AUDIT AND GOVERNANCE

OECD

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INTRODUCTION
Introduction

• « Every activity and every entity of the bank should fall within the scope of internal audit “ (Basel Committee);

• Henceforth, Governance is included;

• But to which extend?
1- BNP PARIBAS GENERAL PRESENTATION
1.1- A growth strategy with a well balanced business mix

- Revenues: 31,037 billion Euros (+11.1%*)
- Gross operating Income: 12,273 billion Euros (+12.8%)
- Net Income (Group Share): 7,822 billion Euros (+7%)

* 2007/2006
1.2- A major player across the world

Top 15 market capitalisations in the world
(in € bn)

<table>
<thead>
<tr>
<th>Position</th>
<th>ICBC</th>
<th>HSBC</th>
<th>BoA</th>
<th>Bank of China</th>
<th>JPM</th>
<th>SCH</th>
<th>Citi</th>
<th>Wells Fargo</th>
<th>MUFJ</th>
<th>BNPP</th>
<th>INTESA SP</th>
<th>UCI</th>
<th>BBVA</th>
<th>GS</th>
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<tr>
<td>Gain</td>
<td>175</td>
<td>124</td>
<td>112</td>
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<td>59</td>
<td>58</td>
<td>57</td>
<td>57</td>
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<td>Loss</td>
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<td>4</td>
<td>5</td>
<td>6</td>
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<td>7</td>
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<td>9</td>
<td>10</td>
<td>13</td>
<td>11</td>
<td>17</td>
<td>12</td>
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- RBS OUT
- UBS OUT
- Wachovia OUT
- Barclays OUT

Position gain
Position loss
2- THE INTERNAL CONTROL SYSTEM

STRUCTURE
2.1- A three-level Internal Control system: Three lines of defence

System balance:
Control independence and management implication

Group Function
Inspection Générale including internal audits

Periodic control

Group Risk Management Compliance

Hierarchical / Functional

Operational

Permanent control

Operational management implication

Independence
2.2- Main actors in Internal Control

- BOARD
- Executive Management
- Internal Audit
- Compliance
- Risk Management
- Management Hierarchy
- Operational Staff

External Auditors
Regulators
3- INTERNAL AUDIT
3-1 Principles of organisation

- The organisation of Internal Audit is based on three main principles:
  - An independence and universal Function:
    - Independence insured by the reporting line of the Inspecteur Général;
    - Universality: all entities and all areas of BNP Paribas Group are included in the audit scope.
  - A hierarchical Function:
    - The whole worldwide community of auditors is under the responsibility of the Inspecteur Général.
  - A decentralised Function:
    - All the operational resources of Inspection Générale are grouped into regional or businesses platforms.
3.2- Management of the Function

- The Inspecteur Général is assisted by deputy heads, either with transversal responsibilities over all the Function, or with responsibilities for specific operational domains due to the decentralization process.
3.3- Key figures

- On October 31st 2007, Periodic Control was composed of 854 members

- ... distributed between 15 hubs and 6 businesses lines.
4- WHAT DO WE MEAN BY GOVERNANCE?
4.1- Definition : an extensive sense

Governance :

“Policies, processes and structures implemented by organisations to conduct and control their activities, reach their objectives and protect the interests of the different stakeholders while being compliant with rules and ethical standards” (A consultant)
4.2- Main stakeholders

- Internal Audit
- Compliance
- Risk Management
- Hierarchy
- Operational Staff
- Providers
- External Auditors
- Regulators
- Clients
- BOARD
- Executive Management
- Internal Audit
- Compliance
- Risk Management
4.3- Corporate Governance and Operational Governance

A useful distinction:

- **Corporate Governance:**
  - the way the functioning rules are defined between Executive Management and the Board of directors,
  - the way major decisions are made by these two corporate bodies, notably vis-à-vis the shareholders

- **Operational Governance:**
  - Implementation within all the entities of the group of Corporate Governance principles and decisions.
5- INTERACTIONS BETWEEN INTERNAL AUDIT AND GOVERNANCE
5.1 - Duties of Internal Audit as regards Governance
5.1- Duties of Internal audit as regards Corporate Governance

- Corporate Governance of the Parent Company:
  - Internal Audit doesn’t assess the Governance bodies of the parent company as:
    - Internal audit is one of the Governance actors;
    - Internal Audit reports to the Executive Management and to the BNPP Board of Directors.

- Corporate Governance within the subsidiaries:
  - Internal Audit should contribute to the improvement of the Corporate Governance process and as a consequence has to assess if:
    - There is an Audit Committee or an equivalent structure within the subsidiary
    - It has the required skills and competencies
    - The audit has an easy and regular access to the Audit Committee
    - The Executive Management has an appropriate oversight on the Internal Control system
    - The subsidiary Board of directors periodically assess the effectiveness of their own governance practices
    - Corporate values and Codes of conduct are duly defined by the Corporate Governance Bodies
Concerning Operational Governance, Internal Audit should assess:

- **The governance structures of the entities (other than subsidiaries):**
  - Are they efficient?

- **The independence of the Internal Audit Function:**
  - Is the reporting line of Internal Audit sufficient to ensure its independence?
  - Does it have no operational activities?
  - Can Internal Audit carry out its work freely?

- **The respect of ethical values:**
  - Are ethical rules communicated to all employees and applied to all Group entities?
  - Is the whistle blowing process efficient?
5.1- Duties of Internal audit as regards Operational Governance

- Internal Audit assesses also the effective management of the performances of the organization

- Internal Audit contributes to promoting the organization’s ethical culture:
  - Auditors possess a high level of trust and integrity within the organization and skills to be effective advocates of ethical conduct,
  - They have the competence and capacity to entice employees to comply with the legal, ethical and societal responsibilities of the organization.
5.2- Duties of Corporate Governance Bodies as regards Internal Audit

In reference to the Basel Committee Document « Enhancing Corporate Governance for Banking organizations » - February 2006
Principle 4: The oversight role of the senior management

- The Board should ensure that there is appropriate oversight by senior management consistent with board policy.

- One of the key roles of senior management is the establishment, under the guidance of the Board of directors, of an effective system of internal controls.

**BNPP’s answer**

*The Executive Management is responsible for setting up an internal control system as required by the CRBF regulation n° 97-02.*
Principle 1: Skills and responsibilities of the Board members

- The Audit Committee is typically responsible for providing an oversight of the bank’s internal (and external) auditors

BNP Paribas set up an Audit Committee 15 years ago. With all its members independent, the Audit Committee has an oversight of internal control and internal audit of the bank.
Principle 5: Sound Internal Control system

The Board and senior management can enhance the effectiveness of the internal audit function by promoting the independence of the internal auditor, for example by reporting to the Board or the board's Audit Committee.

It is a sound practice to consider direct reporting of the internal audit function to the board of directors through an Audit Committee or other structures comprising a majority of independent members.

BNPP’s answer

The Inspecteur Général is appointed by the Chief Executive Officer and the Board is informed. He reports to the Chief Executive Officer and gives him an account of his mission, as well as to the Board, either directly or through the Audit Committee.
Principle 5 : Sound Internal Control system

The Board and senior management can enhance the effectiveness of the internal audit Function by encouraging internal auditors to judge the effectiveness of key internal controls.

BNPP’s answer

The Inspecteur Général oversees the Group’s entire Periodic Control framework. He is responsible for the quality and efficiency of the work carried out.
Principle 5 : Sound Internal Control system

The Board and senior management can enhance the effectiveness of the internal audit Function by acknowledging the importance of audit and internal control processes. They must use, in a timely and effective manner, the findings of internal audits and requiring timely correction of problems by management.

BNPP’s answer

*If the High Risk recommendations are not implemented within the target date they are brought to the attention of the Chief Executive Officer. The Board is also kept informed.*
CONCLUSION
Conclusion

- There is no single model of good Corporate Governance but there are good governance codes as the ones of OECD.

- There is no single Internal Audit model but there is a guidelines framework: IIA standards.

- Corporate Governance and Internal Audit are two systems both based on Corporate values and that follow the same main objectives: risk control, achieving goals, protection of the shareholder’s interest.
Focusing on ethical corporate values, Governance bodies and Internal Audit play specific roles respectively but follow a common target:

- Corporate Governance bodies set up these founding values
- Management spreads these Corporate Governance principles under Operational Governance codes and procedures
- Internal Audit contributes to spreading these ethical values and also assesses the adherence to these values

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<tr>
<th>Corporate Governance bodies</th>
<th>Management</th>
<th>Audit</th>
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<tbody>
<tr>
<td>Corporate values</td>
<td>Charters Business lines / Functions / Territories</td>
<td>Operational procedures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Daily personal behaviours</td>
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<td></td>
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<td>Regular assessment of the respect of these values</td>
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