line with the Bank's Performance Management Policy.

## Organizational Structure

- 7.4 The core audit function covering Branch Audit (both domestic and overseas branches), audit of Bank's subsidiaries (both domestic and overseas where there is no separate internal audit function), Management Audit (both domestic and overseas offices), Investigations, Risk Assets Review shall be managed by **Operational Audit Divisions**, segmented geographically. The Division Heads Operational Audit shall report directly to the Chief Internal Auditor.
- 7.5 The **Information Technology/Information Security (IT / IS) Audit Division** shall undertake audit, reviews and investigations of systems, applications, infrastructure and networks etc. (both domestic and overseas operations). The Head of IT / IS Audit Division shall report directly to the Chief Internal Auditor.
- 7.6 The **Risk Assets Review (RAR) Department** shall primarily review Risk Assets and Trade portfolio tagged to major lending branches of the Bank as well as Special Assets Management (SAM) function and also undertake related Management Audits and other credit related assignments of Audit & RAR Group (as applicable to both domestic and overseas operations of the Bank). Moreover, the Basel related assignments shall also be conducted by Risk Assets Review Department. The Heads of Risk Assets Review (RAR) departments shall report to the respective Division Heads Operational Audit.
- 7.7 Audit & RAR Group shall be further strengthened by the following Departments:

## Quality Assurance & Framework Development (QA&FD) Department

- 7.7.1 Quality Assurance & Framework Development (QA&FD) Department shall have two units i.e. Quality Assurance Unit and Framework Development Unit. The Department Head of Quality Assurance & Framework Development shall report directly to Chief Internal Auditor.
- 7.7.2 In order to ensure consistent application of audit approach and documentation of work performed, periodic quality reviews as well as ongoing monitoring for quality assurance (hereinafter referred to as 'Internal Assessments') shall be conducted. The Internal Assessments shall cover the entire audit activity including audits / reviews performed (both domestic as well as overseas) at branches, audits of management functions, IT/IS Audits, investigations, Continuous Auditing activity, activities of Monitoring and Whistleblowing Department etc. The Quality Assurance & Improvement Program shall be developed and approved by the Chief Internal Auditor in compliance with the International Standards for Professional Practice of Internal Auditing ('Standards') published by the Institute of Internal Auditors (IIA) to provide reasonable assurance that Internal Audit activity conforms to the Standards, IIA's Code of Ethics, Global Internal Audit Policy, Internal Audit Manuals and other requirements of applicable Internal Audit Framework. The periodic quality reviews

<sup>6</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

shall be carried out by Quality Assurance Unit for selected audit / review engagements as per the Quality Assurance (QA) Plan approved by the Board's Audit Committee. These periodic reviews shall be over and above the process of ongoing monitoring to be carried out for all audit assignments.

- 7.7.3 Framework Development Unit shall undertake the development work of Policy(ies), Manuals, Guidelines, Standard Operating Procedures (SOPs), Audit Master Data (AMD) and regular updates thereof. This Unit shall also perform the reviews of policies / framework documents, as per management's requests, under "Consultative" role of the internal audit function. However, the objectivity and independence of internal audit function should not jeopardize during these reviews.
- 7.7.4 The Quality Assurance & Framework Development Department shall also be responsible for addressing training needs of personnel in the Audit & RAR Group for ensuring continuous improvement in quality, efficiency and effectiveness of Internal Audit function.
- 7.7.5 Furthermore, this department shall also oversee matters such as liaison with vendor, handling of change requests, timely resolution of issues / challenges regarding the system etc. with respect to internal audit software (i.e. E-Audit).

### **Monitoring & Whistle Blowing Department**

- 7.7.6 The Monitoring & Whistleblowing Department shall comprise of following two functions:
  - 7.7.6.1 **Monitoring function** shall ensure a robust compliance follow up including validation of actions with respect to the Internal Audit findings (pertaining to both domestic and overseas operations), external auditor's observations (pertaining to both domestic and overseas operations) and decisions of the Board and all sub committees of the Board. However, in line with the Bank's Policy on Internal Controls, compliance of all the observations / issues related to regulatory bodies shall be taken care of by Compliance & Controls Group (CCG) of the Bank. Further, as per SBP's directives contained in its letter no. OSED/SEU-13/ 030(01) / 032816 /2019 dated August 23, 2019, Audit & RAR Group (through Monitoring function) will also validate compliance status against SBP observations (marked closed by management) prior to submission of their quarterly compliance status to SBP by the Compliance & Controls Group.
  - 7.7.6.2 **Whistle Blowing function** shall address the concerns of Bank's staff and outside parties such as shareholders, vendors, customers etc. (both domestic and overseas operations) for reported wrongdoings, impropriety, irregularities, financial malpractices, fraud & forgeries and improper conduct, as per scope approved by the Board of Directors as well as relevant laws. The Whistle Blowing function shall be governed by a separate Whistle Blowing Program. This Program shall inter alia; address the protection, rights and rewards of the complainant, disciplinary actions & penalties as well as rights & responsibilities of the suspected parties.

7.7.6.3 Head of Monitoring & Whistleblowing Department shall report to Chief Internal Auditor.

### **Continuous Auditing Department**

- 7.7.7 Continuous Auditing Department (desktop auditing) shall regularly perform system based audit steps as per the pre-defined frequency for identification of breaches / gaps / weaknesses of the controls (at both domestic and overseas operations) to ensure immediate follow-up and remediation by the management. These selected system based audit steps, reviewed annually (including additions, deletions etc.), shall be recommended by the Chief Internal Auditor and approved by the Board's Audit Committee.
- 7.7.8 The Department Head Continuous Auditing shall report to Division Head IT / IS Audit.

## Internal Audit of Overseas Operations

- 7.8 There shall be an Internal Audit Unit in Sri Lanka. The core audit function including Branch Audits, Management Audits and Risk Assets Reviews shall generally be managed by Internal Audit Function Pakistan through Unit Head Audit in Sri Lanka. Unit Head Audit shall functionally report to Chief Internal Auditor through his/her line management in Pakistan and administratively report to Country General Manager – Sri Lanka. However, the operational audit team in Pakistan (including the Risk Assets Review team members and IT/IS Audit team members) may also be engaged in the audit assignments in view of nature and complexity of the assignments. Furthermore, audit assignments pertaining to other overseas locations i.e. Dubai, Bahrain and Azerbaijan will be performed through internal audit team(s) based in Pakistan.
- 7.9 The organizational structure of Audit & RAR shall be reviewed and recommended by the Board Audit Committee to the Board of Directors for its approval, as and when required.

## Consulting / Advisory Services

- 7.10 Consulting services are advisory in nature and are generally performed at the specific request of management. The nature and scope of the consulting engagement are subject to agreement with the management. The terms and conditions under which the internal audit function can be called upon to provide consulting or advisory services<sup>7</sup> as well as detailed guidance for conducting such engagement shall be defined in Internal Audit Manual(s) as well as related guidelines / Standard Operating Procedures.

## Employment Criteria for CIA and Audit & RAR Staff

- 7.11 Provisions in respect of employment of Chief Internal Auditor of Audit & RAR Group are as follows:
- 7.11.1 The appointment (including re-hiring / renewal of contract, remuneration / compensation package and other terms and conditions of employment of the Chief Internal Auditor shall be approved by the Board Audit Committee<sup>8&9</sup>. However, recommendation of Board's Human Resources & Remuneration Committee (HR&RC) may be sought by the Board Audit Committee / Board regarding compensation package of Chief Internal Auditor, keeping in view the institution-wide remuneration policy, formulated in terms of SBP's BPRD Circular No. 01 of 2017, as amended from time to time.
- 7.11.2 The removal / non-renewal of contract / replacement of Chief Internal Auditor shall be approved by the Board Audit Committee.<sup>8</sup>
- 7.11.3 Chief Internal Auditor must be a professional with at least 15 years of experience in the field of finance, with at least 5 years of aggregate audit experience in banks/financial institutions (FI) at the time of appointment.<sup>8</sup> No person shall be appointed as the Chief Internal Auditor unless:
- a) He/she has 3 years of relevant experience in audit or finance or compliance function and is <sup>9</sup> a member of the Institute of Chartered Accountants of Pakistan or Institute of Cost and Management Accountants of Pakistan; or

<sup>7</sup> Central Bank of UAE – Internal Control, Compliance and Internal Audit Standards- Article (4) : Internal Audit Function.

<sup>8</sup> BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function". This clause is applicable to all future appointments / renewal of contracts

<sup>9</sup> Listed Companies (Code of Corporate Governance) Regulations, 2019.



b) He/she has five years of relevant experience in audit or finance or compliance function and:

- i. is a Certified Internal Auditor; or
- ii. is a Certified Fraud Examiner; or
- iii. is a Certified Internal Control Auditor; or
- iv. has a post graduate degree in business, finance from a university or equivalent, recognized and approved by the Higher Education Commission (HEC) of Pakistan and is a member of a professional body<sup>10</sup> relevant to such qualification, if applicable; or

c) He / she has at least seven years of managerial experience in field of audit or accounting or in managing financial or corporate affairs functions of a company and has a suitable degree from a university in Pakistan or abroad equivalent to graduate degree, recognized and approved by the Higher Education Commission (HEC) of Pakistan. <sup>11</sup>

7.11.4 Chief Internal Auditor must be a person of integrity<sup>12</sup>, suitably qualified, experienced and conversant with the Bank's policies and procedures. Furthermore, any director of the Bank cannot be appointed, in any capacity, in the Audit & RAR Group to ensure independence of the internal audit function.

7.12 Provisions in respect of employment of personnel within Audit & RAR Group are as follows<sup>13</sup>

7.12.1 The CIA should ensure that Audit & RAR Group has the mix of professionally competent, technically sound, knowledgeable and skilled internal auditors capable of auditing all the core and support functions of the Bank.

7.12.2 The BAC in consultation with CIA should ensure that IAF staff is equipped with relevant auditing skills, knowledge, tools, methodologies, techniques and competencies to perform their respective roles and responsibilities in an audit assignment/at IAF.

7.13 If required by Audit & RAR Group, staff with required skill set from other functional areas of the Bank may be transferred to Audit & RAR Group on a periodic basis and in a systematic way under Board's approved Transfer / Rotation Policy of the Bank whilst ensuring that such rotation does not have any major negative impact on operations and performance of Audit & RAR Group. Furthermore, Chief Internal Auditor will be exempt<sup>13</sup> from rotation requirements in line with the requirements of SBP's Guidelines for Internal Audit Function.

7.14 The Chief Internal Auditor and all internal auditors must avoid conflict of interests. Accordingly, internally recruited auditors must not engage in auditing activities for which they have had previously involved in / responsibility for before a "cooling off" period of at least one full financial year has elapsed<sup>12&14</sup>.

<sup>10</sup> As per Listed Companies (Code of Corporate Governance) Regulations, 2019 "Body of professional accountants" means:<sup>(a)</sup> Established in Pakistan, governed under a special enactment of the Federal Government as a self-regulatory organization managed by a representative National Council, and has a prescribed minimum criterion of examination and entitlement of membership of such body; or

<sup>(b)</sup> Established outside Pakistan under a special enactment in the country of its origin and is a member of International Federation of Accountants (IFAC).

<sup>11</sup> Listed Companies (Code of Corporate Governance) Regulations, 2019.

<sup>12</sup> Central Bank of UAE – Internal Control, Compliance and Internal Audit Standards- Article (4) : Internal Audit Function

<sup>13</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

<sup>14</sup> Central Bank of Bahrain Rulebook - High-Level Controls (HC)-10.1 Internal Audit"

### Guest Auditor and Talent Exchange / Secondment Programs

- 7.15 Guest Auditor Program is a global concept introduced to ameliorate capacity building efforts within the internal audit function. Audit & RAR Group should also run this program to broaden understanding of internal audit's role within the Bank as well as to enhance business/process insight of the internal auditors.
- 7.16 For better understanding of internal auditors regarding systems / processes as well as to augment internal controls mindset across management functions, a Talent Exchange / Secondment Program may be implemented whereby certain personnel from internal audit function shall be transferred to management functions / branches and vice versa for a period of at least one year.

## 8. SCOPE<sup>15</sup> & RESPONSIBILITIES

- 8.1 Scope and responsibilities of the Audit & RAR Group are as follows:

### Scope

- 8.2 All activities within the Bank (including outsourced activities pertaining to both domestic and overseas operations)<sup>16</sup> are potentially within the scope of internal audit.

The scope of Audit & RAR Group is as follows:

- a. To act as a supervisory function with respect to the review of internal controls.
  - b. To evaluate and validate the effectiveness of control systems, monitor control systems, and contribute to ongoing effectiveness of control systems.
  - c. To report, on quarterly basis, on internal control systems and significant findings to the Audit Committee of the Board.
  - d. To comment on design effectiveness of controls in place / to be implemented by management.
  - e. To conduct investigations (pertaining to both domestic and overseas operations) e.g. fraud investigations and investigations against complaints received by Whistle Blowing Function regarding any wrongdoings, impropriety, irregularities, financial malpractices, fraud & forgeries, personnel harassment and improper conduct etc.
  - f. To internally evaluate the Internal Control over Financial Reporting (ICFR) system, and make timely and practical suggestions to Board Audit Committee for improvement.<sup>17</sup>
- 8.3 The subsidiaries of MCB Bank Limited (where there is no separate internal audit function) will also be subject to internal audit (if permissible by applicable laws/regulations) by MCB Bank's Audit & RAR Group as per the frequency of testing outlined in section 14.1 of this document. However, Board / Board Audit Committee may direct internal audit function to conduct audit of a subsidiary even where internal audit function already exists.

<sup>15</sup> SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>16</sup> Central Bank of the UAE-Internal Controls, Compliance and Internal Audit Regulations.

<sup>17</sup> SBP's OSED Circular 01 of 2014 "Instructions on Internal Controls Over Financial Reporting (ICFR)" (Annexure – A)

## Responsibilities of CIA and Audit & RAR Staff<sup>18</sup>

8.4 Responsibilities of the Chief Internal Auditor and staff of Audit & RAR Group are given below:

8.4.1 Chief Internal Auditor has responsibility to:

- a. Develop and lead an effective and efficient Internal Audit & RAR function.
- b. Develop and implement a multi-year Internal Audit Strategy for Audit & RAR Group to be approved by the Board on the recommendation of Board Audit Committee, setting out the long-term vision, mission and objectives of the Group.<sup>18</sup>
- c. Prepare annual Risk Based Audit Plan (RBAP) of Audit & RAR in line with Internal Audit Framework, while ensuring adequate coverage of all areas of regulatory importance in sufficient detail, for review and approval of the Board Audit Committee. The plan is to be updated for changes in the bank's risk profile, as well as major changes taking place in Bank's institutional / structural / operational / technological setup.<sup>18</sup>
- d. Implement Audit plan, including special assignments such as review of new products / systems, analysis of financial statements etc. as directed by Board Audit Committee or requested by the management. Furthermore, share implementation status of Audit plan with the Board Audit Committee on a quarterly basis. Any deviations of the Audit plan should be documented and presented to Board Audit Committee on a regular basis. In addition, the CIA shall ensure that the Audit plan is reviewed subsequent to significant change(s) in Bank over time i.e. mergers & acquisition, structural changes, establishment of new business lines, reorganization of functions etc. so that the plan remains relevant.<sup>18</sup>
- e. Ensure that function specific internal audit observations in an overseas jurisdiction are forwarded to concerned departments/functions at Head Office.<sup>19</sup>
- f. Ensure that Audit & RAR Group has adequate budget, systems, human resource with sufficient / relevant knowledge, skills, experience, competencies, professional qualifications and other required resources to perform auditing activities and meet the requirements of the Global Internal Audit Policy as well as cover all major heads of accounts maintained by the Bank. Further ensure that there are no unreasonable scope / timeline limitations for audit assignments enabling internal auditors to have complete and comprehensive review of activity/function/process being audited before finalizing their judgment/conclusion.<sup>18</sup>
- g. Ensure that the professional training needs of internal auditors are periodically identified & adequately met; the auditors demonstrate highest ethical and professional standards in performance of their duties and perform their work with dedication & diligence.<sup>18</sup>
- h. Engage with internal audit teams on regular basis to provide guidance and to ensure that auditors performing the work have relevant technical and social skills, sufficient knowledge of the work being audited and are able to perform their responsibilities diligently.<sup>18</sup>
- i. Ensure that independent investigation of suspected / actual fraudulent activities is conducted, its results notified and recommendations / suggestions given to prevent the same, wherever required / necessary.

<sup>18</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

<sup>19</sup> SBP's BPRD Circular 06 of August 06, 2018 "Governance Framework for Banks' Overseas Operations".

- j. Keep the Board Audit Committee abreast of developments and trends in internal auditing and give recommendations for necessary revisions in the Global Internal Audit Policy and Internal Audit Manuals.
- k. Liaise and maintain close coordination with SBP Inspection teams and the external auditors to share knowledge and seek their input on the state of internal controls in the Bank. Ensure that internal audit reports are provided for the review of external auditors and SBP / respective Central Bank's Inspection teams, if requested by them<sup>20</sup>
- l. Ensure that Bank's significant outsourcing arrangements are reviewed by Audit & RAR Group to protect Bank's interests.<sup>20</sup>
- m. Perform any other assignment as may be assigned by the Audit Committee of the Board.

8.4.2 The staff of Audit & RAR has responsibility to:

- a. Follow the guidelines and methodology given by the Chief Internal Auditor.
- b. Exercise due professional care in carrying out audit and other assignments.
- c. Disclose any conflict of interest with the activity to be audited, arising either from their professional or personal relationships, prior to commencement of their audit assignments.<sup>20</sup>
- d. Maintain integrity and objectivity.
- e. Remain objective, constructive and not be influenced by personal, business or other considerations, which may impair impartiality.
- f. Demonstrate highest ethical and professional standards in performance of their duties and perform their work with dedication & diligence.
- g. Immediately report any significant control breaches identified during the course of audit to CIA for their escalation to senior management for taking necessary and timely action(s). Such breaches shall also be shared with the Board Audit Committee on a quarterly basis.<sup>20</sup>

8.4.3 Independence and objectivity shall be of utmost importance for the staff of Audit & RAR Group. Threats to auditor's objectivity include conflicts arising out of self-interest, self-review, familiarity, bias, and/or undue influence etc. As mentioned in clause 8.4.2(c) above, all such conflicts shall be disclosed prior to the initiation of audit engagement.

## 9. AUTHORITY

9.1 The Audit & RAR Group is authorized to:

- a. Openly and independently express its opinion on different affairs of the Bank's overall control environment.<sup>20</sup>
- b. Have unrestricted access to all information/data (both financial and non-financial), functions, systems, records, files, meetings' minutes, property, and personnel anywhere within the Bank (both domestic and overseas operations as well as Bank's subsidiaries).

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<sup>20</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

- c. Allocate resources, set frequencies, select subjects, determine scope of work and apply the techniques required to accomplish audit objectives.
- d. Obtain specialized assistance, wherever required.
- e. Establish, formal or informal, regular communication channels with management as well as other internal control/governance functions (risk management, compliance, finance etc.) to remain aware of entity's future strategy/activities and allied risks.<sup>21</sup>.

## 10. ACCOUNTABILITY<sup>22</sup>

10.1 Chief Internal Auditor, in the discharge of his duties, shall be accountable to the Board of Directors / Board Audit Committee to:

- a. Submit an independent annual assessment / opinion, without fear or favor, on the state of internal controls in the Bank including adequacy and effectiveness of MCB Bank Limited's (as well as its subsidiaries audited during the year) all processes (manual as well as technology based, including financial reporting, business operations and compliance with relevant laws, rules and regulations) for controlling its activities and managing its risks in all the core areas of the Bank's / its subsidiary's operations. The assessment submitted shall be based on the audits conducted during the audit period supported by specific audit observations / conclusions.<sup>21</sup>
- b. Provide periodic reports to the Board Audit Committee and the management summarizing the results of the audit activities, details of significant issues (including critical control breaches recurring in at least two audit periods) identified, together with recommendations for improvements. Moreover, provide analysis regarding the themes and trends of internal control breaches observed by IAF during course of audit.<sup>21</sup>
- c. Provide confirmation to Audit Committee, at least annually (at the time of provision of aforementioned annual assessment / opinion), regarding the organizational independence of Audit & RAR Group.<sup>21</sup>
- d. Provide half yearly / biannual report regarding sufficiency of the Audit & RAR Group resources and appropriateness of their skills, experience and qualifications.
- e. Provide regular information on the status and results of the annual audit plan.
- f. Co-ordinate with and provide oversight of other control and monitoring functions.

10.2 The Board Audit Committee must assess, at least annually, the performance of the internal audit function to ascertain whether Audit & RAR Group and/or Chief Internal Auditor is/are meeting the requirements and/or expectations of stakeholders including the primary responsibility of provision of assurance and value addition to the organization. The evaluation must identify the areas for improvement to enhance Internal Audit Function's efficiency and effectiveness.<sup>21</sup>

10.3 Further, external quality assurance review / assessment must be conducted at least once every three to five years (depending on last external assessment results) by a qualified, independent external professional firm / consultant to ensure compliance with the International Standards for Professional Practice of Internal Auditing published by the Institute of Internal Auditors (IIA).<sup>23&21</sup>

<sup>21</sup> SBP's BPRD Circular No. 2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function

<sup>22</sup>SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>23</sup> Central Bank of the UAE-Internal Controls, Compliance and Internal Audit Regulations.

## 11. LIMITATIONS

- 11.1 The internal audit function must not be involved in designing, selecting, implementing or operating specific internal control measures. Management may, however, engage internal audit function for consultative / advisory services on matters related to risk and internal controls under a clearly communicated and agreed upon scope of such assignments and nature of deliverables, nevertheless, the development and implementation of internal controls remains the responsibility of Management<sup>24&25</sup>. Furthermore, internal auditors and/or Audit & RAR Group, individually or collectively, shall bear no responsibility of the subsequent implementation and / or consequences of the process/system/activity/product in respect of which advice/feedback was provided to management<sup>25</sup>. The Chief Internal Auditor and / or Audit & RAR staff is specifically prohibited from:
- Performing any operational duties, however Audit & RAR may comment on policies and procedures at development stage before their implementation (in line with the “Consultative” role as envisaged in the International Standards for Professional Practice of Internal Auditing published by the Institute of Internal Auditors) provided it does not in any way affect their independence;
  - Allocating audit resources to consultancy/advisory services in excess of 10% of total audit resources at any given point in time;<sup>25</sup>
  - Initiating or approving financial or non-financial transactions except those pertaining to Audit & RAR Group; and
  - Directing the activities of any member of staff not part of Audit & RAR Group, except to the extent such employee(s) have been appropriately assigned to audit team(s) or to otherwise assist the Audit & RAR Group.

Audit team / staff which provided advisory / consultancy services to management should not be assigned to audit the same auditable activity until completion of one audit cycle.<sup>25</sup>

Furthermore, Chief Internal Auditor may attend various Management Committees’ meetings, that pertain to risk & control functions like risk management, compliance, internal controls etc., as a guest member / observer. Moreover, he shall also attend Bank’s Management Committee (MANCOM) meetings as an observer to remain aware of the shift / changes in organizational goals and objectives.

## 12. SKILLS, TRAINING AND ALTERNATE ARRANGEMENTS<sup>26</sup>

- 12.1 Audit & RAR staff will need to have sound judgment. This will require them to have appropriate experience and expertise to perform their work with proficiency and due professional care. Audit & RAR staff will engage in continuing professional development through structured training programs.
- 12.2 However, if the knowledge, skills and competencies required to perform an engagement are not available within Audit & RAR Group, the Chief Internal Auditor will obtain alternative assistance from specialized professional firms, consultants / experts or others with prior written approval of State Bank of Pakistan (SBP) / respective regulator of the host country and the Board’s Audit Committee. Such practices, however, shall be short-term in nature and only limited to such technical areas/risks where in-house expertise is not available. Further, use of such consultants / experts should not compromise the independence and objectivity of internal audit function. CIA must also ensure that these experts / consultants have not been previously engaged in consulting engagement in the same area within the Bank, unless a “cooling – off” period of at

<sup>24</sup> Central Bank of the UAE Notice No. CBUAE/BSN/2018/3017 Dated October 16, 2018 “Internal Controls, Compliance

<sup>25</sup> BP’s BPRD Circular No. 2 of 2019 Dated April 03, 2019 “Guidelines on Internal Audit Function

<sup>26</sup> SBP’s BSD Circular No. 03 of 2007 Dated April 04, 2007 “Policy Framework in Banks”.

least one full financial year 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 twelve (12) months.

- 12.3 The Chief Internal Auditor shall hire / develop resources in Audit & RAR Group to address such risks / audit areas as early as possible. It should be noted that activities of Audit & RAR Group either in whole or any part thereof shall not be outsourced by the Bank.<sup>27</sup>

### 13. STANDARDS OF PRACTICE

- 13.1 Audit & RAR staff must comply with IIA's Code of Ethics, MCB's Code of Conduct and the International Standards for Professional Practice of Internal Auditing published by the IIA (provided that these Standards are not in direct conflict with any regulatory instructions issued either by Host country or Home country).

### 14. FREQUENCY OF TESTING<sup>28</sup>

- 14.1 In general, all areas in the bank (including outsourced activities) would be audited once in every two years, however, low risk non-branch entities may be audited / reviewed once in every three years subject to approval by the Board Audit Committee. Further, overseas operations will be covered in the audit plan at least once a year<sup>29</sup>, however extent of the audits / reviews pertaining, to these operations, will be based on risk assessment carried out by Audit & RAR Group. Moreover, subsidiaries (where there is no separate internal audit function) shall also be audited (subject to permissibility by applicable laws/regulations) at a minimum of once in every two years. However, Board / Board Audit Committee may direct internal audit function to conduct audit of a subsidiary even where internal audit function already exists. Furthermore, high-risk areas would be reviewed more frequently. To determine which area, need more than minimal coverage, the following indicators will be considered:
- a. Analytical review and financial analysis that signal deterioration in a particular area.
  - b. Audit findings that still require close review.
  - c. Instructions/requests by Board of Directors or the Board Audit Committee or the management for special reviews.
  - d. SBP / Regulatory Bodies / External Auditors' Inspection / Audit Report and / or exceptions in other examination reports.
- 14.2 Audit & RAR Group would reassess its audit / review plan and change the priorities as warranted. For example, if an unexpected crisis or demand arises, the internal audit staff should modify its schedule and possibly the scope of its reviews. In that case, it may delay the audit of an efficiently run area or restrict the scope of that audit to accommodate the demands of the more critical area.

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<sup>27</sup> SBP's BPRD Circular No.2 of 2019 Dated April 03, 2019 "Guidelines on Internal Audit Function".

<sup>28</sup> SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>29</sup> SBP's BPRD Circular 06 of August 06, 2018 "Governance Framework for Banks' Overseas Operations".

## 15. REPORTING AND MONITORING MECHANISM<sup>30</sup>

15.1 Following will be the mechanism for reporting:

- a. Each audit assignment shall be followed by a report containing summary and details of findings along with root cause for high risk observations, business impact / risk and recommendations sent to the responsible Groups / Functions and administrative units or branches or divisions.
- b. The reports shall be based on adequate working papers.
- c. The detail findings of the assignments shall be subject to a preliminary discussion with the auditee, in order to enable its responses to be included in the audit report.
- d. Depending on the criticality / degree / quantum of risk involved, findings of significance shall also be reported to the President as and when highlighted by Audit & RAR Group.
- e. Audit & RAR Group shall periodically follow-up on the implementation of its recommendations.
- f. Audit & RAR Group shall timely escalate significant audit / review findings to appropriate levels of management including the President, if unresolved within a reasonable period (as per the best practices) at levels of those responsible. As per international best practices, all high-risk internal audit exceptions should be resolved within 60 days of report issuance and all other internal audit exceptions should be resolved within 90 days unless there are cogent reasons / justifications for delayed resolution such as dependency on IT systems etc.
- g. Significant Audit / Review findings remaining unresolved within a reasonable time at the level of President's Office shall be reported to the BAC.
- h. Where there could be a difference of opinion on the observations/conclusions/judgments made by internal auditors in audit reports and management's point of view on these audit results. In such scenarios, the position taken by internal auditors/CIA would be considered as final and management shall implement all such audit recommendations in letter and spirit. However, in order to provide management a chance to present its point of view, CIA in consultation with Board Audit Committee may establish a mechanism where such exceptional and significant cases of disagreement may be elevated at Board Audit Committee level and decisions be taken accordingly.
- i. Chief Internal Auditor shall promptly report to the Central Bank of the United Arab Emirates (UAE) violations of the Central Bank Law, rules, regulations, instructions and any Matters of Significance (as defined by Internal Controls, Compliance and Internal Audit Regulation of Central Bank of the UAE).<sup>31</sup>
- j. Chief Internal Auditor shall promptly notify Central Bank of the UAE when he / she become aware of significant deviation from this internal audit policy.<sup>31</sup>

<sup>30</sup> SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>31</sup> Central Bank of the UAE-Internal Controls, Compliance and Internal Audit Regulations.



## 16. FRAUD INVESTIGATIONS<sup>32</sup>

- 16.1 While it is the management's responsibility to design and implement programs and controls to prevent, deter and detect fraud, the Audit & RAR staff should have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization.

### Fraud Deterrence Programs

- 16.2 Audit & RAR Group shall assist the management in designing programs for deterrence of frauds. These programs include, but are not limited to the following:
- a. Setting up of a Whistle Blowing Program. The Whistle Blowing Program refers to the deliberate / voluntary disclosure, of individual or organizational impropriety, by a person who has or had privileged access to data, events or information about an actual, suspected or anticipated wrongdoing within or by an organization that is within its ability to control.
  - b. Assisting the management in identification of internal control deficiencies and suggesting measures for removal thereof.
  - c. Commenting on the design effectiveness of the controls to be implemented by the management.
  - d. Assisting the management in ensuring strict compliance with respect to recommendations to overcome the weaknesses identified in the reports of the Internal & External Audits as well as the State Bank of Pakistan / respective regulator of the host country.

### Employee Guidance Where Fraud Is Suspected

- 16.3 Employees are encouraged to report the acts involving fraudulent activities to the Whistle Blowing Function established within the Audit & RAR Group. The Whistle Blowing Program (available on Bank's website) covers in detail the employees' rights, rewards and obligations with respect to making such disclosures.

## 17. MANAGEMENT RESPONSIBILITIES

- 17.1 The Management should ensure that all information relevant to the discharging of responsibilities by the Audit & RAR Group including those related to investigation of frauds is provided promptly to responsible personnel in Audit Group. The information should be complete, correct, reliable, accurate and timely.
- 17.2 Further, senior management must inform Audit & RAR Group of new developments, initiatives, projects, products and operational changes and ensure that all associated risks (both known and anticipated) are identified and communicated to internal audit at an early stage.<sup>33</sup>

<sup>32</sup> SBP's BSD Circular No. 03 of 2007 Dated April 04, 2007 "Policy Framework in Banks".

<sup>33</sup> Central Bank of UAE – Internal Control, Compliance and internal Audit Standards - Article (4) : Internal Audit Function.

## **18. CONFIDENTIALITY AND REPORTING PROCEDURES**

- 18.1 Audit & RAR Group should respect the value and ownership of information they receive. They should not disclose information without appropriate authority unless there is a legal, regulatory or professional obligation to do so. They shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the Bank.
- 18.2 Whenever the Audit & RAR Group has determined that there is evidence that fraud has occurred, that matter should be brought into the attention of an appropriate level of management in a timely manner. This is appropriate even if the matter might be considered inconsequential, such as a minor defalcation by an employee at a lower level within the Bank. Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to the Board Audit Committee. In addition, the Audit & RAR Group should reach an understanding with the Board Audit Committee regarding nature and extent of communication with the Committee about misappropriations perpetrated by lower-level employees.

## **19. INTERNAL AUDIT SOFTWARE / E-AUDIT SYSTEM**

- 19.1 Automated internal audit software shall be deployed in line with requirements of SBP's Guidelines on Internal Audit Function, amended from time to time. This system should be capable of handling complete audit process / lifecycle i.e. data collection, risk assessment, audit planning, execution, reporting and follow-up. The system should also be capable of supporting every type of audit i.e. operational audit, IT/IS audit, management audit etc.

## **20. REVIEW**

- 20.1 This Charter supersedes the Global Internal Audit Policy Version 5.0 of the Audit & RAR Group approved by the Board in its meeting held on August 16, 2022.
- 20.2 Chief Internal Auditor shall review and assess the adequacy of the Global Internal Audit Policy on need basis but at least annually and propose / recommend changes, if necessary, to the Board Audit Committee for its consideration and further recommendation to the Board of Directors for approval.

## 21. GLOSSARY

<b>AMD</b>	Audit Master Data
<b>AML</b>	Anti-Money Laundering
<b>RAR</b>	Risk Assets Review
<b>BAC</b>	Board Audit Committee
<b>BoD</b>	Board of Directors
<b>CBB</b>	Central Bank of Bahrain
<b>CBSL</b>	Central Bank of Sri Lanka
<b>CBUAE</b>	Central Bank of the United Arab Emirates
<b>CCG</b>	Compliance & Controls Group
<b>CEO</b>	Chief Executive Officer
<b>CFT</b>	Combatting the Financing of Terrorism
<b>CIA</b>	Chief Internal Auditor
<b>CPF</b>	Countering Proliferation Financing
<b>FI</b>	Financial Institution
<b>HEC</b>	Higher Education Commission
<b>HR&amp;RC</b>	Human Resource & Remuneration Committee
<b>IAF</b>	Internal Audit Function
<b>ICFR</b>	Internal Control over Financial Reporting
<b>IIA</b>	Institute of Internal Auditors
<b>IPPF</b>	International Professional Practices Framework
<b>IT/IS</b>	Information Technology//Information Security
<b>KPIs</b>	Key Performance Indicators
<b>ML</b>	Money Laundering
<b>PF</b>	Proliferation Financing
<b>QA&amp;FD</b>	Quality Assurance & Framework Development
<b>RBAP</b>	Risk Based Annual Audit Plan
<b>SAM</b>	Special Assets Management
<b>SBP</b>	State Bank of Pakistan
<b>SECP</b>	Securities and Exchange Commission of Pakistan
<b>SOP</b>	Standard Operating Procedure
<b>TF</b>	Terrorist Financing
<b>UAE</b>	United Arab Emirates