

***Higher performance
by design: A blueprint
for change***

2014 State of the Internal
Audit Profession Study
*Banking and capital markets
industry*

Contents

- Overview
- Heart of the matter
- At a glance: Banking and capital markets industry sector responses
- The journey to capture unrealized value
- Case for change
- Developing an aligned set of expectations
- Internal audit's communication strategy
- Communicating performance and value
- Successfully making the journey

Overview

- 10th Annual State of the Internal Audit Profession Study recently released
- More than 1,900 respondents: 1,400 chief audit executives (CAEs) and internal audit (IA) managers, as well as more than 520 stakeholders (e.g. board and audit committee members, chief financial officers, chief risk officers, chief communication officers)
- 272 respondents categorized as banking and capital markets industry
- Conducted more than 125 stakeholder and CAE interviews across North America, Europe, Australia, and Asia to gain further insights
- Interviewed certain key regulators across the globe to understand their expectations of internal audit
- Survey focused on:
 - Understanding what is expected from internal audit for the purpose of identifying potential alignment issues
 - Understanding stakeholders' perceptions related to the value of Internal Audit
 - Understanding internal audit/s performance related to key attributes



Heart of the matter

Higher performance by design: A blueprint for change

This year's findings

- Significant differences of opinion exist between stakeholders and CAEs on the nature of what is expected of internal audit (i.e. a misalignment)
- On average, only 56% of banking and capital markets stakeholders say internal audit is performing well at delivering on expectations
- Only 41% of banking and capital markets stakeholders say they do not believe internal audit adds significant value

Leads to the following questions.....

- Is your function aligned to the expectations of its key stakeholders? How do you know what capabilities to develop without clearly knowing what is expected of you?
- Are you aligned with respect to the critical risks?
- Are you expecting enough from your function? Our research shows that when more is expected, internal audit has the opportunity to generate more value to the organization
- Higher expectations require increased capabilities and increased investment

Internal audit must be aligned with the expectations of its stakeholders in order to strategically build the right capabilities and raise both its performance and its value.

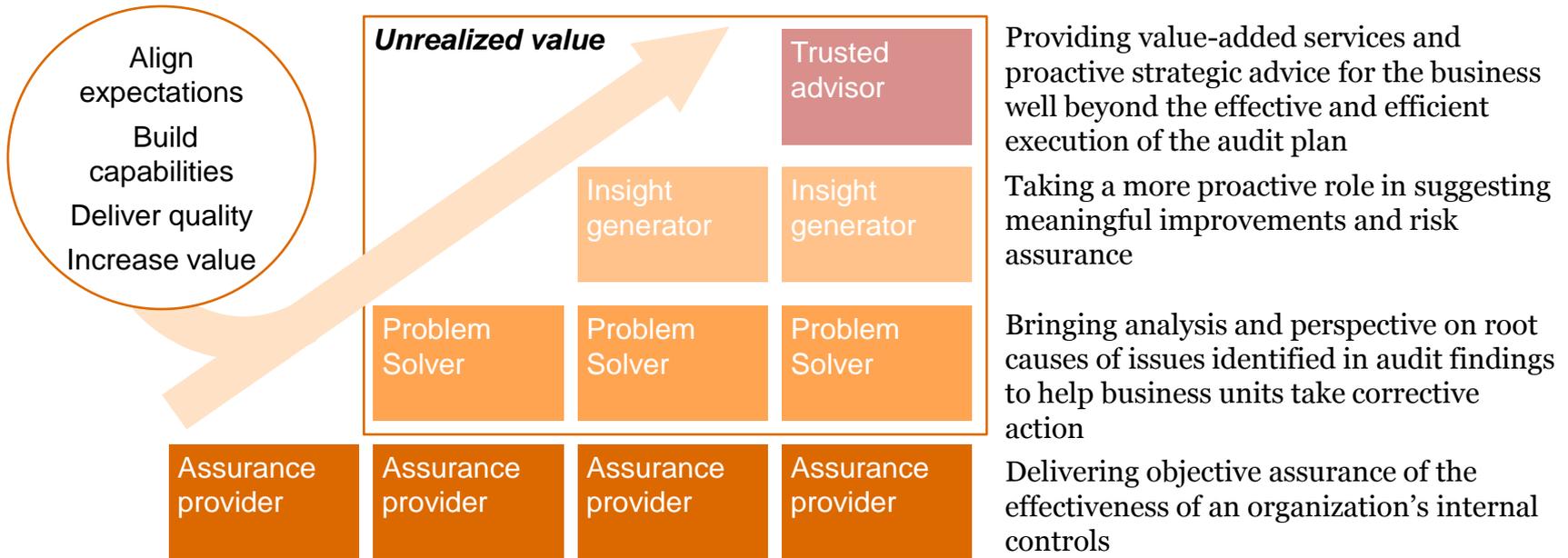
At a glance: Banking and capital markets industry sector responses

272 respondents
from banking and
capital markets
industry

78% of respondents
from the banking
and capital markets
industry were CAEs

58% of banking
and capital markets
industry respondents
reported >\$1 billion
in revenue

The journey to capture unrealized value



Case for change

Value

Stakeholders continue to have significantly different views of internal audit's value

Performance

Banking and capital markets industry's internal audit functions are struggling to prove their performance to stakeholders

Critical risks

Banking and capital markets industry companies are remaining somewhat consistent in their perceptions of how internal audit is managing critical risks

2013

71% of banking and capital markets stakeholders see significant value

74% of banking and capital markets stakeholders rank internal audit performance as strong

83% of banking and capital markets stakeholders say risks are well managed

2014

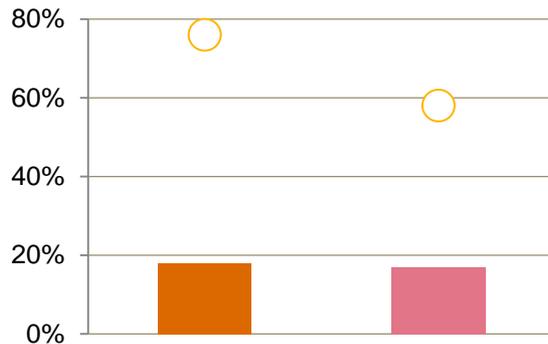
59% of banking and capital markets stakeholders see significant value

*56% of banking and capital markets stakeholders rank internal audit performance as strong**

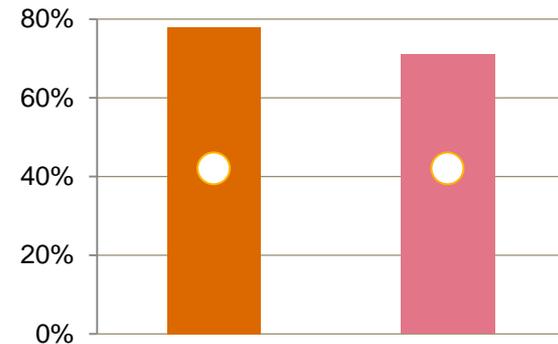
79% of banking and capital markets stakeholders say risks are well managed

*Represents the average of the “performs well” ratings across 18 capabilities in 2014 versus 8 capabilities in 2013.

The case for change: Banking and capital markets industry



Engaging and managing a relationship with stakeholders



Using technology effectively in the execution of audit services

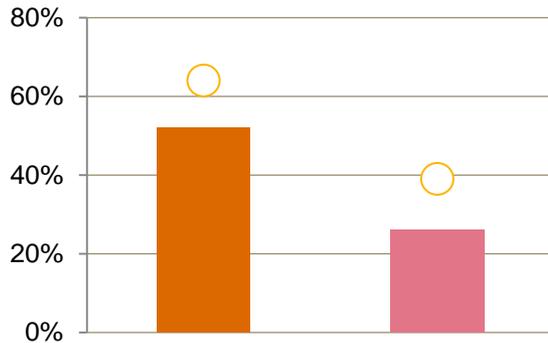


Expectation: % who expect this from internal audit; base = total survey responses

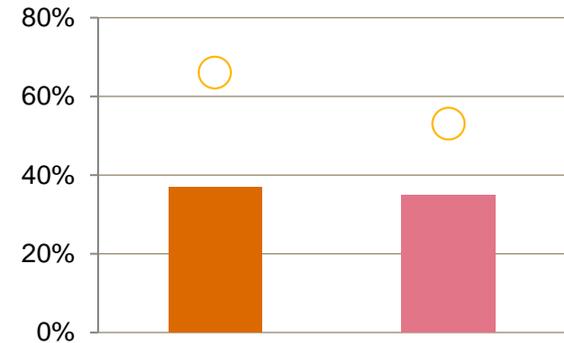
Performance: % who say internal audit performs this well; base = only those respondents who expect internal audit to do this

Stakeholders are not aligned in their expectations of internal audit regarding key attributes for the banking and capital markets industry.

The case for change: Banking and capital markets industry



Identifying thematic issues the organization is facing



Promoting quality improvement and innovation

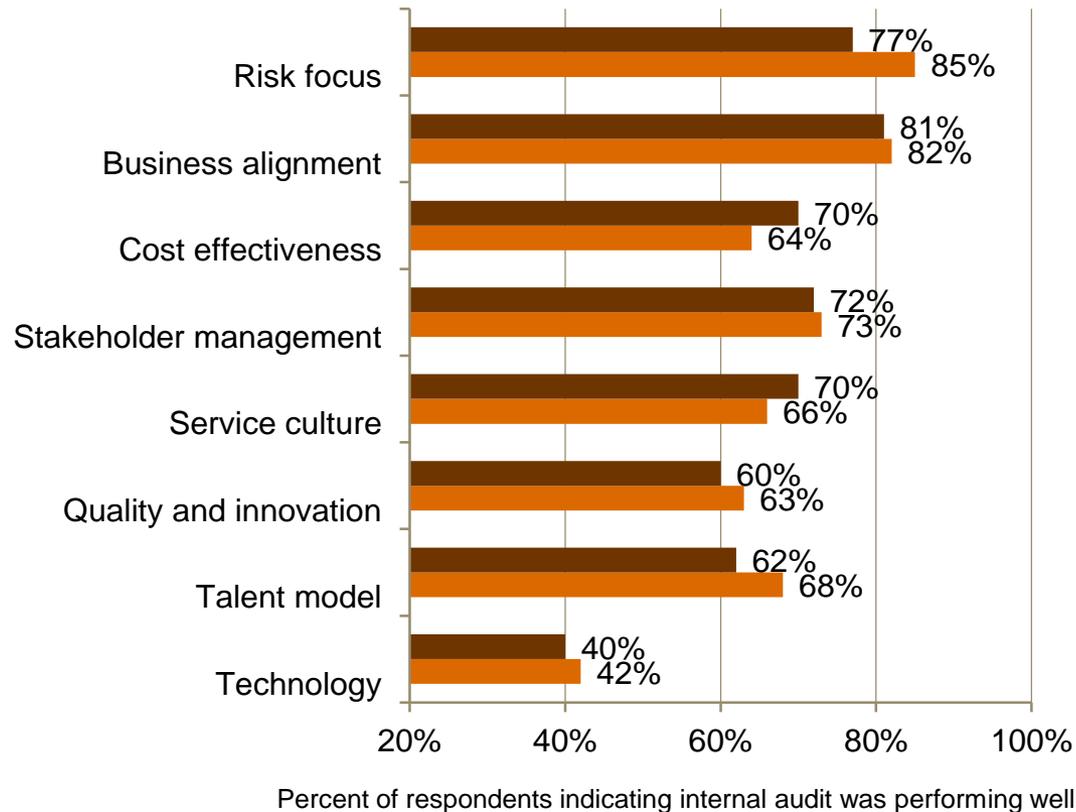


Expectation: % who expect this from internal audit; base = total survey responses

Performance: % who say internal audit performs this well; base = only those respondents who expect internal audit to do this

In banking and capital markets, CAEs' and stakeholders' expectations of the internal audit function are being exceeded by internal audit's performance—especially when they're identifying thematic issues the organization is facing.

The banking and capital markets industry found internal audit to be performing 8% higher than population for “risk focus”



■ Overall ■ Banking & capital markets industry

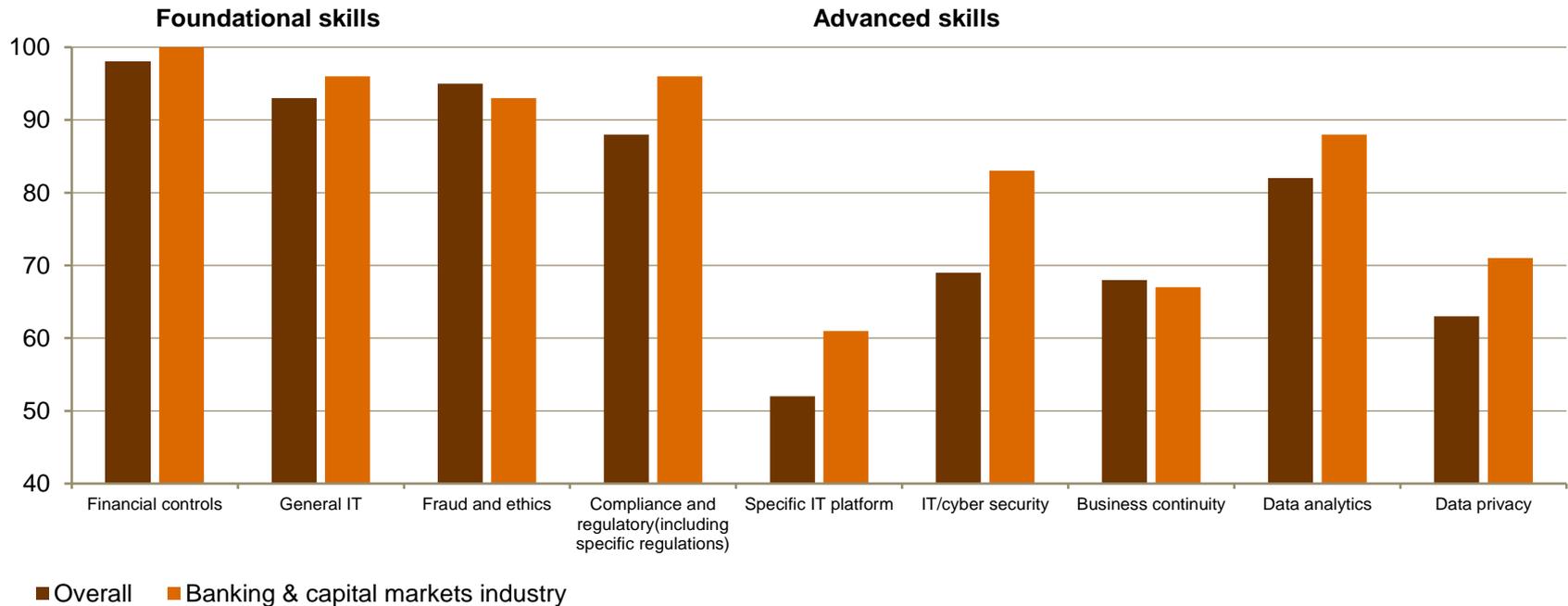
Expanded expectations and alignment of stakeholder expectations create an opportunity for internal audit to raise its performance and provide added value for the organization.

Developing an aligned set of expectations

- Align and agree on the critical risks the organization faces (fundamental)
- Establish detailed expectations aligned to the eight foundational attributes
- In developing these detailed expectations, consider:
 - Future needs and emerging issues and risks
 - Regulatory expectations
 - The first and second lines of defense
- CAE should drive the discussion
- Proactively share your expectations, but do so with open lines of communication across the key stakeholder group

Achieving alignment on the breadth of expectations and critical risks is a significant step toward internal audit's improving its relevance and value to the business.

Building the capabilities to deliver on expectations



Banking and capital markets industry respondents focus more on compliance and regulatory-related, IT/cybersecurity, and analytics capabilities than on other sectors.

Internal audit's communication strategy

| | Overall | Banking & Capital Markets |
|--|---------|---------------------------|
| Specific communication with audit committee chair and board on internal audit mandate | 73% | 77% |
| At least an annual discussion with key stakeholders to ensure internal audit's role is aligned with expectations | 72% | 76% |
| A meeting held between internal audit, management, and board members to agree on expectations | 67% | 72% |
| Top-down communication with internal audit members on expectations | 61% | 67% |
| Specific communication with internal audit members on expectations | 63% | 66% |
| Regular survey of stakeholders on internal audit's performance and adherences to stakeholders' expectations | 40% | 49% |
| A meeting held with external stakeholders such as regulators and external auditors to discuss expectations | 43% | 64% |
| Posting of internal audit expectations on company's internal website | 29% | 35% |

All of the above eight tactics were seen as more important by banking and capital markets when compared with the overall population, particularly with respect to holding meetings with external stakeholders.

Communicating performance and value

Advanced metrics being used to measure internal audit performance:

- Involvement and value provided in all key initiatives and emerging risk, including new systems, acquisitions, dispositions, new products, and new regulations
- Ability of internal audit to provide macro/horizontal views on key issues and areas of critical risk to the organization
- Ability of internal audit to be a change agent in the organization; that is, is the overall control environment improving year over year because of internal audit's influence?
- Annual voice-of-the-customer survey
- How well internal audit is able to answer questions from the board and management
- Value of recommendations provided
- Cost savings and revenue enhancement based on internal audit's recommendations and findings

Trusted advisors focus on communicating the value they bring to the organization through the recommendations they make and their involvement in emerging issues rather than on classic value measures such as successful completion of the audit plan.

Successfully making the journey

Each stakeholder plays a role in enhancing the value internal audit can deliver

Chief audit executives

Lead the design and the communication plan

- Develop a point of view on what stakeholders expect of internal audit and how you are fulfilling those expectations
- Use an aligned set of expectations to assess needed skill sets against your current capabilities and to develop an action plan, including milestones and metrics to address any capability gaps
- Create a communication plan to purposefully gain alignment on the suggested inventory of expectations

Management

Support the design

- Involve internal audit in nontraditional areas, and value the new perspectives and feedback the function can bring
- Support efforts to align skill sets with business risks and the aligned expectation set
- Support internal audit's efforts to develop metrics that align with expectations, and expect more than the typical report on controls

Board members

Provide proactive input and approve the design

- Provide input on expectations, with an understanding of leading practices and the value internal audit could deliver if expectations, supported by capabilities, are more strategic in nature and better aligned with the most critical risks of the organization
- Provide input on the performance that internal audit is expected to achieve through its short- and long-term strategic plans, including the need to invest in skill sets and processes that will deliver on expectations
- Provide input on when and how the CAE should communicate with the board and how and when the board prefers internal audit to report progress against expectations

