INTERNAL AUDIT CHARTER AND OPERATING STANDARDS
1 OVERVIEW

This document sets out the basis for internal audit: (i) the Internal Audit charter, which establishes the framework for Internal Audit; and (ii) how the auditing process operates practically, including:

- the preparation and approval of the annual Internal Audit Plan;
- the preparation and approval of Internal Audit review scope documents;
- issue of Internal Audit reports in draft form and final form, including the basis of grading audit issues and reports;
- reporting and tracking of audit findings; and
- follow up on implementation of management actions to address audit findings.

A separate Charter for Lloyd’s China is attached as Appendix I, in accordance with CIRC regulatory requirements for Lloyd’s China.

2 INTERNAL AUDIT CHARTER

2.1 Mission

Internal Audit’s mission is to provide reliable independent assurance to the Audit Committee and Executive Team on the adequacy, effectiveness and sustainability of the system of internal control. This is achieved through implementation of best practice methodologies and leveraging expert capability. In carrying out its activities Internal Audit aims to contribute to

- building strong and effective risk awareness and control consciousness within Lloyd’s;
- continuously improving risk management and control processes so they operate at optimum effectiveness and cost efficiency and reflect leading practice; and
- sharing best practice with regard to risk management and assurance across Lloyd’s.

2.2 Role & Responsibilities

Internal Audit is the “third line of defence” in the risk governance structure, providing independent and objective assurance over the design and effectiveness of controls in place to manage the key risks impacting Lloyd’s business performance. Internal Audit has a key role in supporting the accomplishment of Lloyd’s objectives.

Internal Audit is accountable for developing and delivering a programme of assurance aimed at validating the effective management of key business risks. Internal Audit is accountable for reporting its findings, conclusions, and recommendations to the audited parties, Executive Team and Audit Committee. Management is responsible for the effective identification of risk and the maintenance of adequate systems of controls. Internal Audit is responsible for ensuring that timely follow-up on management actions occurs. Management is responsible for corrective actions on reported weaknesses.

Management can request Internal Audit to perform audit reviews subject to these requests not affecting Internal Audit’s independence and objectivity. The final decision for any changes to the Internal Audit plan rests with the Audit Committee.

An annual review of the adequacy of this Internal Audit Charter is also performed by the Audit Committee.
2.3 Independence and rights of access

Internal Audit must be independent from management at all times in order to be effective in executing its work freely and objectively, including:

- Internal Auditors have no direct responsibility or authority over any operating activities reviewed and should not relieve others of their responsibilities;
- Internal Audit are specifically prohibited from performing management activities, including:
  - performing operational duties, including operation of policies and procedures;
  - initiating or approving accounting transactions; and
  - undertaking consulting engagements, specifically, those engagements where the primary aim includes process improvement, implementation of systems, or advising on operating practices (e.g. benchmarking);
- The Head of Internal Audit has a direct reporting line to, with direct and unlimited access to, the Chair of the Audit Committee and a secondary reporting line to the Chief Executive Officer. In addition, the Head of Internal Audit also reports to the Lloyd’s Japan Board for work performed;
- The Audit Committee approves Internal Audit’s annual Plan and the overall budget;
- Internal Audit is authorised to review all areas of Lloyd’s and has full, free, and unrestricted access to all activities, records, property, and personnel necessary to complete their work including correspondence with regulators and Franchise Board and Committees meeting minutes;
- Internal Audit is authorised to allocate resources, set frequencies, select areas, determine audit scopes and apply audit tools and techniques, and to obtain the necessary assistance and specialised services within or outside Lloyd’s to accomplish its objectives;
- Internal Audit reports with significant findings will be reported in full to the Audit Committee; and
- Internal Audit has the right to be informed by management, on a timely basis, of any significant control failures identified by management or the external auditors.

2.4 Annual Internal Audit Planning

To ensure adequate audit coverage of the Company’s systems and controls an “audit universe” is prepared by Internal Audit. Our annual Internal Audit Plan is derived from the audit universe, providing consideration of rotation of audit areas and areas of greatest risk. Our planning approach includes interviews with each executive and key senior managers in the Corporation. The Plan is submitted to the Executive Team for their review prior to approval by the Audit Committee.

The audit universe and annual Plan are developed independently by Internal Audit with full reference to:

- the Executive Team’s and senior management views of the key risks facing the business;
- expectations and issues raised by the regulator;
- the Risk Management team to ensure all relevant risks are addressed in a plan that forms part of a value adding assurance framework; and
- Internal Audit’s discussions with the external auditors (PWC).

In addition, IA will agree audit planning, audit scopes and audit reports with the Lloyd’s Japan Board for work conducted.

2.5 Scope of work

The primary scope of Internal Audit’s activities is the examination and evaluation of the adequacy and effectiveness of Lloyd’s systems of risk management, internal control and governance processes for the Corporation of Lloyd’s and its subsidiaries. In addition to this, Internal Audit’s scope will include review of:

- compliance with policies;
- reliability and integrity of information;


- means of safeguarding, verifying and accounting for assets; and
- economic and efficient use of resources.

2.6 Code of Ethics & Professional Standards

Internal Audit will comply with the International Standards for the Practice of Internal Auditing issued by the Institute of Internal Auditors (“IIA”). Internal Audit management and staff are expected to comply with the IIA’s Code of Ethics and demonstrate the Lloyd’s values.

2.7 Quality Review Process

A thorough and well defined quality assurance process exists over deliverables produced by Internal Audit (including workpapers, reports and plans). All audit work is firstly reviewed by the Internal Audit Manager assigned. The work is then reviewed by the audit partner, and where audit reports relate to more complex or sensitive areas, they will be reviewed by a second audit partner, in addition, to the general quality assurance review process within Deloitte. All work is then reviewed by the Head of Internal Audit.

2.8 External Audit

IA liaises with External Audit (PWC) to share information and share ensure adequate coverage of risks. This should include:
- External Audit relying on the work performed by Internal Audit to drive efficiency of approach; and
- consideration by Internal Audit of the control weaknesses identified by external audit, both in individual internal audit planning and annual internal audit planning.

3 INTERNAL AUDIT OPERATING STANDARDS

3.1 Audit scope documents

3.1.1 Contents and timing

Internal Audit drafts each scope document, following a planning meeting with management, outlining
- the review objectives;
- the scope of the review, including specific points of focus for the review; and
- the proposed time of commencement and the estimate of the days required for completion.

The draft scope document is agreed with management and then issued for approval to the Executive responsible for the auditable area.

3.1.2 Approval

A Lloyd’s Project Sponsor, being the Director responsible for the area of operations subject to review, is appointed for each Internal Audit. The scope document is reviewed and approved by the Project Sponsor for completeness to identify areas of known concern and/or areas that require remedial action. The Project Sponsor is not allowed to restrict the scope, but may identify areas of specific focus that may be added to the agreed work programme.

The scope document also requires the approval of the Head of Internal Audit (HIA) to authorise the allocation of the estimated Internal Audit days for the review. Approval is normally required by both the Project Sponsor and the HIA before an audit can commence. In urgent circumstances, verbal approval can be given to commence an audit provided it is formally authorised within a short time period thereafter.
3.2 Internal Audit annual planning process
The annual audit planning process commences in September each year. Internal Audit meets separately with each member of Executive Team and selected senior management to discuss the inherent risk assessment and control environment. The draft audit plan is discussed with the CEO and Director Finance, Risk and Operations, prior to being presented at the Executive Team for discussion and approval. The Internal Audit Plan is then presented at the Audit Committee meeting for discussion and approval.

3.3 Issue of draft and final Internal Audit reports
The following outlines the process for the issue of Internal Audit reports in draft form and final form.

3.3.1 Criteria for ranking of audit reports and audit issues
All audit issues contained in final reports are assigned a priority ranking to determine the relative importance of each issue. The audit issues represent residual risk (the level of risk remaining having taken into account both the inherent risk and the effectiveness of controls to mitigate that inherent risk).

Grading of reports
Reports are assigned an overall grade of Critical, Significant, Moderate or Low. The grading of the reports is based on the underlying issues within each report. The following table provides the report gradings:

<table>
<thead>
<tr>
<th>Grade</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical</td>
<td>Audit reports containing any CRITICAL issues will be defined as Critical. Furthermore, where a report contains a number of SIGNIFICANT issues which, taken together, indicate an overall critical weakness in the control environment for a particular process, the report will be assigned Critical.</td>
</tr>
<tr>
<td>Significant</td>
<td>Audit reports containing any SIGNIFICANT issues will be defined as Significant. Furthermore, where a report contains a number of MODERATE issues which, taken together, indicate an overall significant weakness in the control environment for a particular process, the report will be assigned Significant.</td>
</tr>
<tr>
<td>Moderate</td>
<td>Audit reports containing any MODERATE issues will be defined as Moderate.</td>
</tr>
<tr>
<td>Low</td>
<td>Audit reports containing only LOW issues will be defined as Low.</td>
</tr>
</tbody>
</table>

Grading of issues
Issues identified will be graded Critical, Significant, Moderate or Low depending on the relative importance of the issue. In order to reduce the subjectivity in grading, we have provided a set of guidelines that are used as a basis to assist in the evaluation of the appropriate grade attached to each issue. The table below includes descriptions of example types of impact that an issue could give rise to (e.g. financial loss, reputational damage). These are mapped to appropriate report grades depending on the severity of that impact.

This table is not designed to be a prescriptive set of rules, but rather to be used as guidance. The overall evaluation of the gradings will be assessed with due consideration to the impact and likelihood of residual risk of the audit issues, having assessed the overall effectiveness and efficient of controls.
Table of guidelines for grading issues

<table>
<thead>
<tr>
<th>IMPACT TYPE</th>
<th>LOW</th>
<th>MODERATE</th>
<th>SIGNIFICANT</th>
<th>CRITICAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory</td>
<td>Minor breaches by individual staff members with no consequences; no monetary fine and no disruption to services.</td>
<td>Regulatory breach with monetary fines &lt; £100,000 and potential for extra reporting requirements and/or regulatory examinations</td>
<td>Monetary fine &gt;£100,000 and disruption to scheduled services. Loss of licence in a jurisdiction/ loss of opportunity for licence.</td>
<td>Monetary fine &gt; £250,000 and associated publicity, plus disruption to scheduled services leading to loss of licence in critical jurisdiction.</td>
</tr>
<tr>
<td>Reputation</td>
<td>Adverse coverage in local non-leading financial press. No impact on security ratings, capital providers or regulatory relationships.</td>
<td>Adverse coverage in leading financial press. Capital providers, Rating Agencies or regulators raise issues with management.</td>
<td>Extended negative national media coverage and/or adverse international press coverage. Potential downgrading of security ratings.</td>
<td>Extended international negative media coverage and significant downgrading of security ratings.</td>
</tr>
<tr>
<td>Financial loss:</td>
<td>&lt; £25,000</td>
<td>&gt;£25,000</td>
<td>&gt; £200,000</td>
<td>&gt; £1 million</td>
</tr>
<tr>
<td>o Corporation</td>
<td>&gt;£250,000</td>
<td>&gt;£1 million</td>
<td>&gt;£10 million</td>
<td>&gt; 10% of Central Fund</td>
</tr>
<tr>
<td>o Central Fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change Management</td>
<td>Causes a delay in implementation of a change project of up to 3 month.</td>
<td>Causes a delay in implementation of a change project of between 4 and 6 months that impacts the achievement of strategic goals.</td>
<td>Serious delay of key project by 7 to 12 months resulting in adverse impact to achieving strategic goals.</td>
<td>Serious delay of key project by 12+ months resulting in non-achievement of strategic goals.</td>
</tr>
<tr>
<td>Service Quality</td>
<td>Performance standards missed by 5% due to process problems. Costs 5% over budget.</td>
<td>Performance standards missed by between 5% and 20% due to process problems. Costs 10% over budget.</td>
<td>Performance standards missed by between 20% and 50%. Costs 50% over budget.</td>
<td>Significant loss of customers due to performance standards missed by greater than 50%; costs 50% over budget.</td>
</tr>
<tr>
<td>Likelihood</td>
<td>Probability of less than 10%</td>
<td>Probability of between 10 and 30%</td>
<td>Probability of between 30 and 40%</td>
<td>Probability greater than 40%</td>
</tr>
</tbody>
</table>

3.4 Reporting and tracking of audit findings

3.4.1 Reporting of audit reports

Final Critical and Significant audit reports, as defined above, are reported to the Executive Team. Critical and Significant reports will also be advised to the Chair of the Audit Committee on a timely basis and will be reported in detail to the Audit Committee.

The key issues of Moderate reports will be reported to the Executive Team and an overview will be provided to the Audit Committee. An overview of the findings of Low reports will be reported to the Executive Team and Audit Committee.
3.4.2 Tracking of audit findings
Internal Audit follows up on the status of each outstanding audit issue each quarter. Each director is asked to sign off on the status prior to the issues being collated by Internal Audit. Aged outstanding items are highlighted to the Executive Team and Audit Committee.

3.4.3 Reporting to the Executive Team and the Audit Committee on audit issue status
A quarterly status report on the progress of Internal Audit is provided to the Executive Team. This status report includes issued audit reports, audits in progress, changes to plan and/or budget, and the status of implementation of audit findings. Where critical and/or high risk issues are identified during an audit, these are reported at the next Executive Team meeting. An overall summary, by grade, of agreed audit issues requiring management action are included in the quarterly reporting. The report is then provided to the Audit Committee for their consideration.