



**INTERNAL AUDIT FUNCTION
CHARTER**

November 2019

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UPDATE AND AMENDMENT RECORD

Amendment No	Date
1	March 2015
2	December 2017
3	November 2019

1. DEFINITION OF INTERNAL AUDIT

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

2. INTERNAL AUDIT CHARTER

The aim of the Internal Audit Charter (Charter) is to define the purpose, standing, authority and responsibility of the Internal Audit Function (IAF) within the Cyprus Development Bank Group (CDB Group). The Charter seeks to lay down the purpose of internal audit, specify the scope of its work and its reporting lines, as well as define the way and level of cooperation with external auditors and other control functions.

The Central Bank of Cyprus (CBC) Directive on Governance and Management Arrangements in Credit Institutions requires the establishment of an IAF independent from the operational functions and which shall have sufficient authority, stature, resources and access to the management body, and defines its reporting and other responsibilities. The Internal Audit Charter should be in line with the Directive.

3. MISSION OF THE INTERNAL AUDIT FUNCTION

The purpose of the IAF, as defined by the Institute of Internal Auditors (IIA), is to provide "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process".

The IAF aims to be proactive and professional rather than reactive, aiming at:

- assisting the Board of Directors of CDB Group (Board) to carry out effectively its oversight duties
- providing assurance that risk management processes are managing risks effectively through the internal control framework
- making value-added recommendations based on best industry practice and tailored to CDB Group needs, to help strengthen the control environment and governance processes, as well as, the effective utilisation of resources, rather than simply generating findings
- providing rigorous independent assessments of CDB Group's risks and controls

4. RESPONSIBILITIES OF THE INTERNAL AUDIT FUNCTION

The Head of the Internal Audit is appointed by the Board, following recommendation by the Audit Committee, and after having obtained the consent of Central Bank of Cyprus.

The scope of internal audit encompasses, but is not limited to, the provision of independent assurance through the examination and evaluation of the adequacy and effectiveness of CDB Group's governance, risk management, and internal controls, as well as, the quality of performance in carrying out assigned responsibilities to achieve the organisation's stated goals and objectives. This includes:

- Assessing the effectiveness of risk management processes to organisational objectives.
- Evaluating the appropriateness, adequacy and effectiveness of the corporate governance framework.
- Appraising the means by which CDB Group manages and mitigates risks to preserve its assets, and seeks to prevent fraud, misappropriation or misapplication of assets.
- Evaluating the reliability, integrity and completeness of the accounting, financial reporting, management information and information technology systems.
- Assessing the design and operational effectiveness of internal control systems and control functions, as well as, the totality of these controls.
- Assessing any other matters as these may be requested by the Board, Audit Committee, Senior Management or the CBC and any matters that the IAF self-determines they require review.

The IAF should not be involved in designing, selecting, implementing or operating specific internal control measures; IAF may provide input / consulting services on matters related to risks and internal controls upon request by Senior Management for as long as the independence of audit assignments is not called into question.

As per IPPF, consulting services are defined as advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility.

IAF can provide the following consulting services:

- Facilitating in the identification & evaluation of risks
- Coaching management in responding to risks

Before accepting consulting services, the IAF should ensure that objectivity is maintained and not assume management responsibility. If IAF perceive that independence or objectivity relating to proposed consulting services can be impaired by providing these services, then relevant disclosure must be made prior to accepting the engagement. In such cases, relevant measures should be implemented to safeguard objectivity e.g. by reassigning resources to the engagement which are independent or in case the objectivity is not safeguarded the engagement will not be accepted.

IAF may provide assurance services where it had previously performed consulting services, provided the nature of the consulting did not impair objectivity and provided individual objectivity is managed when assigning resources to the engagement.

The IAF must carry out such assignments as are needed to fulfill its responsibilities to provide assurance, through routine audits and special audits, both announced and unannounced.

The following audit activities should be included, as a minimum, in its scope of internal audit assignments:

- Assessment of the appropriateness and adequacy of the organizational structure and human resource management and the extent to which the institution has established appropriate corporate governance policies and procedures.
- assessment of the extent to which the institution's collective bodies as well as its operational units and internal control units effectively utilize the means and resources made available to them, follow the directions and procedures which have been officially set, whether due attention is paid towards ensuring the completeness and accuracy of information and whether they arrange to integrate in all procedures and transactions carried out, appropriate risk preventive and control mechanisms.
- Assessment of the effectiveness, adequacy and adherence to the risk management and compliance procedures.
- Assessment of the integrity of information technology systems including the risk management and accounting information systems as well as the accuracy, reliability and completeness of the information data used or produced in line with the principles mentioned in Appendix 3 of the Directive of Governance and Management Arrangements in Credit Institutions.
- Assessment of systems and procedures which govern the production of reliable, complete and up-to-date financial, management and regulatory information.
- Assessment of the institution's information security for information of any kind, residing on any media including information in printed format.
- Assessment of the procurement/ tendering procedures and actual tenders.
- the evaluation on the completeness and effectiveness of the outsourcing policy.
- The assessment of the completeness and adequacy of the institution's Business Continuity and the Information Technology Disaster Recovery Plans.

- The assessment of the completeness and adequacy of the institution's information security policy, including Information Technology security.
- the evaluation of the process for assessing the institution's capital adequacy relative to its risk profile (ICAAP), the parameters upon which the institution has based its capital adequacy calculations and the review of the process for stress testing the institution's capital levels, taking into account the frequency of such exercises, their purpose, the reasonableness of scenarios, the underlying assumptions employed and the reliability of the processes used.
- Assessment of the extent to which the approval procedures for new product developments are applied in accordance with the new products approval policy and whether these procedures are adequate and effective.
- Assessment of the appropriateness of the remuneration policy in relation to the predetermined goals set by the legal and regulatory framework, and the possible consequences of the policy in the assumption and management of risks.
- Assessment of the adequateness and enforceability of the claw back arrangements as well as the structure of the bonuses regarding the deferred payment element requirements and its linkage with future performance within a reasonable time horizon.
- Assessment of the adequacy and effectiveness of the compliance function, risk management function and information security function.

5. RIGHTS AND AUTHORITIES

In the performance of assigned duties, the Head of Internal Audit and staff of the IAF should have authority of access to all operations, records, property and staff at each location. All employees must co-operate fully with and provide full and complete information to the IAF as and when requested.

In particular, the IAF personnel shall have the right:

- of access to all premises of the CDB Group and the right to inspect, examine, and audit all correspondence, files, books, records, accounts and all other documents or forms of information held by the CDB Group as are necessary for the performance of audit duties;
- to require all officers of the CDB Group to supply such information and explanations as are necessary for the performance of audit duties;
- to require the Manager of the audited area to respond in writing to the Internal Audit report within an agreed time period.

Employees, whenever called upon by the IAF personnel within the context of performing their duties, shall:

- produce on request for inspection all relevant files, records, vouchers, documents, computer reports and the like, under their control;
- produce on request for inspection all plant and equipment under their control;

- produce on request for counting, all monies and valuables held by them;
- supply on request all relevant information and explanations;
- furnish within an agreed time period written replies to Internal Audit memoranda or queries addressed to them; and
- generally, render all possible assistance to the IAF as required during the course of the audit.

6. REPORTING LINE

6.1 Reporting by the IAF

The Internal Auditor should report to the Board of Directors through the Audit Committee. The Internal Auditor should not be subordinate to any other operational unit of the Bank; however, all its reports are communicated to the Bank's Senior Executive Management.

The Internal Auditor should meet regularly with Senior Executive Management in order to establish communication lines and monitor progress towards corporate objectives.

Internal Auditor administratively reports to the Bank's CEO. More specifically requests approval for the following:

- a) Annual Leave,
- b) Office equipment.

6.2 Reporting to the IAF

The Head of Internal Audit should be notified of the date of commencement of all regulatory inspections. The Head of Internal Audit should also be copied in on all regulatory reports that may result.

The Head of Internal Audit should be consulted before the introduction of all new or enhanced products or systems to allow the opportunity for the proposed control procedures to be evaluated. Managers with responsibility for the development of a product or system should ensure that the Head of Internal Audit is advised at an early stage and kept aware of progress throughout the life cycle of the development.

7. PROFESSIONALISM

The IAF will govern itself by adherence to the Institute of Internal Auditors' mandatory guidance including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing. This mandatory 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.

The IIA's Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the IAF will adhere to the CBC relevant Directives and Circulars, in particular the CBC Directive on Governance and Management Arrangements in Credit Institutions, as well as, to IAF's standard operating procedures manual.

8. OUTSOURCING

The Head of Internal Audit has the right to request from the Audit Committee to outsource certain audit assignments. Outsourcing may involve:

- Co-sourcing through which external resources participate on joint engagements with in-house staff of IAF
- Subcontracting of audit relating to specific engagement or portion of some engagement or to a special investigation

Where audit engagements are subcontracted due consideration will be given to the content of contracts and engagement letters. In addition, ownership of work papers and use of results will also be addressed. The outsourcing procedure shall be adhered to the Bank's outsourcing policy.

9. ANNUAL AUDIT PLAN

The Head of Internal Audit will prepare, for the Audit Committee's consideration, review and approval an annual audit work plan in a form agreed with the Audit Committee.

The internal audit plan will consist of a work schedule, as well as, resource requirements. The Head of Internal Audit will communicate the impact of any resource limitations and interim changes to Management and the Board.

The internal audit plan will be developed based on a risk-based methodology, including if necessary, input of Management and the Board.

A risk-based approach is designed to be used throughout the IAF to efficiently and effectively focus the nature, timing and extent of audit procedures to those business areas that have the highest risk potential that may hinder CDB Group's objectives. The annual audit plan will be based on the results of the business units risk evaluation. Riskier areas will be covered first and more frequently with the aim of providing assurance that important risks are being managed properly. The risk-based audit approach provides IAF with an approach to conduct the audit as efficiently and effectively as possible, benefiting the organisation.

The audit plan should ensure that all entities and all activities of CDB Group are audited at least once within an appropriate period of time, which should not exceed 3 years. The Head of Internal Audit will review and adjust the plan, as necessary, in response to changes in the organisation's business, risks, operations, programs, systems and controls. Any significant deviation from the approved internal audit plan will be communicated to Senior Management and the Audit Committee by the Head of Internal Audit.

The audit plan should ensure that as a minimum:

- Credit review of an appropriate scale are carried out on an annual basis as a means for assessing:
 - The adequacy and effectiveness of, and adherence to, the credit granting procedures and policy, including the procedures for the assessment of credit applications and approval of credit facilities, as well as on the management and monitoring mechanism of collaterals and securing compliance with the credit covenants, in accordance with the CBC Directive on Loan Origination and the Bank's Policy on Loan Origination.
 - The correct application of the internal credit rating system developed in accordance with the guidelines of the CBC in relation to the management of credit risk.
 - The appropriateness, adequacy and correct implementation of the provisioning policy as well as on the adequacy of the provisions and the completeness of the methodology and procedure for the calculation of loan impairments, including the selection criteria of loans for impairment testing.
 - The completeness of the methodology and procedure for the calculation of the impairment of other assets as well as of the adequacy of the relevant provisions and impairment write-offs.
 - The adequacy of the monitoring procedures and handling of non-performing and problematic loans.
 - The adequacy and effectiveness of internal controls.
- The adequacy of, and adherence to, the procedures for granting credit facilities to members of the Board and connected persons, major shareholders and connected persons as well as to other persons who maintain a special relationship with the Bank is assessed on annual basis.
- Special audits of an appropriate scale are carried out on an annual basis as a means for assessing the adequacy and effectiveness of:
 - the risk management framework
 - the internal control systems, the information systems and information security
- The effectiveness and adequacy of the policy, procedures and controls for the prevention of money laundering and terrorist financing, and the level of

compliance with the provisions of the Prevention and Suppression of Money Laundering Activities Law of 2007 and its subsequent amendments and the Prevention of Money Laundering and Terrorist Financing Directive of 2019 is assessed on annual basis in accordance with the provisions of the aforementioned Directive;

- The adequacy and completeness of the outsourcing policy is assessed at least every three years and corrective measures are followed-up on an annual basis, notwithstanding the duty of IAF to assess the adherence to the outsourcing policy prior to the outsourcing of material operations.
- The application of the remuneration policy by the senior management and its compliance with the relevant policies and procedures adopted by the management body is assessed at least on an annual basis.

10. REPORTING AND MONITORING

The Head of Internal Audit reports to the Board through the Audit Committee, at least on a quarterly basis, of all major observations emanating from the audits carried out since the last report to the Board as well as recommendations for addressing any weaknesses identified. In case of significant weaknesses identified, the Head of Internal Audit has the responsibility to communicate them as soon as practically possible to the Board.

An internal audit report should include management's response and corrective actions taken or to be taken in regard to the specific findings and recommendations. Management's response should include a timetable for anticipated completion of actions to be taken, an explanation for any corrective action that will not be implemented and the person assigned to perform the corrective action.

The IAF will be responsible for appropriate follow-up on engagement findings and recommendations. All significant findings will remain in an open issues file until settled.

It is the right of the Head of Internal Audit to freely express and report the IAF's findings to the Board and its relevant committees without the presence of executive members of the Board.

Additionally, the Head of Internal Audit submits an annual report to the Board within 2 months as of the end of each year, through the Audit Committee, which is also copied to the CEO, with the following minimum information:

- The audit plan approved by the Board for the year under review.
- Summary, coupled with comprehensive comments, of the major findings and weaknesses identified from the routine inspections and special audits carried out during the year under review for each audited area.
- An updated summary of the progress achieved in the implementation and the effectiveness of the corrective actions taken in addressing any weaknesses and

findings identified in the various inspection reports of the internal and external auditors, as well as those of the supervisory authorities.

- Verification of the accuracy of the returns submitted to the CBC, including COREP, FINREP, large exposures, prudential liquidity and facilities to members of the Board, major shareholders and their connected persons.
- The audit and action plan for the following year.

11. INTERACTION WITH OTHER CONTROL FUNCTIONS

IAF maintains good working relations and communication channels with all the other control functions, namely risk management, compliance and information security; towards this end the Head of Internal Audit will hold periodic meetings with the other control function heads during which any matters arising from the work of the IAF that may affect the work of other control functions and vice versa will be discussed. In addition, internal control, governance, emerging regulatory issues, trends, market conditions and other issues that may affect the work of the control functions will be discussed.

Notwithstanding the above, the IAF retains the right to examine any activity of the other control functions.

12. INTERACTION WITH CENTRAL BANK

In accordance with the CBC Directive on Governance and Management Arrangements in Credit Institutions, the Head of Internal Audit should inform the CBC of any significant findings / developments that have a material impact on CDB Group's risk profile and of any significant changes in the structure and functions of the IAF. Additionally, the Head of Internal Audit is expected to hold meetings with the CBC at least annually or at any other interval the CBC may require, to discuss the scope and coverage of the work of the IAF, its risk analysis, findings and recommendations.

The Head of Internal Audit's interaction with the CBC may cover items such as:

- the adequacy and effectiveness of CDB Group's processes for objective setting and strategic decision making
- the quality and substance of management, governance structure and processes
- CDB Group's capital and liquidity positions and its processes and methods for identifying, monitoring, controlling, and reporting on material risks
- CDB Group's business model including risks related to its business activities, processes and functions and the adequacy of the control and oversight of these risks such as:

- application and effectiveness of risk management procedures and risk assessment methodologies as applied to material risks
- appropriateness and adequacy of the provisioning policy, as well as the adequacy of the provisions
- completeness of the impairment / write-off methodology
- significant transactions
- handling of non-performing and problematic loans
- frauds
- outsourcing arrangements
- issues related to business conduct such as:
 - management of conflict of interest
 - adherence to rules for providing services to clients
 - anti-money laundering processes and controls
- issues related to internal controls and adequacy and effectiveness of other control functions.

13. GROUP RESPONSIBILITY

On an annual basis, IAF provides Internal Audit services to the subsidiary Global Capital Securities and Financial Services Ltd in accordance with a relevant agreement between CDB and the subsidiary.

14. COORDINATION OF THE IAF WITH THE EXTERNAL AUDITORS

IAF can add value to shareholders by coordinating with the external auditors. The combined different strengths of internal and external auditors increase the effectiveness and efficiency of audits by minimising duplication of audit effort, through sharing information of perceived risk areas. As a result, communication and coordination between IAF and external auditors on matters of mutual interest raise the possibilities of fraud detection and increase trust between them.

The ideal relationship, also in accordance with the recommendations of the Institute of Internal Auditors, is when the internal and external auditors meet periodically to discuss common interests, thus benefiting from their complementary skills, areas of expertise and perspectives; gain understanding of each other's scope of work and methods; discuss audit coverage and scheduling to minimize redundancies; provide access to reports, programs and working papers; and jointly assess areas of risk.

The scope of coordination between IAF and external auditors encompasses, without being limited to, the consideration by the IAF of the external auditor's Management Letter findings and deviations when setting the priorities of the annual audit plan, as well as, ensuring that relevant follow-up and corrective actions have been taken by the responsible divisions.

The Head of Internal Audit proactively communicate and engage with the external auditor on a regular basis through formal meetings as well as informal meetings (e.g. emails and phone calls). Formal meetings will be held throughout the year. Moreover, relative constant communication will be maintained so that both parties stay focused on improving the audit coverage in CDB Group.

15. QUALIFICATIONS AND SKILLS OF INTERNAL AUDIT STAFF

All IAF personnel must possess the necessary professional competence and due professional care for the effective discharging of their duties.

An internal auditor must, as a minimum, have the knowledge, experience and capacity in:

- Applying suitable audit methodologies, tools and techniques for:
 - The collection and processing of information
 - The examination and evaluation of audit evidence
- Communicating in a clear and effective manner with the stakeholders of the IAF.

Additionally, an internal auditor is expected to:

- Act with integrity, carrying out his/her duties in an honest and professional manner and informing the Head of Internal Audit if his/her fitness to carry out an audit assignment is called into question
- Be diligent in the protection of information acquired in the course of his/her duties
- Ensure that his/her professional judgment is not influenced by any personal or commercial consideration.

16. REVIEW AND APPROVAL

The Internal Audit Charter will be reviewed and updated periodically by the Head of Internal Audit. Any substantive changes will be formally approved by the Board on the recommendation of the Audit Committee.