INTERNAL AUDIT SUPPORT

INVESTMENT AND WEALTH MANAGEMENT

March 2023

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BDO FS INTERNAL AUDIT CONTACT POINTS

BDO's Investment and Wealth Management Update summarises the key regulatory developments and emerging business risks relevant for all designated investment firms and wealth managers.

Our FS Advisory Services team are working with more than 60 investment and wealth management firms, including platform providers and administrators, as internal auditors and advisors, giving us a broad perspective on the issues facing the sector. We have aggregated insights from our in-house research, client base, the Regulators and professional bodies, including the Chartered Institute of Internal Auditors (CIIA), to support your audit plans and activities.

We hope this pack provides value to you and your colleagues; please do share with us any feedback you may have for our future editions.

LEIGH TREACY
Partner

+44 (0)7890 562 098
leigh.treacy@bdo.co.uk

RICHARD WEIGHELL
Partner

+44 (0)7773 392 799
richard.weighell@bdo.co.uk

CHRIS BELLAIRS
Partner

+44 (0)7966 626 128
christian.bellairs@bdo.co.uk

BRUK WOLDEGABREIL
Associate Director

+44 (0)7467 626 468
bruk.woldegabreil@bdo.co.uk

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2023 REGULATORY PRIORITIES

2023 REGULATORY PRIORITIES

FCA 'Dear CEO' letter to Asset Managers

REGULATOR	SECTOR RISK	FCA FOCUS
Product Governance	That the quality and value of product offerings, or the quality of communications with customers, do not deliver good outcomes for consumers or meet their needs, e.g., because the product carries excessive costs and charges, is not designed with the target audience in mind, or is distributed to the wrong type of investor.	FCA's expectation is that firms achieve the Consumer Duty requirements when they determine or have a material influence over retail customer outcomes. The regulator will follow-up on its 2021 Assessment of Value review findings and seek to identify outlier firms. It will also conduct another review in 2024 to assess the embeddedness of the Duty, with a focus on Price and Value.
Environmental, Social and Governance (ESG) and Sustainable Investing	Risks exist that some claims about ESG and sustainable investing are misleading or inaccurate. Inaccurate or misleading information may negatively impact the integrity of the UK financial disclosure regime and is likely to harm investment confidence.	The governance structures that oversee ESG and stewardship considerations, including whether firms deliver on the claims made in their communications with investors, and outlier firms that have been identified in previous supervisory activities or other ongoing surveillance. The regulator is keen to see that firms ensure their governance bodies are appropriately structured to oversee and review management information about product development, ESG and sustainability integration in investment processes, third-party and proprietary ESG information providers, and other ESG and sustainability claims made by authorised firms.
Product Liquidity Management	Open ended funds can have a liquidity mismatch between the terms at which investors can redeem and the time needed to liquidate fund assets to meet the redemption request. A variety of market and pricing shocks have caused liquidity issues for Liability Driven Investment portfolios, property funds, and money market funds. Firms have tools available to improve the quality of their liquidity risk management, but we have concerns that they may not always oversee them correctly or use them consistently.	The FCA is working with the Bank of England, and other regulators internationally, to strengthen resilience of money market funds, funds with significant liquidity mismatches, and transmission of risk from the non-bank financial sector to the wider market. The regulator is also in the process of completing a liquidity management multi-firm (thematic) review.

2023 REGULATORY PRIORITIES

FCA 'Dear CEO' letter to Asset Managers

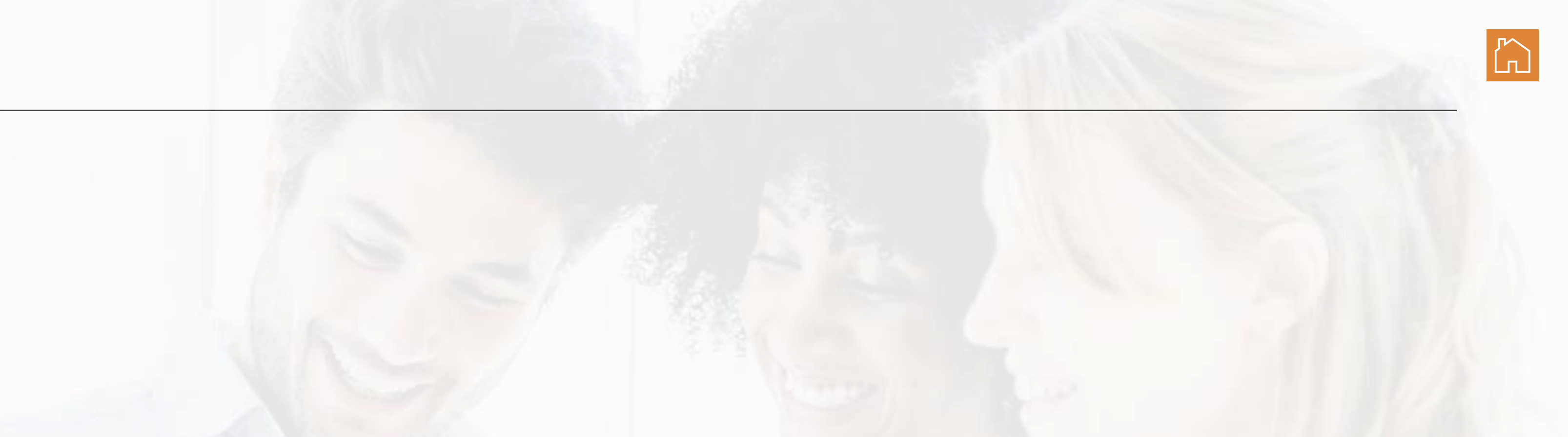
REGULATOR	SECTOR RISK	FCA FOCUS
Investment in Operations and Resilience	Underinvestment in operations can lead to service disruption or failure, with consequential loss to investors and detriment to markets. Increased market volatility or stress may heighten the impact of disruption on consumer outcomes and market integrity. Poor investment in operations can hamper innovation, reduce efficiency and increase cost, and can result in service decline for investors. It may also result in business disruptions, or lead to vulnerabilities that can be exploited to control systems or inappropriately transfer information.	The FCA will complete a range of proactive programmes to monitor and test Asset Managers' ability to meet operational resilience regulatory requirements. Firms may be selected for further regulatory review, including the FCA's use of its cyber and operational resilience assessment tools, as well as intelligence-led penetration testing scheme (CBEST).
Financial Resilience	Disorderly firm failure has the potential to cause significant material detriment to consumers and markets.	The regulator will continue to assess firms' prudential health using internal and external data sources and, where necessary, will conduct targeted monitoring visits. Where firms are failing, or are likely to fail, the FCA will take appropriate actions to minimise the harm from failure. In H1 2023, the FCA aims to publish initial observations on firms' implementation of the IFPR requirements, which should be considered by firms when reviewing and strengthening processes.

02

MEET THE TEAM

RICHARD WEIGHELL
Partner, Financial Services Advisory

MEET THE TEAM



Each month, we shed more light on our FS Internal Audit practitioners so that we can get to know the person behind the practice in 10 questions. This month, we get properly introduced to Richard Weighell.

1. What has been your career leading into BDO?

I started out in industry as a management accountant, but after a year I got the chance to try out internal audit and loved it. I moved into professional practice and did a fair stint in external audit before getting the chance to move back into internal audit with a mix of risk consulting projects and worked my way up to senior manager. Then in 1999, I took what felt like a bold step in taking a role in Pannell Kerr Forster as a director with a remit of setting up an internal audit function. After a few anxious months of wondering if that was a bad decision, the momentum started to build, with a team established and the work started coming in covering lots of sectors. That got me partnership in 2001. The business grew and then the rebranded PKF merged with BDO in 2013 and I went with it. After a couple of years at BDO I specialised fully in financial services. And here I am.

2. Describe your role in the FS Internal Audit team?

There are broadly four strands to what I do. First and foremost, I am the lead on a mix of outsourced and co-sourced internal audit engagements, mainly working with the banking and capital markets/platforms sectors. I don't generally do reviews, but I am active in understanding the businesses, determining what we review, making sure what we do is of the right quality and in context, and communicating the results.

Second, I lead our FS climate and ESG reviews, which are a mix of internal audits, assurance reviews and advisory engagements. Then I am responsible for quality and risk across FS Advisory, so practicing what I preach for our own business. And finally, there is the role of leading the team. Fortunately, we have a lot of talented people. My role is to get the best out of them.

3. What's the most interesting thing you're working on right now?

I love helping clients sort out problems, so probably the two projects that have got my attention most at the moment is one about working out how something went horribly wrong and how to put in right, and the other is helping a firm to work through the embedding of ESG in their business.

4. Best thing about being part of the Internal Audit Team?

I love working with people. The Internal Audit team has people from different backgrounds and skills and we handle a wide variety of clients and projects and hopefully stay with our clients for a number of years and really get to know them. The Internal Audit team is a pretty social group and we enjoy ourselves.

5. What drives you to do what you do?

I like working with people. I love helping sort out issues and coming up with ideas. When the day finally comes that I hang up my pen, I will need to find something to replace that buzz.

6. What's something that has surprised you about your IA career path?

That it opens you up to such a mix of people and businesses, of all kinds, that it really could have gone into any number of specialisms, locations or size of function. If you told me in my 20's as a humble accountant what I would be doing now on a day-to-day basis, I doubt I would have believed you!

7. What's the best piece of professional advice you've ever received?

Follow your instincts but back your views up with evidence.

8. How do you see internal audit changing over the next few years?

More use of data to provide in depth reviews and ongoing monitoring. More focus on what traditionally were seen as softer areas such as culture, conduct and competence. A greater diversity of skills in the teams.

9. What is your favourite thing to do when you're not working?

Too many things to choose from. I am a big rugby and cricket fan and an obsessive runner. I love my food and wine. I cultivate bonsai trees. I love going to new places. My life has a musical soundtrack.

10. If you were stranded on a desert island, what three items would you want to have with you?

My Swiss army knife, something that played music with a battery that never runs down and a close friend.

03

FCA DISCUSSION PAPER ON SUSTAINABILITY CHANGE - WILL VOLUNTARY DISCLOSURES SOON BECOME REGULATORY REQUIREMENTS?

GLORIA PEREZ TORRES
Senior Manager

FCA DISCUSSION PAPER ON SUSTAINABILITY CHANGE

Will voluntary disclosures soon become regulatory requirements?

BACKGROUND

On 10 February 2023, the FCA published Discussion Paper DP23/1: 'Finance for positive sustainable change' which seeks stakeholder views on whether more regulation would be beneficial for firms to embed sustainability matters in areas such as governance, remuneration, incentives, strategy and accreditation for sustainability professionals.

At this stage, the discussion paper does not make any concrete regulatory proposals; however, it does pose 15 questions for stakeholder debate, mainly on whether there is a need to regulate the aforementioned areas.

Below, we consider what DP23/1 could mean for firms in the financial services sector and, more specifically, for internal auditors when reviewing sustainability control frameworks.

EXPECT INCREASED SUSTAINABILITY REGULATION IN THE NEAR FUTURE

In the UK, the regulatory focus on ensuring that the financial sector supports an economy-wide transition to net zero, and a more sustainable future, is widely known and we have indicated in previous monthly editions of this pack that we expect increased regulation and supervision. The potential move beyond disclosure-based initiatives, as expressed by the FCA in DP 23/1, should therefore not come as a surprise to firms.

What is important to note is the aim of the DP, which was clearly stated by the FCA as gathering views on how to 'move effectively from disclosure-based initiatives' to regulation, encouraging firms as they develop sustainability arrangements in areas such as:

- Stewardship, governance, resourcing, and associated incentive mechanisms
- Conflict of interest policies (mainly for FCA-regulated asset managers and asset owners)
- Board skills and awareness of sustainability matters, diversity and inclusion for decision making and delivering effectively on sustainability commitments
- Senior management responsibilities for sustainability-related strategy and the delivery of the firm's climate transition plan
- Governance and oversight of products with sustainability characteristics, or that make sustainability-related claims. For example, to clarify the roles and expectations of governing bodies such as Fund Boards
- Remuneration incentives and alignment to sustainability related strategic priorities.

FCA DISCUSSION PAPER ON SUSTAINABILITY CHANGE

Will voluntary disclosures soon become regulatory requirements?

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

Throughout the discussion paper, the FCA references a variety of existing initiatives such as the Task Force on Climate-related Financial Disclosures (‘TCFD’) Recommendations, the Transition Plan Taskforce (‘TPT’) Disclosure Framework and Recommendations (draft), the Consumer Duty and the UK Stewardship Code.

This constitutes a useful reminder for internal auditors regarding the FCA expectations over environmental and social objectives, policies, strategies and competence to deliver effectively on sustainability objectives.

Per the FCA, the expectation is that TCFD disclosures should be used by firms to demonstrate that climate issues have received appropriate board and senior management attention.

In terms of culture, the FCA is focused on four key drivers: purpose, leadership, governance, and approach to rewarding and managing people. Culture must be aligned with sustainability-related strategic ambitions through leadership and training programmes, human resources, policies and procedures and wider workforce engagement.

In addition, the FCA clarifies that they expect published sustainability commitments to be supported by a credible strategy to deliver on those commitments. A sustainability strategy, to be credible, needs to include a suitable timeframe and milestones, articulation of the interaction with other parts of the business plan, identification of roles, responsibilities and accountability, and link with incentive structures – potentially including remuneration linked to achieving sustainability objectives. Internal audit plans must, therefore, cover those components in order to ensure framework alignment.

From a training and competence perspective, firms should be prepared to demonstrate the arrangements they have put in place. Sustainability, or a desire to ‘make a difference’ is not sufficient. Subject matter expertise needs to be developed by credible and proven upskilling approaches. The FCA is keen to avoid ‘competence washing’ in firms in an effort to improve their ESG performance. Genuine capability-building among firms needs to be built through appropriate training needs assessments and programmes.

The FCA is interested in hearing from firms on how they are embedding a clear ESG purpose, how this relates to sustainability objectives, and the strength of the ‘tone from the top’ on sustainability-related matters from both an environmental and a social perspective. Comments on the DP can be submitted until 10 May 2023.

04

RISK MANAGEMENT -
INSIGHTS FROM OUR
RECENT INTERNAL AUDITS

SONAL SHAH
Senior Manager

RISK MANAGEMENT

Insights from our recent internal audits

In this ever-changing and evolving economic, political, and regulatory climate, effective risk management must remain at the forefront and uppermost on the senior management's agenda.

The PRA reminds us that 'The board and senior management are responsible for ensuring that an adequate risk management framework is in place, which is tailored to the nature, scale and complexity of the business and its risk profile'.

While the board and senior management are ultimately accountable for ensuring the firm operates within an effective risk management framework, risk management should be every colleague's responsibility to varying degrees.

For Internal Audit, risk management is central to the purpose of the IA function (… "to evaluate and improve the effectiveness of risk management, control, and governance processes) and essential for the correct performance of internal audit assurance and consulting services (Performance Standard 2120 – Risk Management"). Therefore, IA teams should demonstrate leadership in the development and enhancement of the firm's enterprise risk management, more commonly seen in the sector as the firm's risk management framework.

ESTABLISHING AND MAINTAINING A RISK MANAGEMENT FRAMEWORK

During the early stages of a firm's business development, e.g., following FCA and/or PRA authorisation, the identification of key risks and establishment of a risk management framework is usually performed using a top-down approach, which should be led by the Chief Executive and applicable senior management. The Head of Internal Audit, and wider IA function, can play a substantial supportive role in this process through:

- **Industry benchmarking** - Considering the risk management frameworks in comparable firms within the sector, identifying good practices for common processes, such as risk assessments;
- **Workshops/staff training** - Delivering a risk management training programme as a facilitative consulting engagement to the business; and
- **Horizon scanning** - Coaching the business to develop a wholistic horizon scanning process for the identification of emerging risks (which we covered in greater detail in September 2022 of this monthly pack).

As the firm evolves its business model and matures its risk management processes, the key risks to the firm should, in general, be identified, assessed, mitigated and managed by the use of advanced tools, such as Risk and Control Self-Assessments (RCSAs), that are led by a bottom-up approach, i.e., the business teams taking active ownership of their risks.

RCSAs, like many other assessment tools, are not meant to be a static document or 'one-off' exercise; rather, these assessments should be maintained on a periodic basis, proportionate to the risk profile of the business area, and be led by the business' senior management to ensure that risk management arrangements remain effective. Where issues are identified through RCSA exercises, these need to be documented and escalated appropriately in a timely manner.

To ensure the RCSA is objective and adds value to the firm, the IA function should have a facilitative role in the process and independently report the results to the board and senior management.

RISK MANAGEMENT

Insights from our recent internal audits

CULTIVATING THE RIGHT RISK CULTURE

One of the fundamental pillars to achieve a consistently effective risk management framework is by embedding a supportive risk culture. This is achieved by:

- **Leadership:** The 'tone at the top' needs to emphasise effective risk management as essential for the sustainable success of the business through, for example, town hall messages incorporating high level feedback on the firm's risk profile following significant business changes, current state of regulatory engagement, recent stress test results, etc. to ensure the firm's leadership is actively engaging the staff on risk management developments
- **Staff training:** Ensuring that all employees receive ongoing risk training and various initiatives to raise risk awareness, as well as managing risk issues (e.g., incidents) as learning opportunities to help continuously develop the risk management framework
- **Embracing operational resilience:** the essence of operational resilience is that risks will, most certainly, materialise at some point; but having an effective response to get the business back on its feet should be the aspired attitude, rather than primarily focusing on 'who's to blame?' as soon as an incident occurs. The incident post-mortem, which Internal Audit can (and should) support, will bring out the accountable colleagues and processes as the root cause of the incident.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

Having noted the above, we do come across a number of common issues from the risk management internal audit reviews we perform for a variety of financial services firms.

Below is a selection of themes to which IA teams should be vigilant:

- **Three Lines of Defence:** The 1LOD and 2LOD blur their respective roles and responsibilities, thereby impacting on the proactive ownership of risks by the business and the effectiveness of the oversight activities undertaken by Risk, Compliance etc. Often this occurs where staff migrate between the lines of defence and carry on their historic roles beyond their transition (i.e., keeping within their comfort zone) or pushback from either the business or oversight teams leading to an imbalance in workload/responsibilities (i.e., egos at play in the boardroom)
- **Inadequate documentation and/or supporting evidence:** Some firms work on the presumption that Senior Management Functions neatly align with the expected roles of a Three Lines of Defence model; however, without clear documentation to evidence the model's existence, and its constituent SMFs and their responsibilities mapped to the firm's Responsibility Map, there is no discernible enterprise risk management taking place for the firm's advisors, or the Regulator, to engage with
- **Lack of defined Risk Taxonomy or inconsistent application of Risk Taxonomy: best illustrated by example -** The concept of 'Financial Risk' can mean different things to different personnel (e.g., CFO vs. CRO). The use of common terms interchangeably across the firm's risk management framework can give the misleading appearance that risks have been comprehensively identified and managed with an appropriate risk response. It is critical that an approved firm-wide risk taxonomy with clear definitions, and practical examples, is consistently adhered to in the production of formal documents and discussion of the firm's risks
- **Compulsory Business Training (CBT) modules:** Where training tends to be largely or wholly reliant on CBT modules, staff typically have a limited and, largely, theoretical knowledge of the firm's risk management framework at best. This comes across in staff interviews within post-mortem and remediation engagements following a significant incident. A recent example is where staff confuse 'tipping off', within the context of financial crime investigations, with 'inside information' in the context of Market Abuse Regulation (MAR) – the former is a criminal offence, the latter can be managed appropriately as part of a MAR compliance programme.

05

MERGERS, ACQUISITIONS AND INTEGRATION: AN INTERNAL AUDIT PERSPECTIVE

KARUNA BHANDERI
Director

MERGERS, ACQUISITIONS AND INTEGRATION: AN INTERNAL AUDIT PERSPECTIVE

The last few years have seen a number of mergers and acquisitions in the wealth and investment management sector. The drivers for this activity vary from increasing market share, through straightforward acquisitions, to more complex strategic purchases where targets have product or technological expertise.

Although the risks related to the transaction itself are typically dealt with during legal and commercial due diligence, we have seen through our work that there is also specific value in assurance of any internal acquisition framework as well as post-transaction internal audit reviews.

WHAT ARE THE RISKS?

- Commercial and legal due diligence will typically capture core risks and may not identify practical challenges such as integration of key processes or systems that may lead to unanticipated operational or conduct risks
- In our experience, the approach to regulatory or compliance risk is sometimes limited to a focused assessment of relevant policies and recent incidents. Further consideration is merited either during due diligence through deep dives on key areas, or on a prioritised basis post-transaction
- From a people perspective, integrating staff where roles and responsibilities are shifting or being consolidated can cause unnecessary friction and disruption to the firm's culture if not carefully managed. Mitigating the associated risk of attrition and loss of knowledge is a key consideration and relies on the acquirer having a solid understanding of their current state to ensure that staff are prepared to meet such a challenge.

Two brief case studies from our recent delivery work can help illustrate these points.

CASE STUDY 1: MERGERS AND ACQUISITIONS REVIEW

- We undertook an M&A review for a growing IFA network to provide assurance over their acquisition framework considering the firm's strategic priorities
- Our review focused on the management of strategic, operational, legal, and reputational risk
- Through a combination of workshops, interviews and detailed document review we assessed the firm's existing framework and control environment to ensure coverage of the key M&A risks at a deeper and more meaningful level.

CASE STUDY 2: POST-TRANSACTION REVIEW

- Our client had recently completed a transaction and our review sought to assess how the firm was governing, managing, and monitoring business integration. The review particularly focused on alignment of the target to the firm's culture and business objectives in order to provide assurance as to the overall approach to integration
- The review involved an assessment of key integration programme material, as well as walkthroughs, and staff interviews at the firm and those joining from the acquisition
- This blended approach elicited a richer qualitative data set that may otherwise have only been obtained via staff surveys which, while useful, have inherent limitations and can be difficult to facilitate at scale and interpret at a time of ongoing transition.

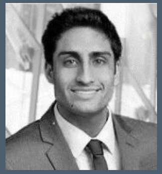
MERGERS, ACQUISITIONS AND INTEGRATION: AN INTERNAL AUDIT PERSPECTIVE

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

- **Acquisition framework** - An assessment of the governance and programme management approach in place to ensure it is clearly structured, provides appropriate coverage, and is clearly defined
- **Integration approach** - An evaluation of the integration framework in place to ensure it provides appropriate coverage of products and services, technology, people etc
- **Post-transaction review** - An appraisal of the success of a transaction to provide an independent view of the lessons learned and to identify enhancements for the future
- **Culture review** - To assess the preparedness of staff for a significant transaction and identify any enhancements required to mitigate attrition and culture risk
- **Documentation** - Is there an overall informality in the framework with a lack of documentation of key processes, roles and responsibilities and consequently of appropriate senior oversight?
- **Integration risk assessments** - Such assessments can be informal or narrow in scope
- **Lessons learned** - Whether an adequate lessons learned exercise has been undertaken and is of suitable depth to identify key learnings
- **Staff training/induction** - Induction and training programmes for incoming staff should be structured and clear to ensure they are appropriately informed of key policies and are well set up to meet the standards of the firm.

06

EFFECTIVE RESOURCE MANAGEMENT



SHRENIK PAREKH
Director

SCOTT THOMPSON
Manager

EFFECTIVE RESOURCE MANAGEMENT

RESOURCING CHALLENGES

Whether your firm has a mature, in-house, internal audit activity or outsources its risk and controls assurance requirements to a third party service provider, the challenge of achieving effective resource management to deliver an agreed upon audit plan will never cease. In this article, we consider the key factors driving the resource management decisions for in-house Heads of Internal Audit, who have a dedicated IA team, and what options they would have in harnessing external expertise.

THE CONSTANT CHALLENGE FACED BY HEADS OF INTERNAL AUDIT

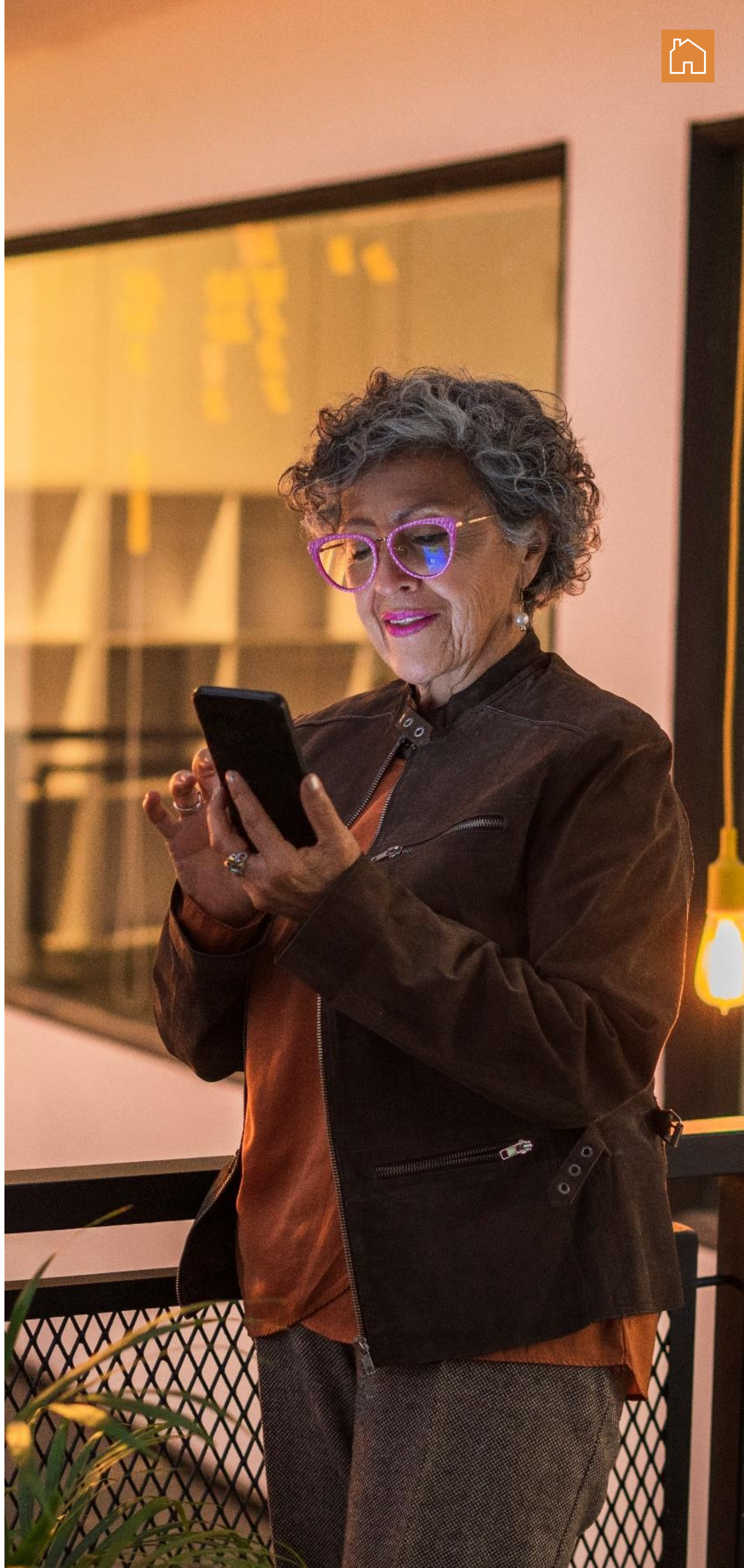
Heads of Internal Audit have to establish a function that ensures both appropriate technical skills, knowledge and competencies, as well as a sufficient amount of resources to deliver the agreed upon audit plan. The IIA standards captures this clearly within PS 2030 ('Resource Management') and, for the financial services sector, codified under Section F of the CIIA's Internal Audit Financial Services Code of Practice ('Resources').

In practice, the role of the Head of Internal Audit is one of prioritising as there will always be a constraint on the resources that a firm is willing to dedicate to it, and sometimes the number of reviews a business can cope with. But it is important that in getting the plan the right size for the resources i.e., a combination of shedding less important audits, certain reviews being deferred into next year or re-incorporated into the assurance activities of 2LOD teams, there could still remain significant limitations to achieve the plan with the current skills available within the team, and in some cases covering for posts that are hard to fill. So what can you do? Same as you would expect for a response to any type of risk, you either:

- **Avoid:** Not really an option here. You'll have to achieve a plan approved by the AC
- **Accept:** Accepting a substantial reduction in the audit plan down to its bare essentials is possible, but likely undesirable in our ever-changing regulatory landscape. The list of 'must-haves' for most regulated firms keeps growing, e.g., AML/KYC, conduct risk, climate change risk, prudential risk, operational resilience, consumer duty etc., and the risk to the firm climbs considerably if audit coverage cannot address the minimum, critical assurance requirements
- **Mitigate:** Mitigating the resourcing risks can take different forms, including:
  - Providing advanced training to staff, whether internally or through an external advisory team
  - Organising a recruitment pipeline, typically with a third-party recruitment specialist to maintain an accessible pool of talent with a sensible lead time
  - Implementing a rotational audit plan, whereby secondees from first and second line teams can bolster the skills base for highly technical reviews. Provided independence and objectivity requirements are safeguarded, rotational audits can also enhance internal audit's reputation within the firm and better demonstrate the value that the function provides the business.

EFFECTIVE RESOURCE MANAGEMENT

- **Escalate:** If after all mitigation efforts are expended, then escalation to the AC Chair would be the next port of call. As the Standards clarify in PS 2020 ('Communication and Approval'), the Head of Internal Audit will have to communicate the impact of resource limitations for delivery of the audit plan
- **Transfer:** Escalation to the AC could, after some detailed business cases and delicate negotiations with the wider senior management to gain executive support, eventually lead to some expansion of the IA function's budget. This could then open up a number of possibilities in transferring some of the resource management complexities to an external service provider as a co-sourced internal audit relationship. Co-sourcing can:
  - Flexibly allocate technical and specialist reviews, e.g., ESG and climate change financial risk, to external advisors that have the established contacts base and brand power to continuously recruit market-leading practitioners for targeted projects. Advisory firms also have the advantage of incorporating the lessons learned from the many reviews they carry out for their other clients
  - Help plug resourcing gaps within the existing IA function. In this manner, the in-house function continues to lead and deliver the audit plan, but is supplemented with staff to help progress high-volume activities, e.g., outcomes testing following implementation of the incoming consumer duty
  - Facilitate knowledge sharing from the advisory team's experts and, thereby, enhance the technical expertise (and confidence) of the in-house team to address more complex reviews. This is especially the case with data analytics – advisory teams have the advantage of dedicated IT, risk and modelling practitioners under one roof to help automate testing at scale or support implementation of analytics software, as well as the associated training and practical applications of the new tools (as the advisory firm uses them too)
  - Introduce the business to a wide pool of talent and advisory support that can go beyond internal auditing. As established advisory firms are also typically Skilled Persons, the collective knowledge of the co-source provider can address internal audit requirements and, provided independence is safeguarded, help the business resolve large-scale change management, remediation or regulatory projects.



EFFECTIVE RESOURCE MANAGEMENT

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

Given Heads of Internal Audit and their IA activities vary in size, maturity, complexity and geographical spread (and the impact of Hybrid Working for IA is another article altogether), its not sensible to have a 'one-size fits all' approach for the unceasing resource management debates taking place in every IA function. That said, audit leaders navigating the business' growth and transformational periods will need to be proactive in assessing and responding to the changing environment with a coherent resource strategy which should at least include budget headroom for external expertise as and when required. Heads of Internal Audit need to consider:

- **Resource strategy and recruiters:** How would you achieve comfort that the IA resource requirements have been properly assessed, challenged and supported by a coherent resourcing strategy that encompasses all internally and externally available options? Who in the Executive management team will help you – Human Resources? Operations? 2LOD oversight teams, such as Risk, Compliance, Legal etc? Additionally, resourcing strategies would require a managed recruitment pipeline to pull talent into the function, rather than carpet emailing recruiters as soon as a resignation comes through. Ideally, working with HR to develop relationships with a handful of experienced, well established IA recruitment specialists can help the recruiter understand your function and anticipate who might need before the need comes up
- **Training and development:** What is the current training and development plan for the IA function and is it aligned to support the audit plan for next year and beyond? Are audit staff proactively approaching their own professional development – AS 1210 ('Proficiency') reminds us that individual auditors are ultimately responsible for their knowledge, skills and competencies to perform their roles, Heads of Internal Audit have to ensure that, collectively, the team's proficiency can land the plan or (AS 1210 A1.) obtain competent advice and assistance from external parties
- **Quality assessments:** The 2022 CIIA Benchmarking Report revealed that 34% of IA functions that responded to the survey have never conducted an External Quality Assessment (EQA) and that 18% confirmed an EQA was not being considered. Quality assessments, whether as an EQA, or self assessment supported by an advisor, could help unearth critical issues affecting resource management that are beyond the considerations in this article's analysis, e.g., is there a staff morale issue? Does the business value the IA function and perceives it as a supportive partner? Is the function keeping vigilant to the business' changing objectives? In some cases, we have seen resource issues as the symptom, not the cause, of difficulties within IA functions and, therefore, regular quality assessments, as well as an actively led quality assurance and improvement programme, can help resolve the bigger problems that eventually manifest as severe resource constraints on the plan.

07

KEY RESOURCING TRENDS FOR INTERNAL AUDIT TEAMS IN 2023

ADAM JACKSON
Director, BDO Regulatory Solutions

KEY RESOURCING TRENDS FOR INTERNAL AUDIT TEAMS IN 2023

Being appropriately resourced is key for Internal Audit to operate effectively. The CIIA recently reported within Risk in Focus 2023:

"Boards should work with their internal audit function to evaluate whether the organisation's human resources strategies are aligned with its vision and mission, and whether they are suitable for these times of scarcity…"

It is also sobering to note that in a recent survey the CIIA stated:

"…36% say their budget must increase if they are to fulfil their responsibilities."

Given the budget constraints and skills shortages that many organisations are facing across key functions, the ability to access and deploy the required skills on an interim basis has become increasingly important.

This helps Internal Audit to respond quickly to changing priorities while giving a high degree of flexibility over spend.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

In the Investment and Wealth Management sector, we are seeing the following trends in resource requirements from our clients:

- In response to the shifting regulatory environment, firms are expressing their growing need for operating model and compliance experts who can provide effective challenge to senior management on its plans to develop business operating models. Compliance practitioners are back in high demand to ensure that new regulations are being effectively implemented
- As with other sub-sectors within the FCA's perimeter, the Consumer Duty requires firms to assure good customer outcomes. Investment management firms have increasingly sought outcome testing experts to enhance their outcome testing capabilities, bringing in an external perspective to benchmark their frameworks and increasing their capacity through teams already experienced in testing customer outcomes
- The increasing emphasis on delivering good customer outcomes has also started to drive demand for complaints and remediation practitioners. Several medium to large scale firms are now seeking substantial resource in these areas, including additional case handlers to augment existing teams through to larger, fully managed, operational teams
- Preventing financial crime remains a high priority for the investment management sector. KYC/AML analysts are in high demand to ensure firms are carrying out adequate customer due diligence and effective screening processes
- As discussed, above, in this monthly pack, the resourcing challenges for new and growing IA teams is multifaceted when we consider the determinants for efficient resource allocation, technical competency within teams, and recruiting professionals with a sound understanding of the regulatory landscape.

Whether sourcing individual SMEs for specific projects or providing a scalable interim team to deliver substantial change, we can help with all types of resource augmentation, secondments and programme management.

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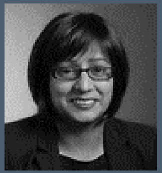
ECONOMIC CRIME UPDATE



SONIA DOHIL
Manager, Financial Services Advisory

ECONOMIC CRIME UPDATE

Last month, you will recall we examined Fraud Risk Management.

Since then, there have been further developments around fraud that we discuss in greater detail, below. In addition, we consider the Transparency Internationals Corruption Perceptions Index 2022.

NEW UK 'FAILURE TO PREVENT FRAUD' A CRIMINAL OFFENCE

The UK Government has recently confirmed that it intends to expand the Economic Crime and Corporate Transparency Bill with the introduction of an offence of 'failure to prevent fraud, false accounting or money laundering'. It is likely that a failure to prevent fraud offence would be enacted and it is estimated that the act will come into force in 2024.

It is expected that the failure to prevent fraud offence, will be similar to that of the 'failure to prevent bribery' under the Bribery Act 2010, and the 'failure to prevent the facilitation of tax evasion' offences within the Criminal Finances Act 2017. Any firm that fails to prevent fraud would be committing an offence. The only defence for firms would be to demonstrate that they had reasonable procedures in place to prevent fraud or that it was reasonable not to have such procedures in place. The new offence would allow for easier prosecutions of firms for involved in a fraud and for failing to prevent fraud being carried out by others.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

As fraud falls within the FCA's objective of reducing the risk of financial crime, it is expected that firms will have appropriate systems and controls in place to mitigate the risk of fraud. Internal audit teams are encouraged to review the firm's fraud frameworks to ensure that it covers:

- **Policies and procedures** - IA should provide assurance that fraud policies and procedures are risk based and aligned to the business, and that the firm's fraud risk assessment informs the controls designed
- **Top-level commitment** - The IA activity should evaluate governance processes to ensure that there is clear involvement from senior management in fraud risk prevention, especially in any key decision making for fraud frameworks
- **Risk Assessment** - Reviews need to be conducted on fraud risk assessments, examining internal and external fraud risks including any associated persons
- **Due diligence** - Assessments should ensure that due diligence procedures are in place for those who perform or will perform services for or on behalf of the firm
- **Training** - Firms will need to ensure that staff and, where appropriate, associated persons, are provided with fraud training using examples relevant to the firm and additional training is provided to those in higher risk roles
- **Monitoring and review** - Internal audit will also need to provide assurance that regular review and monitoring is in place to reduce the risk of fraud and identify any new emerging fraud risks.

ECONOMIC CRIME UPDATE

2022 CORRUPTION PERCEPTIONS INDEX (CPI)

Transparency International first published its CPI in 1995. It is in its 28th iteration, and whilst the 2021 CPI noted that corruption levels remained the same, the 2022 CPI noted that most countries are failing to stop corruption and scores for a signification number of countries had dropped down within the index.

The CPI ranks 180 countries 'on a scale from 100 (very clean) to zero (highly corrupt)' based on its position between 1 May 2021 and 30 April 2022. The CPI source data is built from a combination of at least three data sources drawn from 13 different corruption surveys and assessments. Transparency International states that these data sources are collected by a number institutions.

KEY CHANGES FOR THE 2022 CPI INCLUDE:

- Nine countries in the top 10 of the 'clean' countries for 2021 had dropped at least one level of rating, with one falling out of the top 10
- 72 countries dropped at least one rating level, including the United Kingdom with a significant drop of five levels
- 26 countries had fallen to its lowest rating to date
- 155 countries had made no significant progress against corruption or had declined since 2012.

It is clear that there a been a significant increase in corruption exposure across the global in the past year, and country risks have deteriorated in the current geopolitical climate. Transparency International highlight that low scoring countries have been unable to make significant progress in reducing corruption and those on the top had suffered from a lowering of standards and active enforcement of corruption.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

While firms are, understandably, focused on the regulatory requirements of the list of high-risk countries as set out in schedule 3ZA of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, firms should ensure that all key country risks are captured within a firms Country Risk Matrix (CRM). Internal audit teams should be working with their financial crime colleagues to effectively mitigate and manage country risks through the CPI:

- As part of the process for developing and maintaining an effective CRM and meeting FCA expectations, firms should utilise a range of country risk indications, such as the CPI, to enrich their country risk matrix
- Firms should also ensure that they annually reassess CRMs by incorporating updates to country lists reported in the CPI.

FOR MORE INFORMATION:

RICHARD WEIGHELL
Partner

+44 (0)7773 392 799
richard.weighell@bdo.co.uk

www.bdo.co.uk

42020160