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Higher performance by design – A blueprint for change

2014 State of the Internal Audit Profession Study

May 2014

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Agenda

- Setting the stage:
  - The 2014 research
  - Reintroduction of 8 foundational concepts
- Overall findings of PwC's 2014 State of the Internal Audit Profession study
- The Namibian perspective
- Questions and answers

At a glance

- *PwC's 10th* Annual State of the Internal Audit Profession Study
- Over 1900 respondents, including 1400 CAEs including IA managers, and more than 520 stakeholders (Board and Audit Committee Members, CFOs, CROs, CCOs, etc.)
- Conducted over 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 stakeholder perceptions related to the value of Internal Audit
  - Understanding internal audit performance related to key attributes

The heart of the matter

Higher performance by design: A blueprint for change

18

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 49% of senior management and 64% of board members believe internal audi… performing well at deli… expectations
- More tha… manageme… audit adds …

Assurance provider, or

Trusted Business Advisor

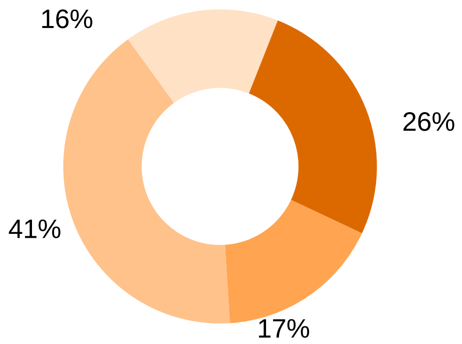
Leads to the following que… ….

- Is your function … …pectations of its key stakehol… …hat capabilities to d… …at is expected of
- …spect to the critical risks?
- …pecting enough from your function? Our …arch shows that when more is expected, internal audit has the opportunity to add more value to the organization
- Higher expectations require increased capabilities and investment

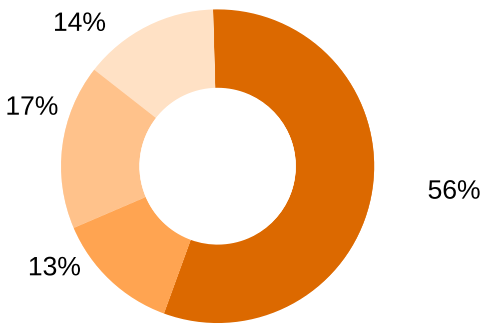
Internal audit m… aligned with the expectations of its stakeholders in order to strategically build the right capabilities and raise its performance and value.

Expanding the expectation set

Stakeholder perceptions of internal audit departments with Assurance Provider expectations



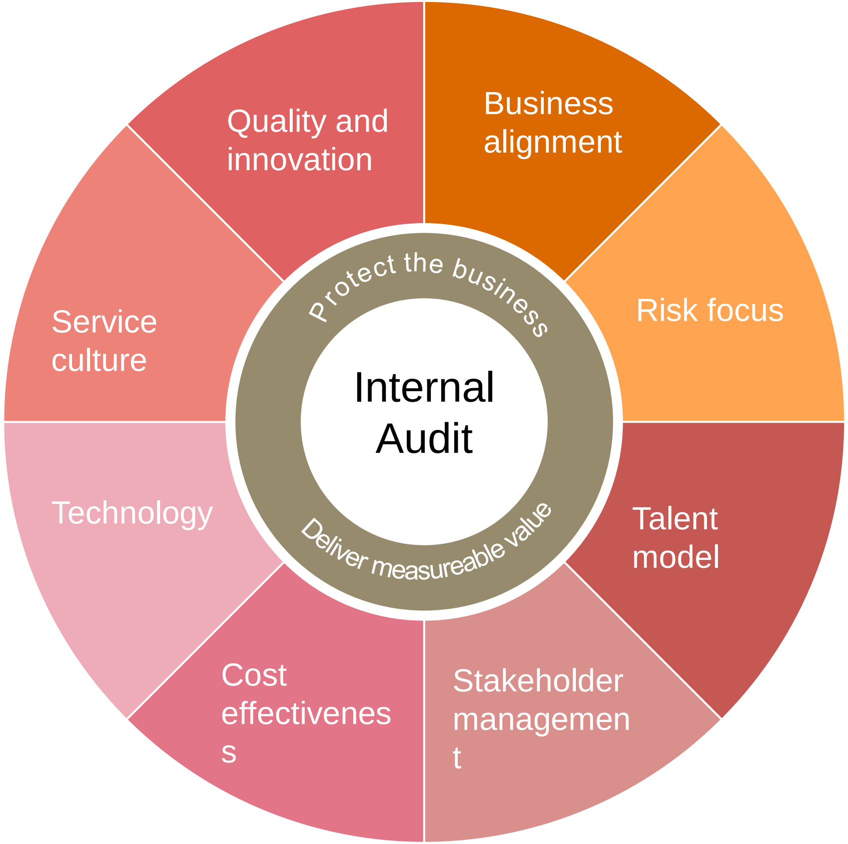
Stakeholders perceptions of internal audit departments with Trusted Advisor expectations



- Internal Audit adds significant value and performs well
- Internal Audit adds some value and performs well
- Internal Audit adds value but performs poorly
- Internal Audit adds little value or don’t know

Internal audit has the opportunity to drive greater value to the organization by expanding capabilities and skill sets, regardless of expectations/role.

Eight foundational attributes of internal audit



The results of our research

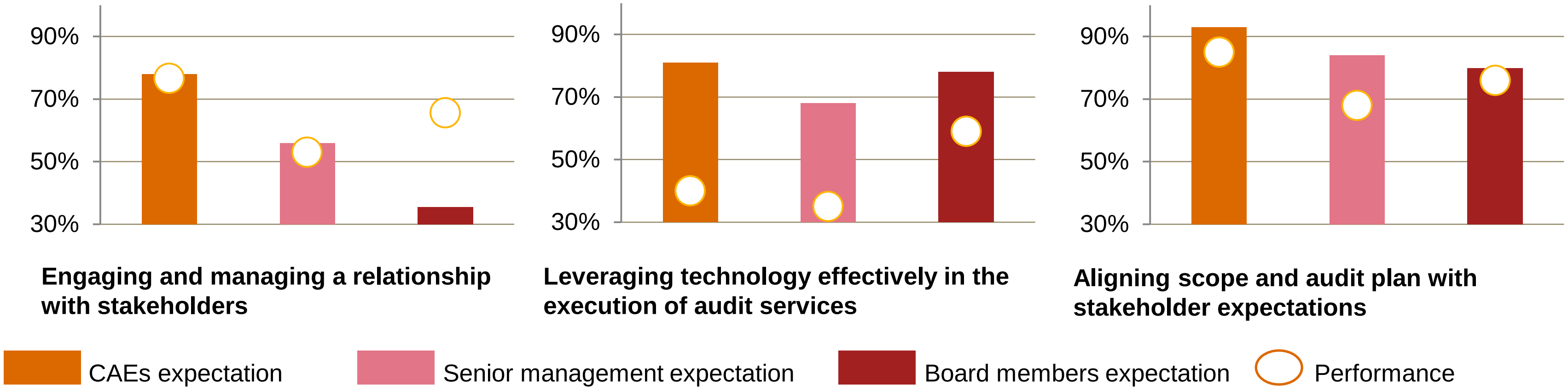
- The case for change
- Expanding the expectation set
- Developing an aligned set of expectations
- Developing the capabilities to deliver on expectations
- Internal Audit’s communication strategy

Case for change

	Value Stakeholders have significantly different views of internal audit value	**Performance** Performance has shown improvement since the prior year but many functions are still challenged	**Critical Risks** Companies are doing a better job at managing critical risks
2013	***79%** of board members see significant value, while only **44%** of management do*	***56%** of the board ranks IA performance as strong, while **37%** of management do*	***60%** of the board members believe risks are well managed vs. **52%** of management*
2014	***68%** of board members see significant value, while only **45%** of management do*	***64%** of the board ranks IA performance as strong, while **49%** of management do **	***80%** of the board members believe risks are well managed vs. **66%** of management*
	QAR - strategic	QAR – IIA standards	ERM

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

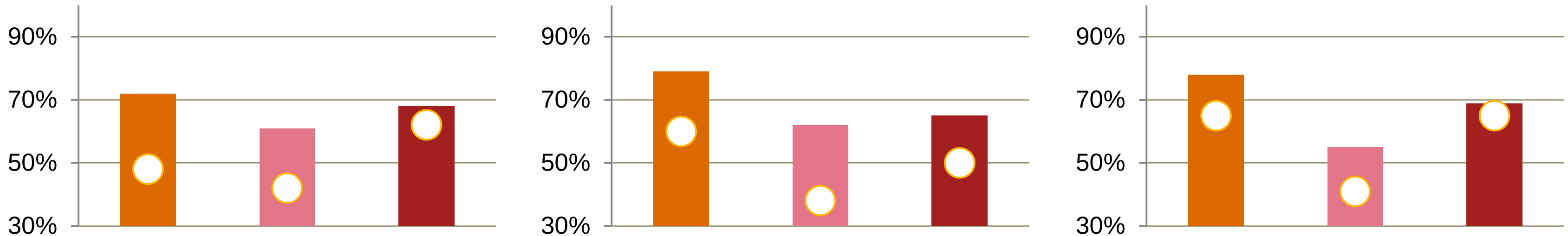
The case for change



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

Stakeholders are not aligned in their expectation of internal audit over key attributes.

The case for change



Involvement in company initiatives before, during and after deployment

Identifying thematic issues the organization is facing

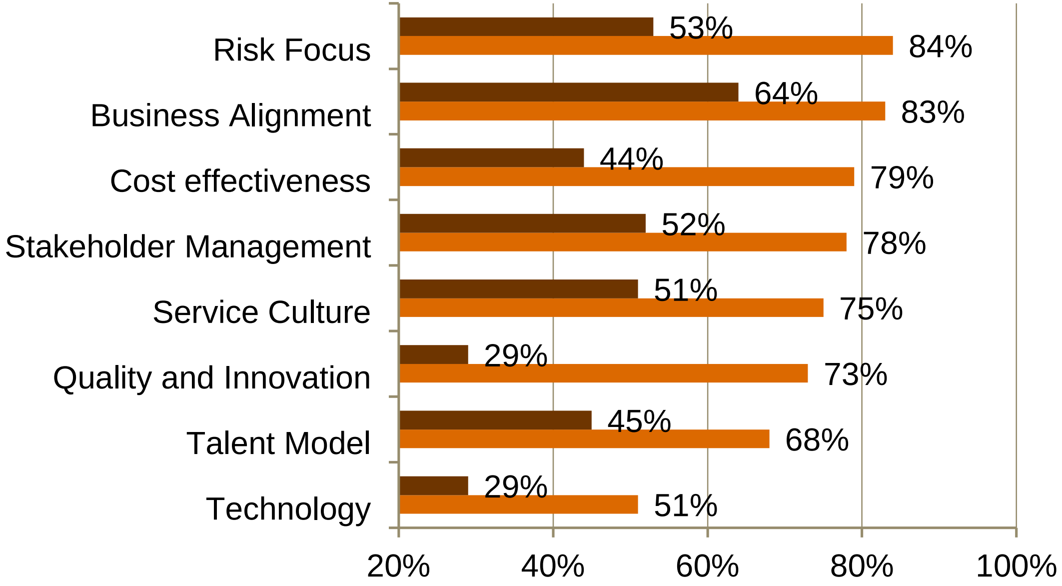
Promoting quality improvement and innovation

CAEs expectation   Senior management expectation   Board members 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

Stakeholders are not aligned in their expectation of internal audit over key attributes

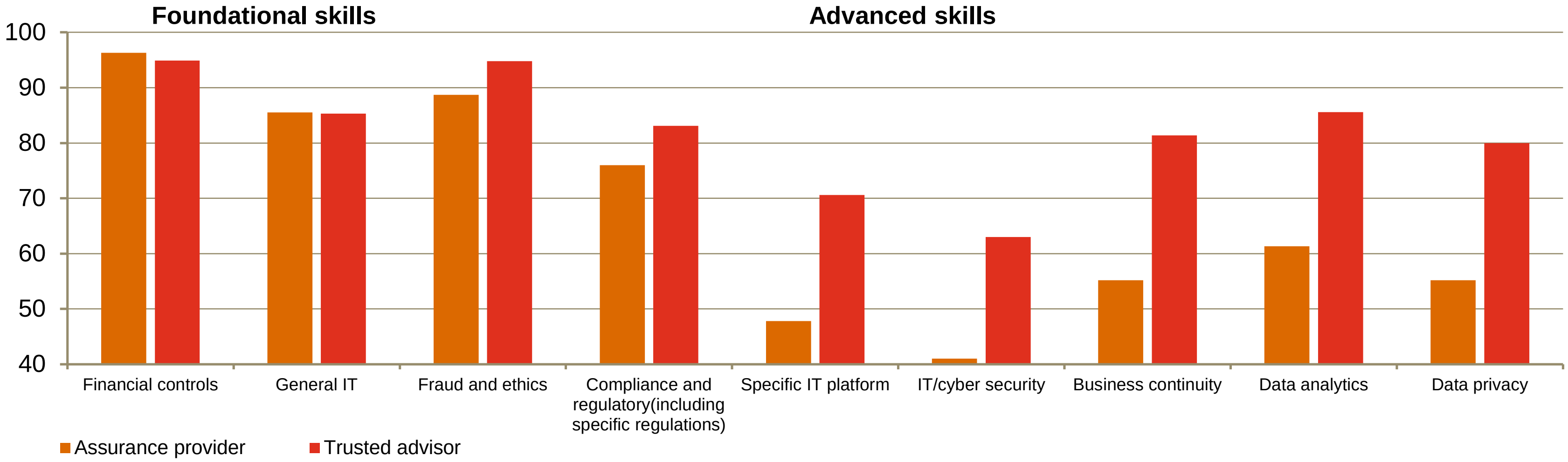
Trusted advisors have higher performance on 8 foundational attributes



and Alignment of stakeholder expectations creates an opportunity for Internal Audit to raise its performance and provide added value to

Achieve alignment on the breath of expectations and critical risks is a significant step towards internal audit improving its relevance and value to the business.

Building the capabilities to deliver on expectations



Trusted advisors are performing at a significantly higher level because of the purposeful plan to obtain skill sets most valued by the organization.

Internal audit's communication strategy

Specific communication with audit committee chair and board on internal audit mandate	77%
At least an annual discussion with key stakeholders to ensure internal audit's role is aligned with expectations	73%
Hold a meeting between internal audit, management and board members to agree on expectations	73%
Top-down communication with internal audit team members on expectations	71%
Specific communication with internal audit members on expectations	70%
Regular survey of stakeholders on internal audit's performance and adherences to stakeholder expectations	49%
Hold a meeting with external stakeholders such as regulators and external auditors to discuss expectations	45%
Post internal audit expectations on company's internal website	31%

CAE's of internal audit functions that are seen as trusted advisors are leveraging the tactics above to communicate across the organization to stay the course of alignment on 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, new regulations, etc.
- 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 recommendations and findings

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

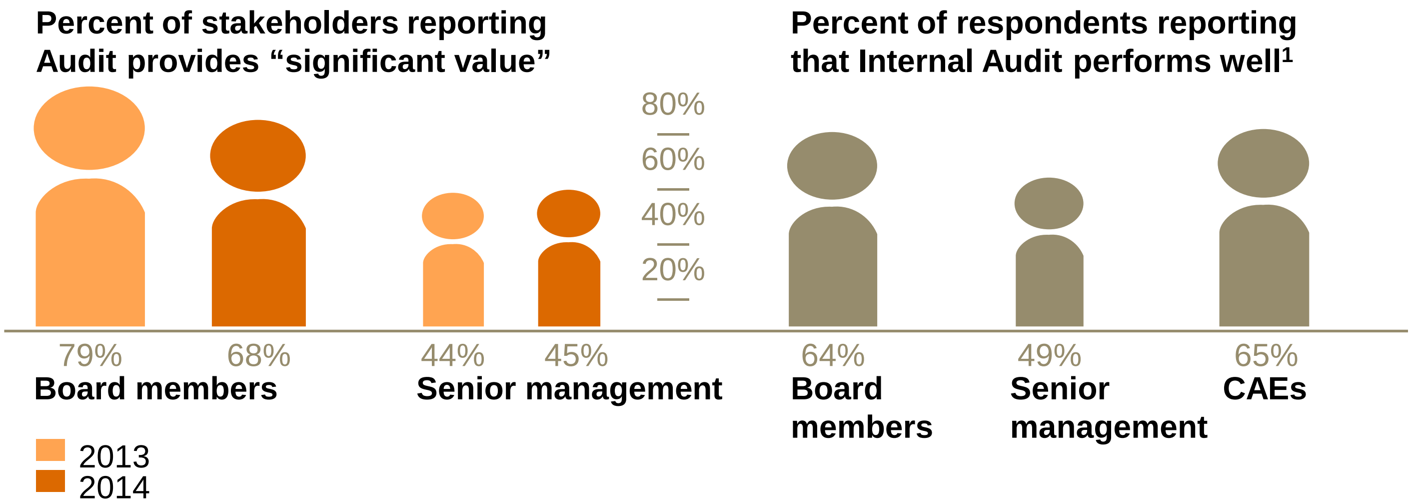
Taking action

CAE
Lead The Design
Pro-Active Communication

Board Members
Pro-Active Input On The Design
Facilitate alignment when needed
Approve Design

Senior Management
Active Participation in Design
Support The Agreed Upon Design

Board and management perception of value



[1]Represents the average of the “performs well” ratings across 18 capabilities

Namibian context

- IIA membership

	Namibia	SA
• Population	2,2m	49m
• CIA	27	5000??
• Members	200	1800??
• Population per members	11,000	4,900
• Status of PIA/GIA learnerships	??	Established

Namibian feedback

- The regulator/s
- Great expectations?
  - Controls, Risk, Governance
  - Fraud
- Is excel enough?
- Independence
- Pro-active
- Namcode
- Think-tank vs do-tank

Namibian contributions

- Relationships & word of mouth
- Identifying red flags – early warning
- Love vs respect
- Understanding the business
- Common understanding
- Transparency
- Streamlined reporting

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Risk in Review

Re-evaluating how your company addresses risk

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Agenda

- New risks, new opportunities
- Sweeping market and business change translates to increasing risk
- Risk imperatives for 2014
- Questions

At a glance

- Eurozone emerged from recession
- GDP in US slowed to 1.9% growth (from 2.8% in 2012)
- Growth amongst the BRICs cooled
- Collapse of the Rana Plaza garment factory in Bangladesh made conditions for workers in developing countries a major public issue

PwC conducted its fourth annual risk survey in the fall of 2013, polling **1,940** *executives across* **37** *countries to seek a detailed picture of the state of risk in today's business climate. This study presents key findings and insights from that survey, as well as from a series of related, in-depth executive interviews.*

The shift

Over the next 18 months, executives in our survey expect ongoing market changes will effect their firms in 3 key areas:

- Technological change and related IT risks
- Increasing regulatory complexity and
- Rapidly changing customer needs

75% of executives report that risks to their businesses are increasing and these shifts are opening capability gaps in risk management, particularly around data management, business strategy, and technology.

Expected progress toward greater risk maturity in four areas:

- Aligning business and risk strategy
- Adopting and applying risk appetite statements
- Managing stakeholder expectations
- Improving risk monitoring and reporting

Levels of risk management maturity

- Analysis identified 3 levels of risk management maturity:
  - Early stage organisations – these companies must put the basic elements of risk management in place, de-siloing risk process by extending them across the organisation.
  - Developing organisation – these organisations must link business and risk strategy, consolidate risk reporting, and build an organisation-wide risk culture.
  - Risk leaders – companies with the most mature risk management systems must put in place regular review, evaluation, and updating of their processes, incentives and risk culture.

In depth discussion

External change drivers:

Figure 1: Technology and regulation are the biggest external change drivers

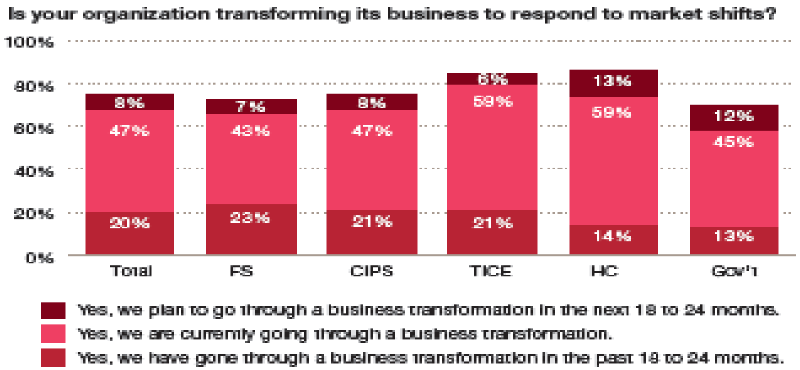
In your view, which of the following external drivers of change will have the biggest impact over the next 18 months on your organization?	Total	FS	CIPS	TICE	HC	Gov't
Technological change and IT risks	58%	64%	49%	71%	59%	67%
Increasing regulatory complexity and scrutiny	56%	79%	48%	42%	71%	29%
Changing customer needs/behavior	50%	43%	51%	70%	57%	35%
Government policy changes (fiscal and monetary policy, etc.)	42%	43%	37%	29%	60%	64%
Global economic shifts and uncertainty	42%	41%	49%	41%	15%	33%

Note: FS = financial services; CIPS = consumer and industrial products and services; TICE = technology, information, communications, and entertainment; HC = healthcare; and Gov't = government agencies

In depth discussion

In response to these powerful shifts in the market, organisations in all sectors are undertaking dramatic business transformations, altering their strategies and driving radical change.

Figure 2: Business transformation sweeps all sectors



Note: Excludes "No" and "Don't know" responses

FS = financial services; CIPS = consumer and industrial products and services; TICE = technology, information, communications, and entertainment; HC = healthcare; and Gov't = government agencies

In depth discussion

- Internal drivers

Figure 3: Business transformation is the dominant internal change driver

In your view, which of the following internal drivers of change will have the biggest impact over the next 18 months on your organization?	Total	FS	CIPS	TICE	HC	Gov't
Business transformation / change management initiatives	71%	70%	49%	67%	77%	79%
Growing reliance on technology and IT systems	59%	63%	54%	55%	59%	66%
Innovation around products, services, and business models	52%	57%	51%	66%	53%	44%
Changes in talent, staffing, and resources	38%	37%	37%	30%	36%	53%
Mergers, acquisitions, and divestitures	32%	28%	39%	41%	43%	6%

Note: Includes top five responses

FS – financial services; CIPS – consumer and industrial products and services; TICE – technology, information, communications, and entertainment; HC – healthcare; and Gov't – government agencies

External shifts + Internal change = capability gaps and heightened risk exposure

Our survey identified the top 3 gaps relate to the effects of fast-moving internal change:

- Fragmented risk data and analysis
- Gaps arising directly from business transformation initiatives and
- Cyber security gaps.

Creating a risk aware culture to address capability gaps and non-traditional risks

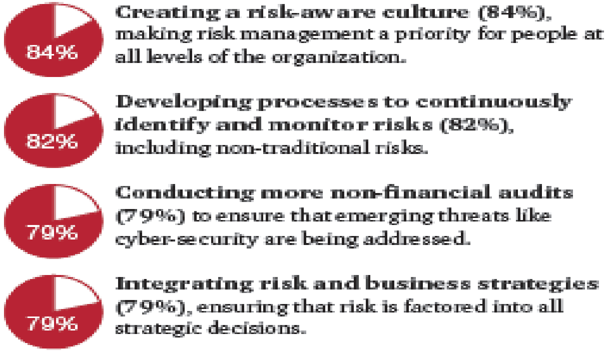
Improving competencies is an important step in closing capability gaps, organisations are making broader changes across 3 areas:

- People and culture
- Strategy and vision
- Process, systems and technology

The objective is to embed risk awareness across the organisation, improve processes to monitor risk and increase companies' attention on non-traditional risks.

Top-ranking changes

Survey respondents have made or plan to make the following changes over the next 18 months:



Collaboration and communication

Miscommunication between the **management/ board level and risk/compliance** exacerbates capability gaps

Our survey revealed a sharp disconnect between management/board level and the risk/compliance functions. They seem to disagree on type and degree of key risks facing the company and the organisations capabilities.

Management devotes more attention to strategic issues such as global economic shifts and uncertainty, while risk and compliance direct their attention to day-to-day risks such as the velocity of change in the business environment.

Despite improvements, collaboration among **the lines of defense** (business units, risk and compliance and internal audit) still requires optimisation to prevent exposure due to capability gaps.

Risk imperatives for 2014 – what this means for your business

Aim of risk management: sustainability (making sure the odds favour the company’s survival) and the ability to capitalise on change. This means continuing to look forward and becoming ever more sensitive to the complex interplay of risk and opportunity.

What should organisations in their different stages do?

Early-stage

Developing

Risk Leader

Important to remember that even for risk leaders,
the journey to higher levels of capability never ends.

“You need to change with the times and evolve to take advantage of what technology can do to support the business and mitigate risk.”

– Pat Roche, VP, Information Technology Solutions, C. R. Bard

Questions

Thank you.