A close-up photograph of a person's hand pointing at a document on a desk. Another hand is holding a pen over the document. A laptop is visible in the background, and the scene is lit with warm, golden light.

Risk Based Internal Audit – (Need & Implementation)

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Post COVID World – WEF/ Global Risk Insights 2022

- Vaccine inequality and COVID Variants
- Uneven economic recovery widening the income gap
- Extreme weather and climate action failures
- Consistently volatile environment with multiple surprises
- Progressive tipping points with catastrophic outcomes
- Labour mobility, migration and livelihoods
- Growing digital dependence altering societies
- Looming debt crisis
- Social cohesion erosion
- Wars and resulting geo economic uncertainties

- Rapid transformation to Business Models for survival and adaptation
- Inflationary pressures leading to rising input costs
- Quick changes in consumer (bargain hunting) and investor preferences
- Cost of Capital, Liquidity mismatches and going concern status
- High attrition rates
- Rising stress in businesses
- Rising cases of defaults and frauds
- Shifting of Performance Matrix from Financials to ESG
- Increase in Board, Regulatory oversight and overreach

**Significant Impact on
Internal Control Environment & Audit Planning**

**People, Policy,
Processes, Practices,
Culture & Conduct**

Stakeholders – Key Expectations

CEO

- In one line or few words
- No disclaimers
- No surprises

Audit Committee

- 100% assurance on statutory compliances
- Un-answered questions in IA basket
- Timely reporting

CFO

- Value add/ Cost savings
- Give full assurance but in lesser time and information

Regulators

- Detection of frauds
- Certificates

Auditees

- Reporting of miss-outs
- No adverse ratings





If you don't invest in risk management, it doesn't matter what business you're in, it's a risky business.

— Gary Cohn —

AZ QUOTES



KEY ELEMENTS OF RBIA AS RECOMMENDED BY RBI

WHAT IS RISK BASED INTERNAL AUDIT SYSTEM (RBI)?

As per RBI circular an effective Risk-Based Internal Audit (RBIA) is an **audit methodology** that links an organization's overall risk management framework and provides an **assurance** to the Board of Directors and the Senior Management on the **quality and effectiveness of the organization's internal controls, risk management and governance related systems and processes**

- A contemporary internal audit function plays a crucial role in evaluating an entity's internal control, risk management, governance systems and processes (in the context of both current and potential future risks) – areas in which the Boards and regulatory authorities have a keen interest.
- Further, **internal auditors use risk-based approaches to determine their respective work plans and actions**. The internal audit function should develop an independent and informed view of the risks faced by the bank based on their access to all bank records and data, their enquiries, and their professional competence.
- The head of internal audit is responsible for establishing an annual internal audit plan that can be part of a multi-year plan. The plan should be based on **a robust risk assessment (including input from senior management and the board)** and **should be updated at least annually (or more frequently to enable an ongoing real-time evaluation of where significant risks lie)**.
- The board's approval of the audit plan implies that an appropriate budget will be available to support the internal audit function's activities. The **budget should be sufficiently flexible to adapt to variations in the internal audit plan in response to changes in the entity's risk profile**.

RBIA – Roles & Responsibilities as per RBI Direction

Board & AC

- Oversee RBIA
- Approve RBIA Policy
- RBIA Policy to clearly demarcate Purpose, Authority, Responsibility of IA & RM, etc
- Approve Annual Plan based on direction of Risk, as consistent with entity's goals
- Risk Assessment once a year
- Performance review of RBIA
- AC to formulate QAIP
- Promote use of new audit tools/ new technologies for reducing manual monitoring

Senior Management

- Adhere & implement RBIA policy
- Develop effective internal control function/ systems
- Ensure appropriate action is taken on internal audit findings within given timelines
- Present consolidated position of major risks faced by the organisation atleast annually to ACB/ Board, based on inputs from all forms of audit

IA

- Recommend to improve governance process on business decision making, risk management and control; promote appropriate ethics and values within organization, ensure effective performance management and staff accountability, etc

KEY ELEMENTS OF THE RBIA AS RECOMMENDED BY RBI

1

The internal audit shall undertake an independent risk assessment for the purpose of formulating a risk-based audit plan. This risk assessment would cover risks at various levels/areas (corporate and branch, the portfolio and individual transactions, etc.) as also the associated processes. The risk assessment in the internal audit department should be used for focusing on the material risk areas and prioritizing the audit work.

2

The risk assessment process should, inter-alia, include identification of inherent business risks in various activities undertaken, evaluation of the effectiveness of the control systems for monitoring the inherent risks of the business activities ('Control risk') and drawing-up a risk-matrix for both the factors viz., inherent business risks and control risks.

3

The basis for determining the level (high, medium, low) and trend (increasing, stable, decreasing) of inherent business risks and control risks should be clearly spelt out.

4

The risk assessment may make use of both quantitative and qualitative approaches. While the quantum of credit, market, and operational risks could largely be determined by quantitative assessment, the qualitative approach may be adopted for assessing the quality of overall governance and controls in various business activities.

KEY ELEMENTS OF THE RBIA AS RECOMMENDED BY RBI

5

The risk assessment methodology should include, inter-alia, parameters such as: -

- (a) Previous internal audit reports and compliance;
- (b) Proposed changes in business lines or change in focus;
- (c) Significant change in management / key personnel;
- (d) Results of regulatory examination report;
- (e) Reports of external auditors;
- (f) Industry trends and other environmental factors;
- (g) Time elapsed since last audit;
- (h) Volume of business and complexity of activities;
- (i) Substantial performance variations from the budget; and
- (j) Business strategy of the entity vis-à-vis the risk appetite and adequacy of control.

6

For the risk assessment to be accurate, it will be necessary to have proper MIS and data integrity arrangements. The internal audit function should be kept informed of all developments, such as introducing new products, changes in reporting lines, changes in accounting practices/policies, etc. The risk assessment should invariably be undertaken on a yearly basis. The assessment should also be periodically updated to consider changes in business environment, activities and work processes, etc.

KEY ELEMENTS OF THE RBIA AS RECOMMENDED BY RBI

The SEs may prepare a Risk Audit Matrix based on the magnitude and frequency of risk. The Audit Plan should prioritize audit work to give greater attention to the areas of: -

7

- (a) High magnitude and high frequency
- (b) High magnitude and medium frequency
- (c) High magnitude and low frequency
- (d) Medium magnitude and high frequency
- (e) Medium magnitude and medium frequency
- (f) Low magnitude and high frequency

8

The scope of the audit and resource allocation should be sufficient to achieve the objectives of the audit assignment. The precise scope of RBIA must be determined by each SE for low, medium, high, very high and extremely high-risk areas. The scope of internal audit should also include system and process audits in respect of all critical processes. The findings of such audits should also be placed before the IT Committee of the Board.

9

The internal audit report should be based on appropriate analysis and evaluation. It should bring out adequate, reliable, relevant and useful information to support the observations and conclusions. It should cover the objectives, scope, and results of the audit assignment and make appropriate recommendations and/or action plans.

KEY ELEMENTS OF THE RBIA AS RECOMMENDED BY RBI

10

All the pending high and medium risk paras and persisting irregularities should be reported to the ACB/Board in order to highlight key areas in which risk mitigation has not been undertaken despite risk identification.

11

The internal audit function should have a system to monitor compliance with the observations made by internal audit. Status of compliance should be an integral part of reporting to the ACB/Board.

12

The internal audit function shall not be outsourced. However, where required, experts, including former employees can be hired on a contractual basis subject to the ACB/Board being assured that such expertise does not exist within the audit function of the SE. Any conflict of interest in such matters shall be recognized and effectively addressed. Ownership of audit reports in all cases shall rest with regular functionaries of the internal audit function.



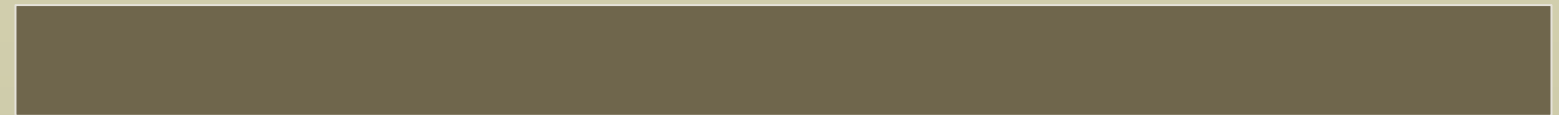
IMPLEMENTATION OF RBIA

REGULATORY EXPECTATIONS ON COMPETENCE & SKILLS OF IA FUNCTION

The desired areas of knowledge and experience include:-

- a) Banking Operations
- b) Accounting
- c) Information technology
- d) Data analytics
- e) Forensic investigation, among others

HIA – Senior, independent, full access, ability to form opinions on other functions, reasonably long tenure as HIA, etc



KEY ACTIONABLE FOR IMPLEMENTING RBI CIRCULAR ON RBIA

STEP I: CREATE GOVERNANCE & FRAMEWORK

- RBI circular on RBIA should be placed before the Board in its next meeting. The implementation of these guidelines as per timeline specified should be done under the oversight of the Board
- **Constitute a committee of senior executives** with the responsibility of formulating a suitable action plan for implementation of RBIA
- The committee should address transitional and change management issues and should report progress periodically to the Board and Senior Management.
- Formulate and adopt board approved **Risk Based Internal Audit (RBIA) policy**. The policy should include: -
 - ✓ Purpose, authority, and responsibility of the internal audit activity,
 - ✓ Clear demarcation of the role and expectations from Risk Management Function and Risk Based Internal Audit Function.
 - ✓ The policy should be consistent with the size and nature of the business undertaken, the complexity of operations and should factor in the key attributes of internal audit function relating to independence, objectivity, professional ethics, accountability, etc.
 - ✓ The policy should also lay down the maximum time period beyond which even the low-risk business activities / locations would not remain excluded for audit.
- Ensure Implementation of the RBIA framework by March 31, 2022, in accordance with the Guidelines on Risk-Based Internal Audit from RBI

TRANSITION STRATEGY & NOTE



POLICY



CHARTER



STRUCTURE

KEY ACTIONABLE FOR IMPLEMENTING RBI CIRCULAR ON RBIA

STEP II: IMPLEMENT FRAMEWORK – OPERATIONALIZING AND REPORTING

- Modify Terms of Reference of Audit Committee to include RBIA
- Appoint Internal Audit Head with sufficient authority, proper stature, independence, and ensure that there are adequate resources in the Internal Audit Team having professional competence. Allocate sufficient budget to the Internal Audit team.
- Internal Audit team should **create audit universe and undertake an independent risk assessment** for the purpose of formulating a risk-based audit plan considering inherent business risks emanating from an activity / location and the effectiveness of the control systems for monitoring such inherent risks.
- ACB/ Board shall approve RBIA plan to determine the priorities of the internal audit function based on the level and direction of risk, as consistent with the entity's goals.
- Carryout Risk Based Internal Audit (RBIA) having focus on the application and effectiveness of risk management procedures, risk assessment methodology a critical evaluation of the adequacy and effectiveness of the internal control systems. This risk assessment should cover risks at various levels/ areas (corporate and branch, the portfolio and individual transactions, etc.) as also the associated processes.
- Review RBIA policy periodically.



KEY ACTIONABLE FOR IMPLEMENTING RBI CIRCULAR ON RBIA

STEP II: IMPLEMENT FRAMEWORK– OPERATIONALIZING AND REPORTING (Cont'd)

- The ACB/ Board should review the performance of RBIA at least once in a year for adherence to the internal audit policy, objectives and expected outcomes.
- ACB/Board shall ***promote the use of new audit tools/ new technologies***
- Internal Audit Team to present major risk faced by the organization at least annually to the ACB / Board: -
 - The internal audit function should assess and make appropriate recommendations to improve the governance processes on business decision making, risk management and control;
 - The internal audit function should provide vital assurance to the Board and its senior management regarding the quality and effectiveness of the entity's internal control, risk management and governance framework
- ***Strengthen MIS and IT***



Risk Identification with respect to: -

Entity

Functions & Products

Processes

Technology

People

Geography



Risk Identification Techniques, in general: -

- Risk climate surveys
- Developing Risk & Control Matrix
- Tracking risk events and documenting impacts/ causes
- Materiality assessment
- Risk focused meetings
- Research sharing amongst peers
- Product specific risk analysis or research
- Data aggregation & warehousing to build trends, outliers, exceptions, etc
- Self-assessments and measurements

INDEPENDENT RISK ASSESSMENT TEMPLATE BY IA – [ILLUSTRATIVE TEMPLATE/ANNUAL]

RBI Prescribes the risk assessment methodology should include, inter-alia, parameters such as: -

- (a) Previous internal audit reports and compliance;
- (b) Proposed changes in business lines or change in focus;
- (c) Significant change in management / key personnel;
- (d) Results of regulatory examination report;
- (e) Reports of external auditors;
- (f) Industry trends and other environmental factors;
- (g) Time elapsed since last audit;
- (h) Volume of business and complexity of activities;
- (i) Substantial performance variations from the budget; and
- (j) Business strategy of the entity vis-à-vis the risk appetite and adequacy of control.

| NAME OF ENTITY | | LOCATION | |
|---------------------------------|--|-----------------------|---------------------------|
| Name of Unit | | Materiality | |
| Risk Assessment Objective | | Level of Risk (H/M/L) | |
| Major Risk Components/ Concerns | <ul style="list-style-type: none"> a) History of exceptions/ audit/ frauds b) Process/ Inherent c) Activities & Locations d) People e) Technology f) Major changes since previous review g) Performance h) Fraud indicators i) External factors j) Compliance amendments k) Third Parties l) Data analytics insights | | |
| Unit Risk Profile | | a) | Unit Risk Trend (>, <, =) |
| Unit Level | a) Positive Factors | a) | Negative Factors |
| Risk Priorities | | | |

Annual Risk Identification on two vectors: -

- Inherent Risk
- Control Risk

Inherent Risk

Inherent Business risks indicate the intrinsic risk in a particular area/activity of the Bank and could be grouped into low, medium and high categories depending on the severity of risk.

Control Risk

Control risks arise out of inadequate control systems, deficiencies/gaps or likely failures in the existing control processes, incidents pointing to gaps in implementation of control processes etc. The control risks could also be classified into low, medium and high categories.

ANNUAL PLAN – (ILLUSTRATIVE)

Risks Not Subject to IA

Skill Gap

Extent of Testing

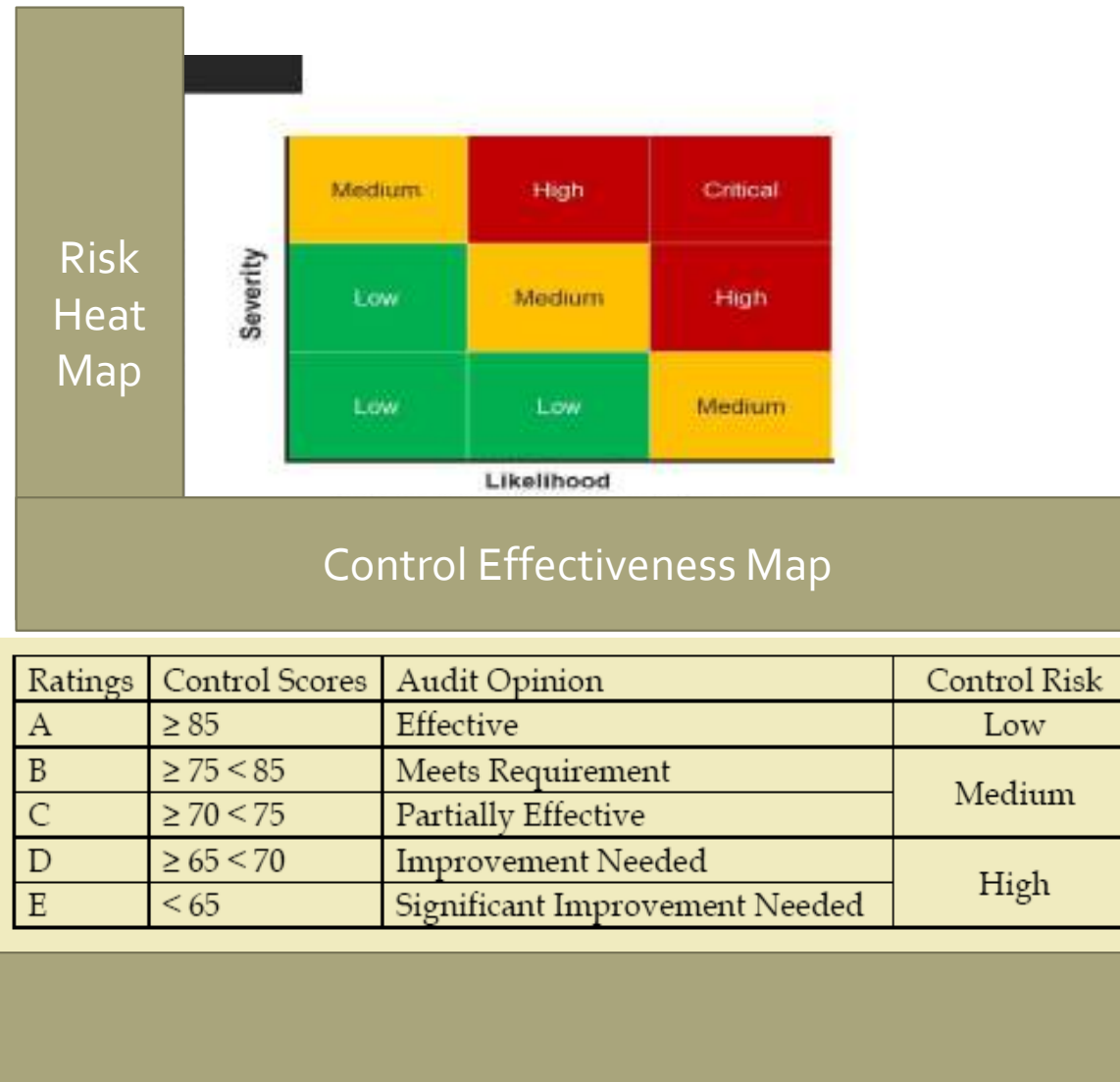
Flexibility & Contingency

| | | Audit Cycles | Risk Level | Frequency | Yr I | Yr II | Yr III | | | | |
|---------------------|-------------|-------------------|------------|-----------|------|--------|--------|---|---|---|--|
| LENDING | COMMERCIAL | Illustrative Unit | Medium | 2 | X | | X | | | | |
| | Consumer | | | | | | X | | | | |
| | Real Estate | | | | | | X | | X | | |
| | Credit Ad | | | | | High | 1 | X | X | X | |
| | Seconda | | | | | Low | 3 | | X | | |
| | TREASURY | | | | | | | | | | |
| | Securities | | | | | Medium | 2 | X | | X | |
| | Cash Man | | | | | Low | 3 | | | X | |
| | Asset/Li | | | | | Medium | 2 | X | | X | |
| | Wire Tran | | | | | High | 1 | X | X | X | |
| ACCOUNTING | Automate | High | 1 | X | X | X | | | | | |
| | Borrowing | Low | 3 | | X | | | | | | |
| | General A | Medium | 2 | | X | X | | | | | |
| | Financial | Medium | 2 | | X | | | | | | |
| DEPOSIT | Medium | 2 | | X | | | | | | | |
| BRANCH | Medium | 2 | X | | X | | | | | | |
| BANK ADMINISTRATION | Human R | Medium | 2 | X | | X | | | | | |
| | Payroll | Low | 3 | | X | | | | | | |
| | Purchas | Low | 3 | | X | | | | | | |
| | Insurance | Medium | 2 | X | | X | | | | | |

High (H); Medium (M); Low (L)

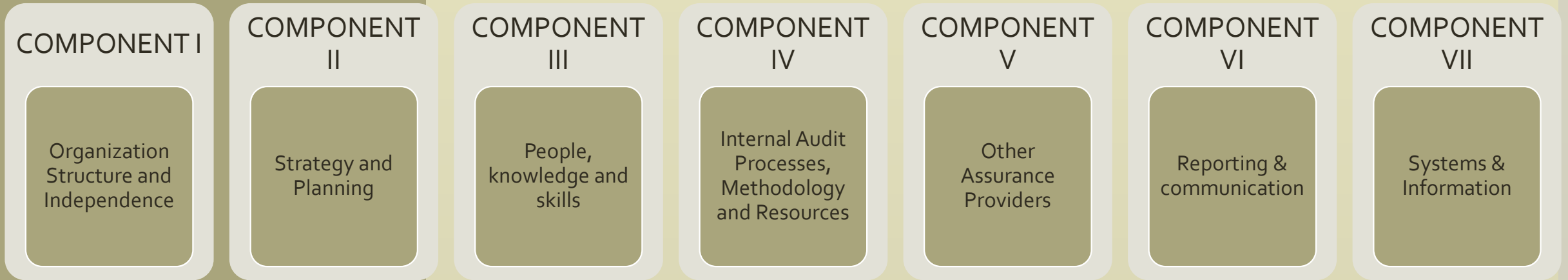
Risk Audit Matrix: -

- Impact of Issue
- Probability of Occurrence
- Control Effectiveness Score





CONTEMPORARY RBIA FUNCTION



1

Risk Profile of each Regulated Entity

- RBIA links SE risk profile to internal audit system
- RBIA introduces a risk scoring system
- Policy for RBIA

2

Function, Authority & Stature

- Authority is defined through a Charter
- Competence
- Rotation of Staff
- Reporting Line
- Remuneration

3

Risk Assessment

- Corporate Level
- Branches
- Portfolio
- Off-site
- On-site
- After on-site
- Planning stage
- Execution stage
- Risk Assessment Methodology
- Risk Matrix
- Sampling to vary depending to risk profile
- Monitoring the Risk trend

RBIA - COMMUNICATIONS

Risk focused Internal audit reports – ratings or subject matter opinions

Fraud risk related – assessments, agreed upon procedures

Risk & Controls Assessment of audit units

IA - Dashboard for continuous improvement activities

Progress reporting on establishment of centers of excellence (automation)

Key insights on emerging matters

Self-assessment outcomes

Third party risk assessments / outsourcing audits/ SSAE 18 attestations

IMPLEMENTATION CHALLENGES

- Prioritizing the Transition
- People alignment and resourcing
- Awareness, knowledge & competencies
- Organizational alignment
- Budgeting & Resources
- Specialized people for risk identification at business/ risk unit level
- Suitable technology stack
- Identifying suitable manpower resourcing partners

RBIA – IS A JOURNEY OF CONTINUOUS IMPROVEMENT !!!

AUTOMATION IN FINANCE FUNCTIONS: LESSONS FROM INDIA AND THE UK

KEY CAPABILITIES NEEDED IN THE ACCOUNTANT OF THE FUTURE

Communication
Collaboration
Curiosity
Enthusiasm
Open-minded



BEHAVIOURAL

Data literacy
Digital literacy
Agile
Analytics and insights



FUNCTIONAL



PROFESSIONAL

Working across teams
Resilience
Prepared to experiment
Ability to learn and re-skill



LEADERSHIP

Adaptability
Relationship building
Value adding
Empowering others



Thank you

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Acknowledgement – This presentation material has used content available from open sources on internet and circulars of RBI. Views expressed are of the presenter and does not necessarily reflects the views of ICAI or IIA or JHS & Associates LLP.