



AFB INTERNAL AUDIT PLATFORM

HEADS OF INTERNAL AUDIT EXPERT PANEL – OUTPUT PAPER

**AFB Expert Panels meet regularly and produce Output Papers on behalf of the whole membership (see Note).*

HOW IS INTERNAL AUDIT RESPONDING TO THE COVID-19 CRISIS?

Battling a global pandemic, Internal Audit ('IA') has successfully been delivering assurance in uncertain times and in an evolving business environment. Financial Services ('FS') businesses have performed reasonably due to their focus on operational and financial resilience.

There have been clear wins for the business and IA - stronger relationships, faster technology enhancements and fixes and improved work-life balance for many. The pandemic has also created an opportunity for IA to demonstrate its value and raise its profile, however, as we continue to respond and recover, IA functions have faced, and continue to face, a number of changes in the way it needs to operate.

Key themes include:

One size doesn't fit all - the depth and breadth of control testing for most firms has been limited and there has been a need for shorter, sharper targeted reviews looking at new risks that have emerged e.g. remote working. More advisory work has been delivered - these have usually been performed through 'review and recommend' scoped assignments although IA must be conscious of not blurring the lines of defence.

Scope changes and deferring work - while this is to be expected, any changes to the audit plan should be appropriately documented and approved by the audit committee. Decision making must be documented. Being engaged and part of the conversation - to realise the benefits from the opportunity to add more value and elevate IA's profile, it was key that IA was visible and had channels to voice its view and provide advice.

1. How have firms' risk and control profiles changed and what are the implications moving forward?

There is still a strong reliance on manual controls within small and medium firms and when this is moved to a remote setting, it could lead to greater operational risk. The uncertainty of the crisis meant a lot of decisions were made very quickly and there is a need for sufficient documentation to justify key decisions, including risk accepted items and/or to revisit these to ensure they remain appropriate in light of risk appetite.

During the crisis, the following risk areas have demanded greater attention from IA, who should be comfortable that the first line has done a robust assessment and has sufficient mitigants in place:

- Overriding of controls
- Conduct risk
- Credit risk
- Cyber and phishing risk
- Internal fraud
- Effective front-office oversight
- Dilution of trust.

We have also seen other challenges for the business and IA, including: third party providers not being sufficiently resilient. There is some skepticism of how well third party providers have operated and this is therefore an element which should be reviewed in 2021. Management oversight and supervision is more difficult when working remotely. This is especially the case for higher risk trading activities - firm's need to consider what's being done to monitor this. Other areas impacted by remote working include:

- Measuring and maintaining productivity, motivation and well-being
- Managing and developing more junior employees
- Retaining/enhancing the corporate culture.

Looking ahead, there will be greater level of interest/focus on data driven audits as a more effective way of monitoring and providing assurance. However, firms will need sufficient and robust data to enable IA to adopt this approach.

2. Has Internal Audit's role and approach changed during lockdown and what does this mean for the future?

Internal audit's operating effectiveness is being impacted as it looks to be taking longer to get things done outside of an office environment. People interactions are vital to help tell the story and maintain/build relationships and this gets diluted in a remote setting. It should be considered what the longer term impacts can be from the way we are currently working and whether we are at risk of overlooking important elements. Audit Committee engagement has been maintained and that is important given IA's direct reporting line to Committee Chairs.

3. Did audit plans change during lockdown and what do they now look like going forward?

The audit plans should be kept under continuous review and we are likely to see more agile, less cyclical audit plans from now on. There should be an ability to revisit the audit plan to allow for hot issues or thematic areas to be reviewed e.g. climate change. There should also be time set aside for more responsive/event driven reviews.

Operational resilience is still on the agenda and more robust business continuity plans are needed. For some firms, the business continuity plan was not as good as thought, as a pandemic may not have been considered previously or if it had, it didn't cover a fully remote situation. Management should consider what other scenarios could appear that are unlikely but can have a high impact.

ROUND TABLE DISCUSSION AND QUESTIONS

Remote working, for all its benefits to work/life balance, doesn't easily support a conducive mentoring/learning environment for new or junior employees. It's hard to observe and build trust over a screen. It will be helpful if the regulators understand and appreciate the benefits of a more agile, less

cyclical IA approach. While there is a need to audit on a cyclical approach, this should be blended with auditing against more immediate business and risk priorities to ensure that nothing is overlooked and value is added.

1. Has anyone conducted audits on work from home policy and conduct risk?

It may not be necessary to review the working from home policy yet, this will enable you to understand if there is a spike of operational risk. There will need to be a distinction between working from home in a crisis and what working from home may be like in the future. It may be more beneficial to review working from home once it has become business as usual, understanding whether the controls that have been put in place are sufficient.

2. Are S166 mainly prudential reporting or transaction reporting (MiFID, SFTR)?

These are, in the main, concerning prudential reporting, in relation to the ICAAP or ILAAP. To date, there haven't been many in relation to MiFID.

3. Should we be reviewing the implementation of new processes design to attend changes in regulation due to Brexit i.e. local transaction reporting to the FCA?

From the Brexit perspective, most banks should have done their preparation well in advance. In terms of a Brexit audit it may not make sense to do it specifically on Brexit, however, an audit on the changes that have been implemented because of it may be more relevant.

4. Can customers be tagged as vulnerable without the explicit consent of the customer?

It is not as clear within the guidance as perhaps it should be, with tension between the FCA position and that of the Data Protection Act. This is an area that the FCA continues to consult on, work with the ICO and intends to provide further guidance about at the end of this year/beginning of 2021. It appears that tagging is desirable and yes, it can be done by firms without customer consent, but firms need to make sure they are clear of the basis on which they are doing so. Hopefully the updated guidance will make this more explicit.

HOT TOPICS FOR 2021 PLANNING - DRIVERS/QUESTIONS FOR INCLUSION IN INTERNAL AUDIT PLANS

- Is there an FS Code requirement? Effective IA in the FS Sector requires us to evaluate – risk management, compliance function, culture, management information etc.
- Evidence of failures. Processes or activities that are showing signs of failure or have failed. Major remediation such as in response to a S166 review
- Major changes. Structural changes, new activities, major changes in processes
- Business and regulatory pressures – Factors subject to enhanced level of risk that would be worthwhile considering in the plans.

NOTE

Meetings of AFB Expert Panels are held in compliance with AFB's Competition Law Guidance. All issues discussed are included in the relevant Output Paper. AFB holds a central record of all attendees at Expert Panel Meetings. AFB Expert Panel Output Papers are intended as general guidance and no action should be taken in reliance on them without specific legal advice.

QUERIES AND FOLLOW UP

If you wish to speak to one of the AFB team, please feel free to contact

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