

Higher performance by design: A blueprint for change

2014 State of the Internal
Audit Profession Study
Retail and consumer industry

Contents

- Overview
- Heart of the matter
- At a glance: Retail and consumer industry sector responses
- The journey to capture unrealized value
- Case for change – Retail and consumer industry
- 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)
- Conducted over 125 stakeholder and CAE interviews across North America, Europe, Australia, and Asia to gain further insights
- 169 respondents categorized as retail and consumer industry
- 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, 56% of retail and consumer stakeholders say internal audit is performing well at delivering on expectations
- 40% of retail and consumer 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.

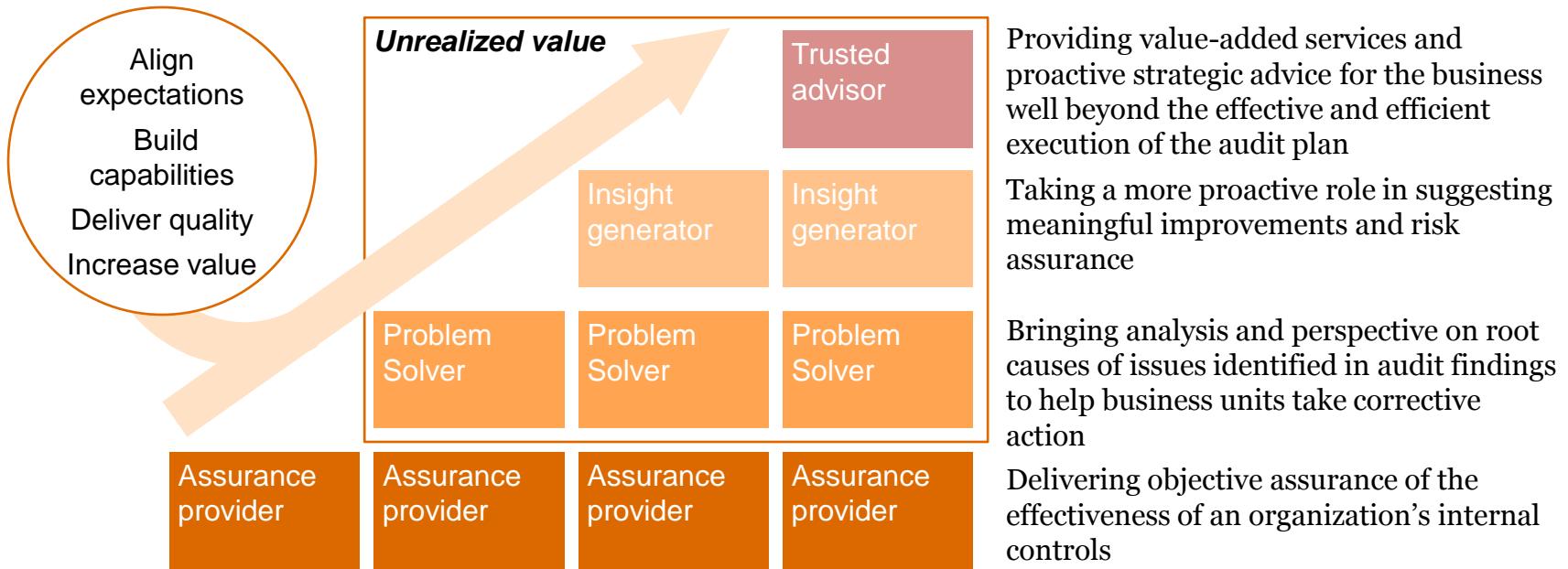
At a glance: Retail and consumer industry sector responses

169 respondents
from retail and
consumer industry

44% of respondents
from the retail and
consumer industry
were CAEs

77% of retail and
consumer industry
respondents
reported >\$1 billion
in revenue

The journey to capture unrealized value



Case for change

Value

Stakeholders have significantly different views of internal audit's value

Performance

Many functions are still challenged with respect to stakeholders' perceptions of performance in the retail and consumer industry

Critical risks

Retail and consumer organizations are losing ground in terms of how well they are believed to be managing risks

2013

52% of retail and consumer stakeholders see significant value

2014

60% of retail and consumer stakeholders see significant value

65% of retail and consumer stakeholders rank internal audit performance as strong

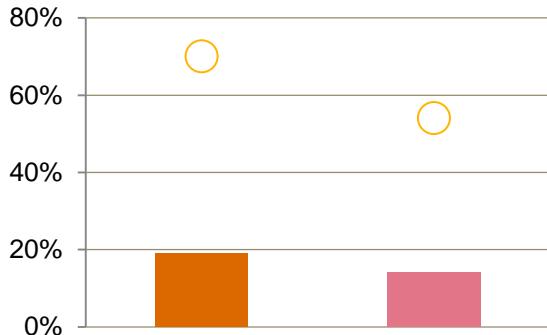
56% of retail and consumer stakeholders rank internal audit performance as strong*

68% of retail and consumer stakeholders say risks are well managed

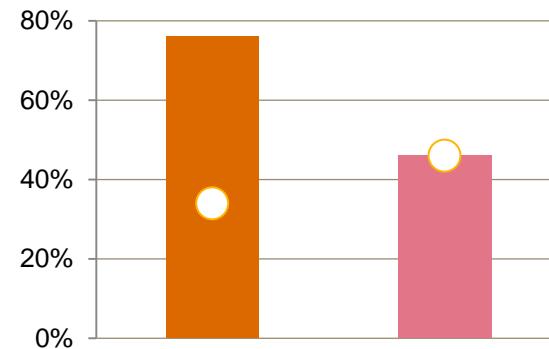
63% of retail and consumer stakeholders say risks are well managed

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

The case for change: Retail and consumer industry



Engaging and managing a relationship with stakeholders



Using technology effectively in the execution of audit services

CAEs' expectation

Stakeholders' expectation

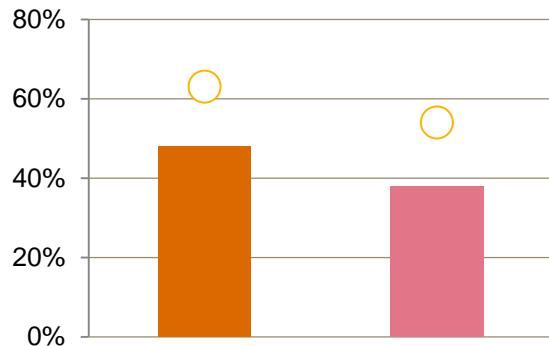
Performance

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

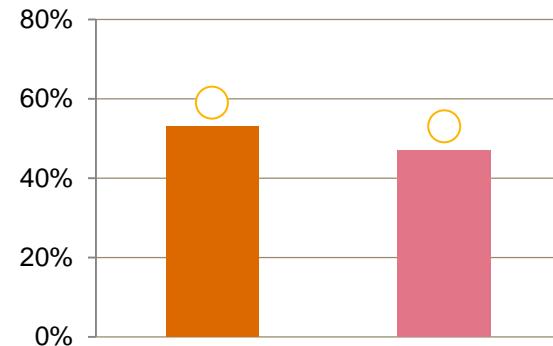
Performance: % who say internal audit performs this well; base = only those respondents who expect internal audit to do this

There is a significant misalignment in the expectations and the performance of internal audit's use of technology in the execution of audit services.

The case for change: Retail and consumer industry



Identifying thematic issues the organization is facing



Promoting quality improvement and innovation

CAEs' expectation

Stakeholders' expectation

Performance

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

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

Within retail and consumer respondents, neither stakeholders nor CAEs place significant value on internal audit's identification of thematic issues, quality improvement, or promotion of innovation. This could be indicative of a more traditional view of internal audit's role in the industry.

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

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.

Internal audit's communication strategy

	Full population	Retail and consumer industry
Specific communication with audit committee chair and board on internal audit mandate	77%	74%
At least an annual discussion with key stakeholders to ensure internal audit's role is aligned with expectations	73%	70%
A meeting held between internal audit, management ,and board members to agree on expectations	73%	65%
Top-down communication with internal audit members on expectations	71%	56%
Specific communication with internal audit members on expectations	70%	67%
Regular survey of stakeholders on internal audit's performance and adherences to stakeholder expectations	49%	30%
A meeting held with external stakeholders such as regulators and external auditors to discuss expectations	45%	35%
Posting of internal audit expectations on company's internal website	31%	16%

CAEs of internal audit functions at retail and consumer companies are lagging behind the general base of respondents with regard to all tactics used in communicating across the organization in terms of expectations and delivering value.

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

