Being Risk “Intelligent” - Finding Strategic Opportunities in Risk

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Agenda

- What is “Risk intelligence”?
- What risks are we facing in today’s world?
- What is Internal Audit’s role in risk management?
- How do we leverage continuous risk assessment to be risk intelligent?
- Strategic opportunities to work with other risk control functions
- Leveraging technology as tool to protect our organization
- What is next for us?

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What is "Risk intelligence"?

He who knows best, best knows how little he knows.

—THOMAS JEFFERSON

The ability to gauge the limits of your own knowledge—to be cautious when you don't know much, and to be confident when, by contrast, you know a lot. (Dylan Evans, Risk Intelligence)

More on "Risk intelligence"

- The organizational ability to think holistically about risk and uncertainty, speak a common risk language, and effectively use forward-looking risk concepts and tools in making better decisions, alleviating threats, capitalizing on opportunities, and creating lasting value. (Leo Tilman, American financial executive, author, and Columbia University professor)

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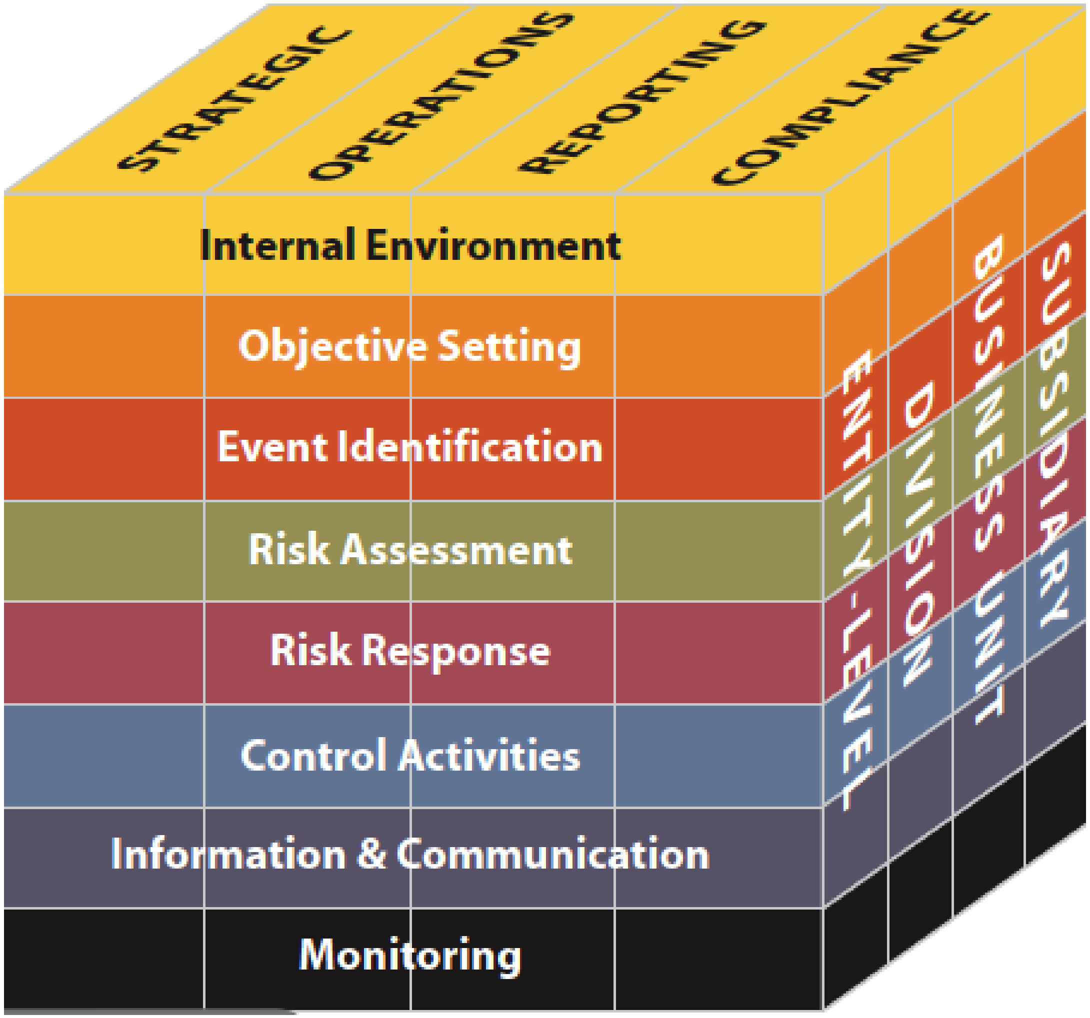
COSO ERM – The basic view of risks and risk management



What risks are we facing in today's world?

Market Risk: the risk of loss due to market fluctuation of financial instruments.

Credit Risk: the risk that a company or individual will be unable to pay the contractual interest or principal on its debt obligations.

Cyber Risk: the risk of loss, disruption or damage caused by failure of its information technology systems.

Strategy Risk: the risk of loss resulting from defective or inappropriate strategy.

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What risks are we facing in today's world?

Operational Risk: the risk of loss caused by inadequate or failed internal processes, people and systems, or from external events.

Legal Risk: the risk of loss caused by a defective transaction or a claim being made which results in a liability.

Regulatory Risk: the risk that a change in laws and regulations will materially impact a security, business, sector or market.

Reputational Risk: the risk of loss resulting from damages to a firm's reputation, in lost revenue; increased operating, capital or regulatory costs; or destruction of shareholder value.

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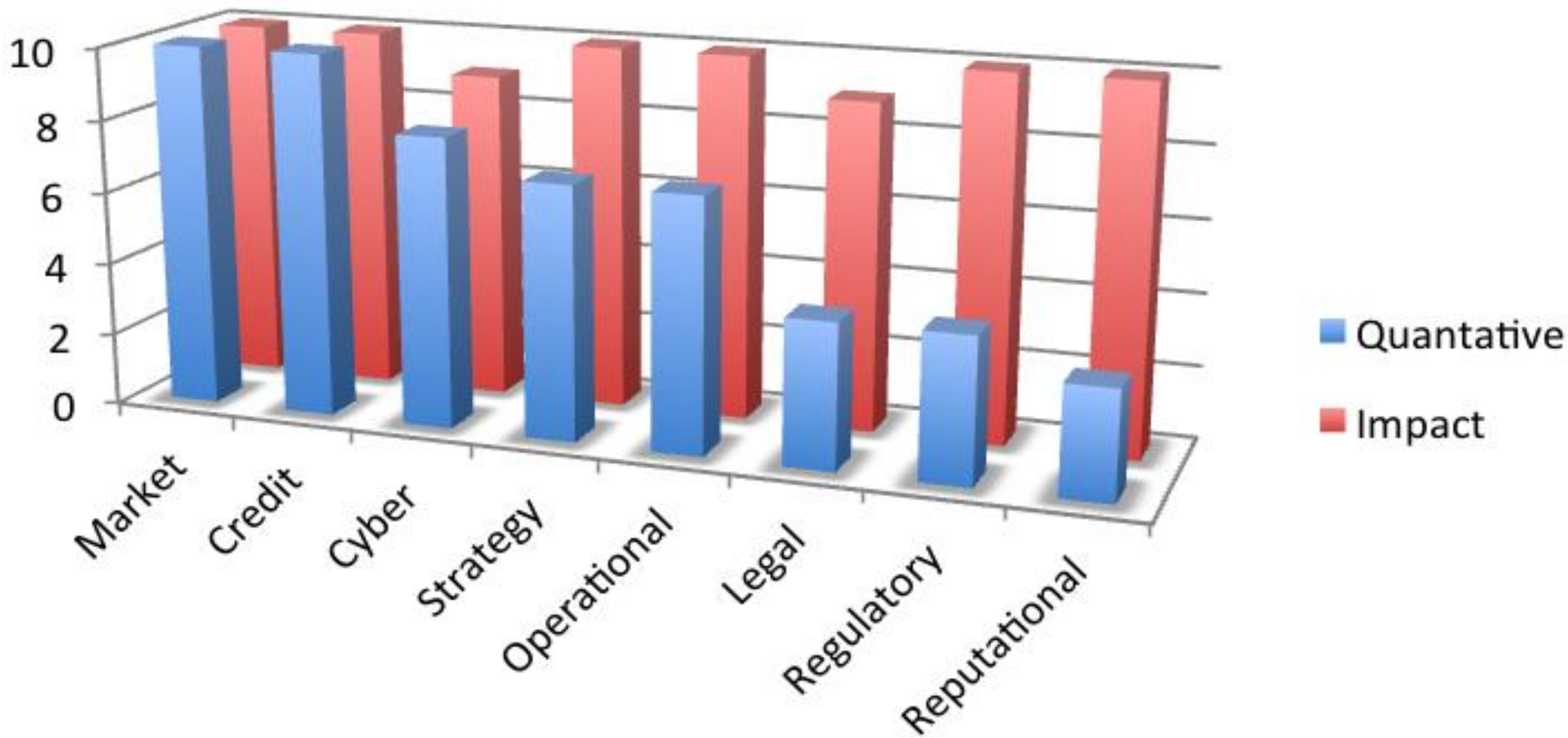
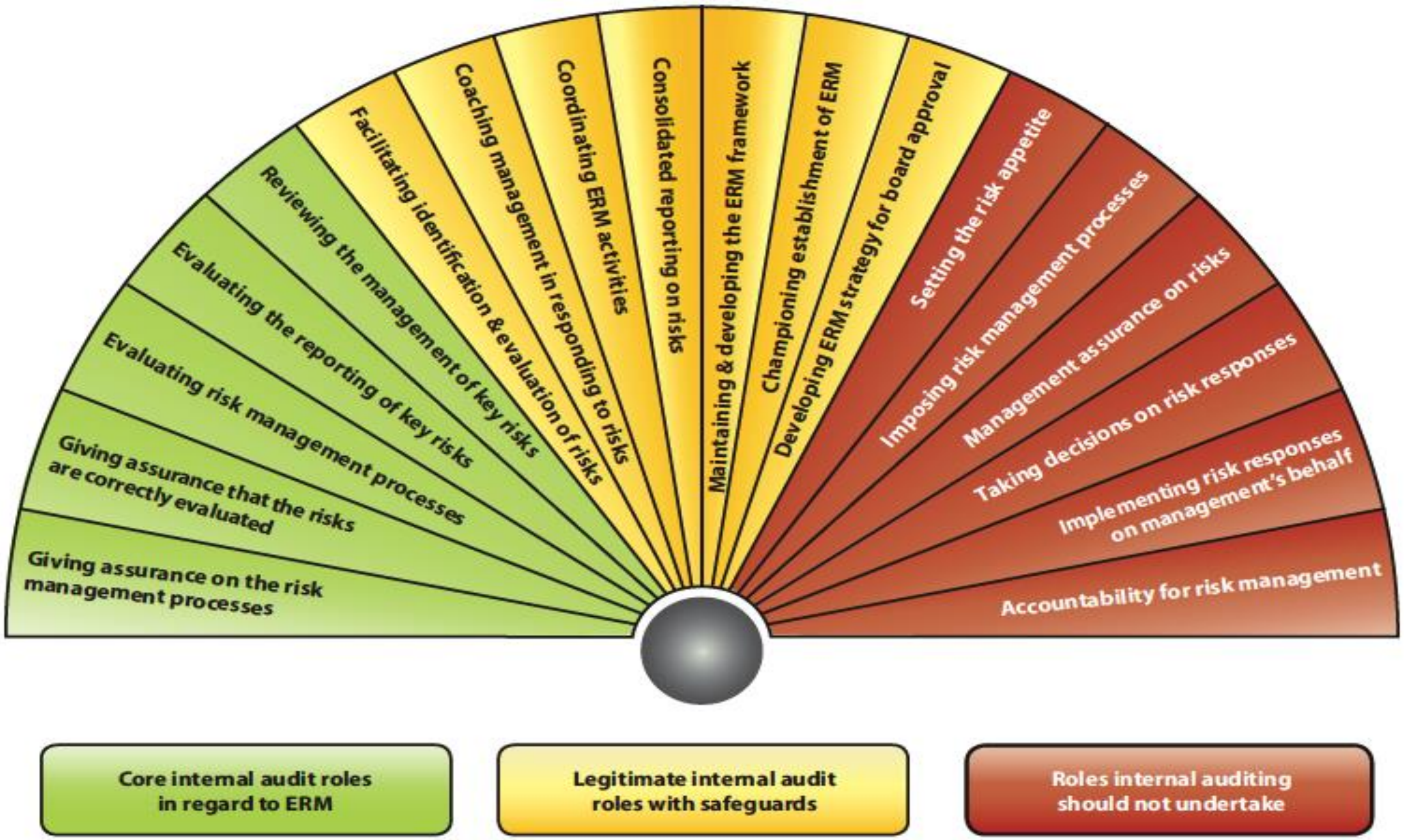
How well do we see risks?

Impact of risk to the measurement



What is internal audit's role in risk management?



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The IIA: The role of Internal Auditing in ERM, 2009

Leveraging continuous risk assessment to be risk intelligent

- Continuous risk assessment (CRA) is a process which provides internal auditors to monitor risks to the organization in real time and adjust audit plan accordingly when traditional risk assessment is done annually or semi-annually.
- CRA includes attending key governance and risk management meetings as well as holding regular dialogues with senior management and the Board.
- CRA should also include reassessing risk to each auditable entities at the end of each audit engagement
- CRA should have sufficient documentation

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Strategic opportunities to work with other risk control functions – 2009 GAIN Flash Survey

ROLE DESCRIPTION	Current Role	Future Role	No Role
1. Informally provides consulting and advice on risk management practices	77%	14%	9%
2. Is the catalyst in forming risk management	48%	14%	38%
3. Has active participation in implementing risk management	45%	20%	35%
4. Participates as part of a formal risk management program	43%	30%	27%
5. Provides independent assurance on risk management	40%	35%	25%
6. Assists and advises a new, separate risk management function	28%	21%	51%

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Paul Sobel: Internal Auditing's Role in Risk Management

Strategic opportunities to work with other risk control functions

- Typical internal audit group do not partner with other risk control functions such as market and credit risk management, compliance, legal, finance, operational and technology risk management due to independence concern.
- As such, separate risk assessment are performed by each function that typically create difference in result. It creates a confusion to senior management and the Board.
- Instead risk control functions should align their views in risk and synchronize their activities to address risk exposures to the organization.

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Risk Appetite Framework (RAF)

- The level of risk that an organization is prepared to accept, before action is deemed necessary to reduce it. It represents a balance between the potential benefits of innovation and the threats that change inevitably brings.
- The Financial Stability Board Principles set out key elements for RAF including: (i) an effective risk appetite framework, (ii) an effective risk appetite statement, (iii) risk limits, and (iv) defining the roles and responsibilities of the board of directors and senior management.

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FSB FINANCIAL STABILITY BOARD

Risk Appetite Framework

- The overall approach, including policies, processes, controls, and systems through which risk appetite is established, communicated, and monitored. It includes a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. The RAF should consider material risks to the financial institution, as well as to the institution’s reputation vis-à-vis policyholders, depositors, investors and customers. The RAF aligns with the institution's strategy.

Risk Appetite Statement

The articulation in written form of the aggregate level and types of risk that a financial institution is willing to accept, or to avoid, in order to achieve its business objectives. It includes qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate. It should also address more difficult to quantify risks such as reputation and conduct risks as well as money laundering and unethical practices.

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Risk Limits

Quantitative measures based on forward looking assumptions that allocate the financial institution's aggregate risk appetite statement (e.g. measure of loss or negative events) to business lines, legal entities as relevant, specific risk categories, concentrations, and as appropriate, other levels.

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Defining Roles and Responsibilities

- The board of directors must establish the institution-wide RAF and approve the risk appetite statement, which is developed in collaboration with the chief executive officer (CEO), chief risk officer (CRO) and chief financial officer (CFO).
- The independent assessment of the financial institution's RAF (i.e. by internal audit, an external auditor and/or other independent third party) is critical to the ongoing monitoring and evaluation of the design and overall effectiveness of a financial institution's internal controls, risk management and risk governance.

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Expectation to Internal Auditor in RAF

- Routinely include assessments of the RAF on an institution-wide basis as well as on an individual business line and legal entity basis;
- Identify whether breaches in risk limits are being appropriately identified, escalated and reported, and report on the implementation of the RAF to the board and senior management as appropriate;
- Independently assess periodically the design and effectiveness of the RAF and its alignment with supervisory expectations;
- Assess the effectiveness of the implementation of the RAF, including linkage to organizational culture, as well as strategic and business planning, compensation, and decision-making processes;

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Expectation to Internal Auditor in RAF

- Assess the design and effectiveness of risk measurement techniques and MIS used to monitor the institution's risk profile in relation to its risk appetite;
- Report any material deficiencies in the RAF and on alignment (or otherwise) of risk appetite and risk profile with risk culture to the board and senior management in a timely manner; and
- Evaluate the need to supplement its own independent assessment with expertise from third parties to provide a comprehensive independent view of the effectiveness of the RAF.

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Working with other risk control functions

- Since Internal auditors are experts in control, we can help other risk control functions by validating controls that are being implemented, identifying root cause of failed business and projects, and providing advice to steering committee of major projects apart from regular audit.
- Internal Audit can also provide assurance on Enterprise Risk Management Framework.
- The Audit Committee, the Board and senior management seek advice from internal audit and other risk control functions for major projects and process changes. Internal Audit can partner with other risk control functions to provide comprehensive advice to them.

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(Risk) Control Self Assessment

- Control self-assessment (CSA) is a technique that allows managers and work teams directly involved in business units, functions or processes to participate in assessing the organization's risk management and control processes.
- In its various formats, CSA can cover objectives, risks, controls and processes.
- Internal auditors can utilize CSA programs for gathering relevant information about risks and controls; for focusing audit work on high risk, unusual areas; and to forge greater collaboration with operating managers and work teams.

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(Risk) Control Self Assessment Process

Documenting & Defining	Identifying	Assessing & Assigning	Reviewing & Approving
1. Document the overall internal control environment	4. Identify RCSA Entity-Level Important Risks	6. Assess (Test) and Rate Key Controls against Important Risks	Review RCSA templates after testing is completed and approve RCSA results
2. Identification of 'Top-Down' Important Risks	5. Identify Key Controls	7. Create Corrective Action Plans (CAPs)	
3. Define RCSA Entity		8. Assign a Risk & Control Rating to each Important Risk on a residual basis	
		9. Assign a Risk & Control Rating to the RCSA Entity and report RCSA information as required	

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Analytics India Magazine

Leveraging technology as tool to protect our organization

- No process exists without IT in today's organization.
- What Internal Audit deals with is data.
- The efficient and effective use of data analytics is a key to provide timely and insightful information about the risks that the organization faces.
- In financial industry, the use of data analytics has been explored in last five to ten years by the business. But most of internal auditors are recently being involved in leveraging the DA tools.

Data Analytics

Data analytics is the process of examining data to uncover hidden patterns, unknown correlations and other useful information that can be used to make better decisions.

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What is next for us?

- Performing forward looking audit by using "Risk intelligence"
- Potential to become a part of preventative control mechanism (not breaching the third line) by introducing profiling opportunities for potential error, misconduct and irregularities using data analytics tools
- Moving from reviewing samples of historical information to the entire population of information to reduce audit risk to zero
- Truly become a risk partner to senior management

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Thank you.

Questions?

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