INTERNAL AUDIT SUPPORT

INVESTMENT AND WEALTH MANAGEMENT

April 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.

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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.

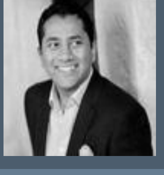
2023 REGULATORY PRIORITIES

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



SAM PATEL
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 Sam Patel.

1. What has been your career leading into BDO?

I qualified at Deloitte and stayed for 9 years. I got tired of delivering the same huge external audits on repeat. I felt like I wasn't learning anything new, so I took a breath and jumped into industry. I had a fantastic experience working in the finance function of a FTSE100 company. I was involved on the onboarding of two acquisitions, set up quarterly reporting and even constructed a cash flow forecast from scratch! I learned so much in a short space of time.

However, I was missing the variety of senior client interactions, meeting new people, going to different client sites so I hastily retreated back into practice to a top 10 firm who wanted me to join them as an internal audit Director. Being an auditor at heart, I took to it like a duck to water, and with an element of being in the right place at the right time, I was promoted to Partner within 6 months. That was in 2012.

When BDO merged with Moore Stephens to become the 5th biggest practice in the UK, I really took notice. I had to get a job here. I felt that I wasn't learning anything new where I was, and I wanted a new challenge. I got in touch with a member of the BDO executive, and after 10 months of various meetings and interviews was offered a role just after the COVID-19 pandemic started.

I started life at BDO in September 2020 and have never looked back! Whilst I am quickly coming up to three years, I am continually amazed by the quality of the people I work with, the leaders within my team and the wider firm. I love the fact that the firm is so diverse and, as a result, I continue to learn, develop and be inspired!

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

First and foremost, I lead a portfolio of outsourced and co-sourced internal audit engagements bringing in the relevant specialists, as required. I also lead the delivery of external quality assessments (EQAs) across financial services clients. This is something that I really enjoy doing and feel that clients really appreciate the added value and benchmarking that we bring when performing these reviews. Whilst I work alongside a fantastic group of four other FS internal audit partners, I work in a fabulous team with a lot of talented people who keep me on my toes! My final role is that I lead on innovation across our Advisory practice. This is something I'm very passionate about. I continue to challenge the team into looking for ways in which we can work smarter and more efficiently. Different ways of working to help the team and our clients succeed is something that's very important to me and a focus of the firm.

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

I have just completed the delivery of an EQA at a global financial services institution with one of the largest internal audit teams globally. As I mentioned, above, I find it extremely rewarding when clients appreciate the support we provide, and we brought valuable insight and added value that was well received.

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

The variety of the job and the people I work with. Whether I am at a client or in the office, I am surrounded by so many smart people who I love working with and learning from. They are also a super fun bunch! I also love the fact that every day is very different. You can go in expecting to get certain things done and come out of the day not having done any of them!

5. What drives you to do what you do?

I'm very lucky in that I really love this job. I love working with the team. Love helping clients. I feel like I am lucky to have found a job that plays to my strengths.

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

How trusted and respected you are as the "third line of defence" and senior leaders of the business world listening and valuing what you have to say.

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

Don't be afraid of shadows. People spend so much time worrying about things that might happen only to worry all over again if they do then happen. Don't waste your time worrying about the shadows.

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

Increased use of data analytics is the obvious one, but the potential of using AI I see as high on the list. Larger IA functions have more people and budget to experiment more in these areas and the things I have seen have been very impressive. I think there will also be an increased focus on skillsets and diversity of views. Exciting times ahead.

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

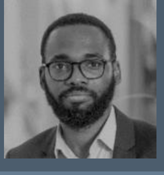
I'm mostly ferrying around my two sons when I am not at work, and I enjoy managing my eldest's Saturday football team. I have an annual cinema pass and love watching films.

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

Wine. A good playlist. Sunglasses.

03

FCA RULES ON APPROVING FINANCIAL PROMOTIONS IN RELATION TO HIGH RISK INVESTMENTS



OSITA EGBUBINE
Associate Director

LYNNE COOPER
Manager

PUBLISHING AND APPROVING FINANCIAL PROMOTIONS IN RELATION TO HIGH RISK INVESTMENTS

Reminder of the final rules

BACKGROUND

On 1 August 2022, the FCA published the Policy Statement PS22/10 which sets out the new rules in relation to the strengthening of financial promotions rules for high-risk investments ('HRI') and firms approving financial promotions.

To recap, the FCA has been dissatisfied with the way some firms have promoted HRIs to consumers. Research has shown a significant percentage of consumers do not appreciate the level of risk associated with these products, and the FCA is concerned that many consumers are overly exposed without sufficient safeguards. To improve customer protections, the new rules cover the adequacy of risk warnings prior to access, the introduction of positive frictions in customer journeys and requirements for firms who approve financial promotions for third parties.

The new rules related to risk warnings for financial promotions of HRI came into force on 1 December 2022 and all other rules came into force on **1 February 2023**.

Which firms does this apply to?

Firms which issue, or approve for issue, financial promotions in relation to HRIs which are directed at, or likely to be received by, retail clients. HRIs comprise Peer-to-Peer ('P2P') investments, non-mainstream pooled investments, non-ready realisable securities and speculative illiquid securities.

Summary of the final rules

The categorisation of High Risk Investments has been simplified to avoid confusion for market participants.

There are now three product categories and accompanying market restrictions:

- **Ready Realisable Securities (RRS)**

  These are listed or exchange traded securities. These can be mass marketed without restrictions.

- **Restricted mass market investments (RMMI)**

  These include non-ready realisable securities (such as unlisted shares), P2P agreements and qualifying cryptoassets. These can be marketed to retail investors subject to certain restrictions. The restrictions applicable to RMMIs remain unchanged.

- **Non-mass market investments (NMMI)**

  These include non-mainstream pooled investments (NMPIs) and speculative illiquid securities. Mass marketing for these securities is banned to retail investors. There are no changes to the rules for marketing these products.

Risk warnings and associated risk summaries

To ensure that customers are not just clicking through without understanding the risks involved, the FCA have introduced new risk warnings.

Incentives to invest

The FCA have banned all incentives to invest in these high-risk investments (with a specific exemption for real-economy goods and services).

Client categorisation

Potential investors must indicate how they meet the high net worth, sophisticated or restricted investor criteria. Potential investors need to provide their income to the nearest ten thousand pounds and net assets to the nearest one hundred thousand pounds.

PUBLISHING AND APPROVING FINANCIAL PROMOTIONS IN RELATION TO HIGH RISK INVESTMENTS

Reminder of the final rules

Cooling off period

The rules have introduced a mandatory cooling of period for first time investors seeking to invest in RMMIs or NMMIs. This is based on behavioural research that such friction in onboarding may help to protect customers.

Firms making Direct Offer Financial Promotions (DOFP) RMMIs are required to wait 24 hours from the time the consumer requests the DOFP to issuing it to them. In the intervening period, the firm is able to carry out activities such as KYC/AML checks, providing personalised risk warnings, client categorisation and appropriateness assessment. For NMMIs, firms must also wait 24 hours from request before showing financial promotions to consumers.

Record keeping

Firms are required to record metrics such as the number of consumers categorised as HNW, sophisticated and restricted and why; and appropriateness assessments with outcomes for each consumer.

Approving financial promotions

The rules for firms approving financial promotions (section 21 (s21) approver) have been strengthened to ensure that firms approving financial promotions have the relevant competence and expertise in the product being promoted. The new rules require approvers to date stamp promotions to make it clear when the promotion was approved and also strengthens the obligation on approvers of financial promotions to perform ongoing monitoring of the financial promotions to ensure they remain compliant with the rules.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

Now that the final rules are live and firms' processes should now be in business-as-usual mode, firms who distribute or approve financial promotions related to HRIs should ensure their customer journeys are compliant with the new rules.

Risk warnings on all the media through which promotions are distributed should now be in place. These should be considered in light of the Consumer Understanding outcome under the incoming Consumer Duty.

Policies and procedures should be updated, if they have not been already, including controls within marketing processes and record keeping.

Financial promotions checklists and methodologies should also be updated.

Training should be provided to internal audit teams so that the new requirements are well understood across the three lines of defence.

Review process should be implemented, including reviewing the governance, MI and record keeping requirements for the approval of financial promotions.

Firms should consider the competence requirements for those involved in the financial promotions approval process and should be able to evidence the assessment undertaken to ensure appropriate competence and expertise is in place.

New data collection processes should be evident to measure consumer behaviour in response to the new rules and to capture the relevant information regarding record keeping.

04

EXTERNAL QUALITY ASSESSMENT
INSIGHTS FROM OUR GLOBAL MARKET EXPERIENCE

SAM PATEL
Partner

SAM CORNISH
Principal

BRUK WOLDEGABREIL
Associate Director

EXTERNAL QUALITY ASSESSMENT

Insights from our global market experience

THE IMPORTANCE OF QUALITY ASSESSMENTS

"Quality" could be defined as the degree to which a product or process meets its expectations.

With that said, it should be no surprise that the IIA places substantial emphasis on the importance of a well-established quality assurance and improvement programme (QAIP), periodic self-assessments, and an external assessment at least every five years to ensure that the Internal Audit (IA) function is operating to a sufficient level of quality.

The reported outputs from the QAIP and external assessment are crucial for the Head of Internal Audit (HoIA) to demonstrate the quality of the IA activity in meeting the expectations of the charter and the degree to which the firm's Audit Committee and Board can place reliance on the function's assurance activities.

However, the 2022 CIIA Benchmarking Report revealed that 34% of IA functions that responded to their 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 a facilitated self-assessment supported by an advisor, could help unearth critical issues affecting the efficiency and effectiveness of the IA function, or indeed the wider environment in which the function operates.

In this article, as part of our series exploring Quality, we briefly explore the key steps in an EQA process and the considerations that internal audit teams should have front of mind before, during and after an external assessment to maximise the review's outputs.

WHAT WILL THE EQA EXAMINE

An external assessment, whether conducted by the IIA or a qualified, independent, assessor such as BDO will not follow a generic checklist. While the IIA standards, Code of Ethics and CIIA FS Code requirements will form the basis for an external assessment, it is critical that the assessment covers whether the IA function is achieving its stated purpose and remit, as well as its standing in the firm, i.e., what is the firm's perception of the IA function? Is it considered useful, competent, and reliable?

Additionally, the assessment will consider:

- **Resources, skills and competencies available in the function:** including its resourcing strategy to support technical and specialist reviews (e.g., co-source and advisory resources available on demand);
- **Internal audit methodology, tools and processes:** this would include policies and procedures, templates / approved formats, approach to sampling, data analytics, and use of audit workpaper software;
- **Performance:** does the IA team 'make a difference' or is it 'going through the motions'? Is the governance within the IA team effective and are operations sufficiently supervised to achieve quality expectations? Are the KPIs and KRIs set by the HoIA supporting an efficient function that maximises the limited (almost always stretched) budget to achieve the annual plan? Is the function distracted by getting involved in first- and second-line work?
- **Reporting results (outputs):** the quality of submissions to the AC and wider Board needs to be value-adding strategic reports, focused on the big picture of how the firm's risk and control framework is holding up against the fast evolving regulatory and economic landscape. Does the reporting provide the committee with everything it needs to know? Is it succinct or voluminous? The Audit Committee will not need to go into the finer details of how many items were sampled etc.

BEFORE THE EQA

Preparation for the external assessment will need the HoIA to engage with the AC and wider executive management to secure the necessary budget and discuss scope for a meaningful assessment of the function. Keep in mind that, while the AC Chair should oversee and approve the appointment process for the independent assessor (Section G, CIIA FS Code), it's incumbent on the HoIA to drive this process every five years (if not requested by the Chair of AC) as set out in AS 1312 ("External Assessments").

All being successful, a tender process should commence to consider the qualified and independent assessors available to carry out the assessment. The HoIA should encourage Board oversight in the appointment of assessor and oversight of the assessment process to mitigate any perceived or potential conflicts of interest.

EXTERNAL QUALITY ASSESSMENT

Insights from our global market experience

DURING THE EQA

Following appointment of an assessor, the EQA team will engage with the IA function for:

- Review of prior EQA outputs (if any available);
- Discussion with the IA team to ensure coverage across seniority grades, one-on-one interviews with a selection of IA staff, excluding the management team, to get a tangible sense of what the IA team thinks about itself, its value to the firm and how the firm perceives the function;
- Sending out a survey to the firm's senior management to build a picture of how the IA function is perceived and whether IA adds value to the business;
- Requesting key documents, e.g., the function's policies and procedures;
- Scheduling interviews, stakeholder meetings and progress update meetings. For larger IA functions, especially if assessing across multiple jurisdictions, this may require a designated point of contact to facilitate introductions and oversee logistical arrangements to be as efficient as possible to support the assessment team;
- Drawing a sample of audit files to assess if engagements have followed established processes, appropriate scoping considerations, and key risks have been sufficiently assessed.

An assessment of the function's conformance with the IIA standards, Code of Ethics and CIIA Financial Services Code is essential throughout the review, as well as any other applicable internal auditing standards, codes and professional guidance for all the jurisdictions that the IA function provides assurance.

We consider this aspect through a case study (further below) following our recent EQA engagement for a globally significant financial services institution.

AFTER THE EQA

The assessment will eventually conclude on whether the IA function is Generally Conforming, Partially Confirming, or Not Conforming to the standards, Code of Ethics and FS Code. This would include any recommended remedial actions for identified vulnerabilities.

But an effective EQA report should also identify any relevant insights, observations, benchmarking and thoughts from the assessment team to help the function improve its effectiveness and, overall, add value to the HoIA. As with any report following assessment, there would be a close out meeting to include the HoIA, AC Chair and senior management team to incorporate feedback into the drafting of the final report.

The IA function would then be able to present the final EQA report to the Audit Committee. Monitoring of remedial actions could then be baked into the QAIP and progress reported by the HoIA to the Board and senior management as part of their conformance to AS 1320 ("Reporting on the Quality Assurance and Improvement Programme").

EXTERNAL QUALITY ASSESSMENT

Insights from our global market experience

CASE STUDY - EQA FOR A GLOBAL FINANCIAL SERVICES INSTITUTION

We recently completed an EQA for a globally significant FS institution by assembling an international team of audit experts from across Europe, UK and the US to provide our client with the specific skills, expertise and insights that they needed from the review. In addition to reviewing the IA function against domestic, European and Global Internal Audit standards (including the CIIA Financial Services Code), the client also asked us to review the maturity of its data analytics strategy and risk culture within the IA department.

Our review considered the global assurance work undertaken by the IA activity, as well as the country specific engagements and reporting that the team does for the cross-border business activities including major operations in some specific global countries.

We were able to work collaboratively with the client to deliver on the necessary timelines they had, given the dates on which Audit Committees to present the EQA were to take place and when senior stakeholders were best available.

The key driver for this successful EQA - a clear work programme, well-structured and well-organised around the overlapping reviews against the different applicable auditing standards, thereby reducing duplication and working effectively within the budget.

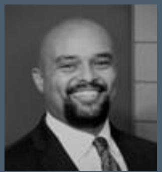
Our presentation of the report results to the Group CEO, Chair of the Audit Committee, Internal Audit ExCo and senior board executives have been very positively received, specifically noting that the insights and observations that we made were valuable and ‘confirmation of why we chose to go with BDO in the first place’.

Following on from the work that was done in the EQA, we are exploring with the client how we can help them to get more efficiency and effectiveness in the delivery of their overall audit plan and looking to improve overall performance of their assurance programme.

05

INTERNAL AUDIT REVIEWS REQUESTED BY THE REGULATOR

PAUL GILBERT
Director



BRUK WOLDEGABREIL
Associate Director

CHRISTIAN JONES
Senior Manager

HOW TO RESPOND TO AND MANAGE INTERNAL AUDIT REVIEWS REQUESTED BY THE REGULATOR

Regulators may request firms to complete internal audit reviews with a prescribed scope to support a broader thematic review. Such thematic reviews are typically focused on an area of recent regulatory change or growing concern and are to be led by the firm's Internal Audit function.

The various reports are provided to the regulator who then sets out findings and actions that firms should take. For example, during 2022, the Financial Conduct Authority reported on the findings from the SME collections and recoveries review.

This article explores how to manage and respond to an internal audit review to be performed at the request of the regulator and how to deliver these in conjunction with internal audit review activity aligned to key strategic risks relevant to your firm.

YOU GET A LETTER FROM THE REGULATOR, NOW WHAT?

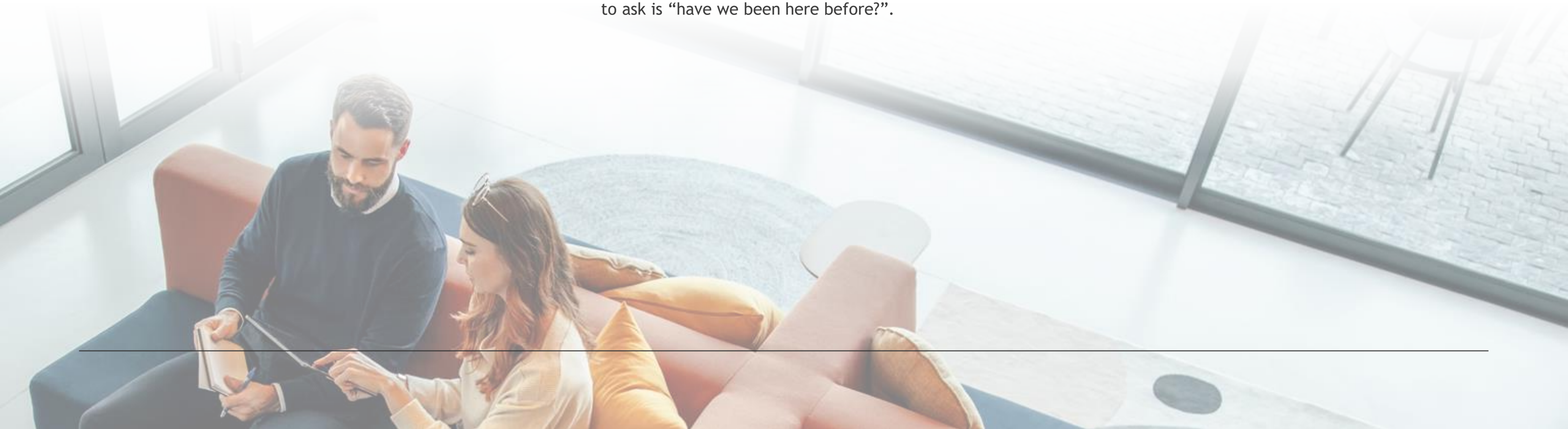
If your firm is selected to take part in a thematic review, you will receive a letter detailing the review's requirements. This could include:

- Details of the required scope;
- Any relevant scope exclusions;
- Administrative details, such as follow up expectations, or amendments to scope; and
- Submission requirements.

Typically, the first step is to ensure appropriate communication of the thematic review within your firm. Typically, this involves the Head of Internal Audit (HoIA), Chair of the Audit Committee and CEO, and should ensure the Board and Senior Management are informed of the regulatory request.

The HoIA will need to also assess the potential impact on the Internal Audit Plan. In our experience, many internal audit functions are not resourced with sufficient contingency in resource availability to be able to deliver regulatory driven reviews without adjustment to the priorities or sequence of assurance activity.

However, before pencils are sharpened for a new engagement to be added to the audit plan, a helpful question to ask is "have we been here before?".



HOW TO RESPOND TO AND MANAGE INTERNAL AUDIT REVIEWS REQUESTED BY THE REGULATOR

MAXIMISING RECENT AND RELEVANT ASSURANCE WORK

If your firm has recently completed a review with a similar scope to that requested by the regulator, you should consider proactively contacting your Supervisory Team to discuss the report's scope, criteria, and its conclusions. The regulator may assess that the completed assurance work could address some, or all, of the thematic review requirements against an agreeable criteria, thereby negating the need for the firm expending further internal audit work.

The internal audit team should consider when the previous review activity took place, along with progress towards resolution and embedding of any actions or recommendations.

Key considerations:

- Have we completed any similar review work recently?
- Was the purpose of the firm's recent review, and its criteria, relevant to the regulator's aim of gathering sectoral assurance?
- Would the firm's progress against the review's recommendations and remedial actions provide the regulator with a perspective that the firm is managing risk?

REVIEWING THE ANNUAL PLAN AND IA RESOURCING STRATEGY

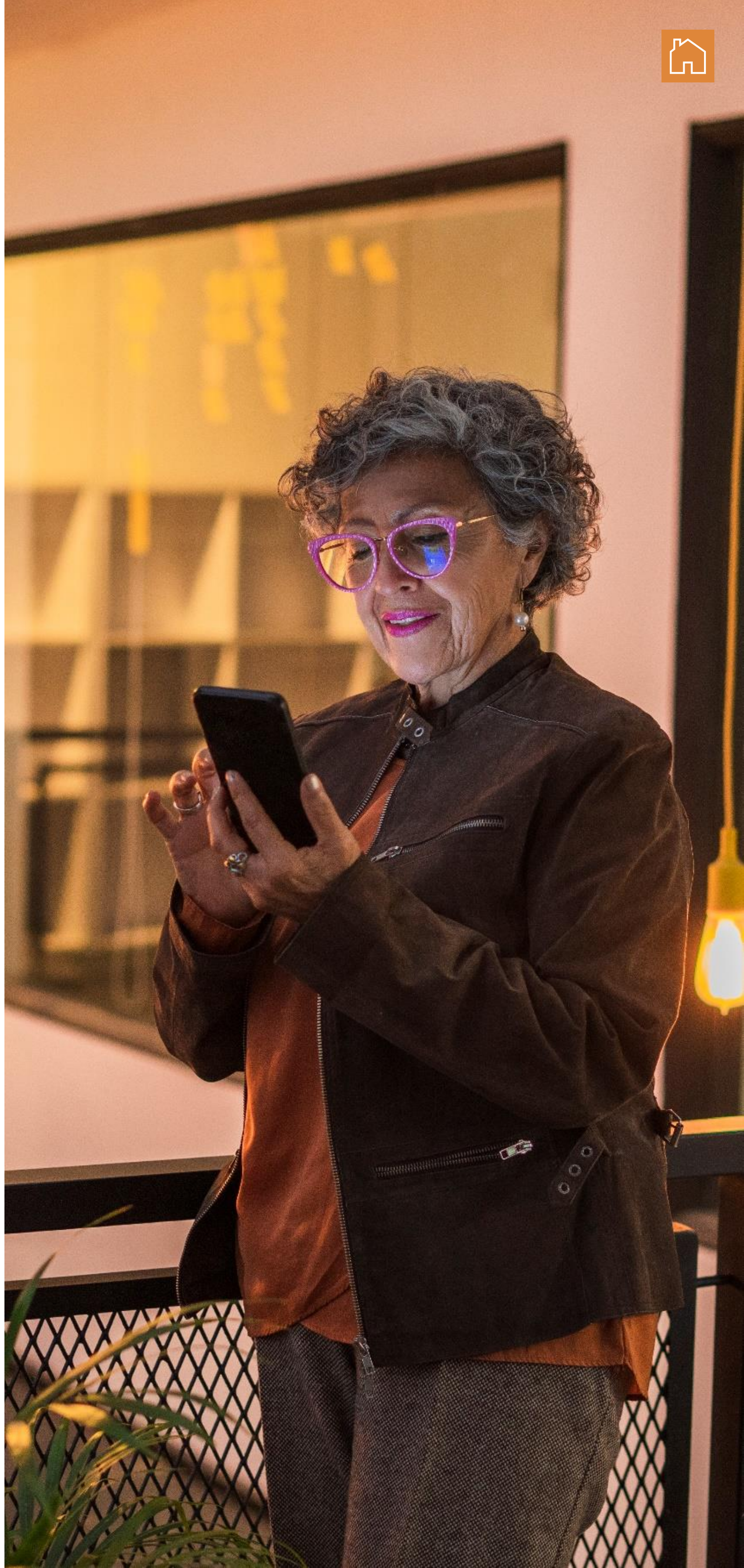
Assuming that the review requested by the regulator is to be completed, the HoIA will now need to review the annual audit plan and is likely to seek approval from the Audit Committee for changes to the plan. The HoIA may also have to promptly trigger aspects of their resourcing strategy for the regulatory review to have sufficient and appropriate resources – a subject covered in detail within our March report.

Given the nature of the request and the requirement for multiple firms to complete the review alongside other business priorities, the regulator will generally provide what may appear to be a generous amount of time for completion. This time is easily spent and, from our market experience, not always used efficiently.

The first step should be to review the annual audit plan in the context of the request. The goal should be to determine what resource is required to complete the review to a high standard and what changes may be required to the plan to enable this. If the addition of the review leads to a significant risk exposure or de-prioritisation of work in high-risk areas, then other options for delivery or support may be appropriate:

Key considerations:

- What technical or specialist skills are required to deliver this thematic review to the right standard?
- If the IA function has a co-source partner, what is the optimum nature of the support that you would like to deliver the review and does the co-source partner have the right practitioners available at the right times to deliver this?
- Aside from the thematic review's impact on the audit plan, what knock-on impact will it have for the firm's assurance map, i.e., will the firm's other assurance providers, e.g., Compliance, have to adapt their planned activities?



HOW TO RESPOND TO AND MANAGE INTERNAL AUDIT REVIEWS REQUESTED BY THE REGULATOR

PLAN EARLY AND PROPERLY

Just because you have plenty of time to deliver the review doesn't mean you should delay; the engagement planning process should start as early as is practical. An initial step should be to identify the review's key stakeholders for a scoping meeting, to develop a deeper understanding of the audit area and secure the support of the area's management and staff. The IA team should share a copy of the scope points with appropriate colleagues to support planning discussions and maintain visibility of the review's requirements throughout the engagement.

When drafting the work programme, ensure there is a "golden thread" between the regulator's letter, the review's scope and the testing procedures designed to achieve the thematic review's objectives. Early and efficient planning for the review will demonstrate to the regulator the prudent and professional approach the firm's IA team, and ultimately its management, adopts to fulfil the regulatory request. Keep front of mind that engagement documentation is a critical component of internal auditing (PS 2330) and may be requested by the regulator alongside the final report to help verify the review's methodology and route to the reported findings. Given the nature of the review, additional time should be built in to allow for review and approval at an executive level.

In a recent example from our delivery work, a client had developed a delivery plan based on routine internal audit procedures without first considering the enhanced scrutiny or approval requirements necessary for an internal audit report that would be shared with the regulator. We were able to support in developing a delivery plan that factored in the review of findings and recommendations at relevant committees, including Audit Committee, and Board. The client followed the revised plan and was eventually able to meet the delivery deadline set by the regulator. Key considerations:

- What are the delivery deadlines for review planning, fieldwork and reporting?
- Who are the key stakeholders for the review and what is their availability during the review timetable?
- What relevant processes and technology will the IA team have to get up to speed on promptly for planning to provide sufficient coverage of risks?
- Given the exposure (to the regulator), and potential complexity, of the review is there is experienced supervision in place within the IA team to ensure that golden thread between the regulator's letter, planning, work programme and reporting?
- Are there any known or previous issues to be considered within the scope of the review, or have there been recent changes in the control environment? If so, these considerations need to be factored into the timing.

In some cases, completing the review early will be of benefit so that any control improvements are known and understood as soon as possible. However, there will also be instances when other factors exist that makes it necessary to perform the review closer to the deadline.

ONGOING MONITORING AND FEEDBACK

The impact of the collective findings of the thematic review can be significant. With that in mind, it is vital that the IA function maintains effective reporting to the Audit Committee and senior management on the review's observations as the audit work progresses. As with all good audit work, there should be no surprises by the time of reporting.

Where feasible, leverage IA resources unconnected to the review, including second-line oversight if appropriate within independence requirements, to sense check findings and proposed solutions. It is important to have as much objective challenge placed on the review's outputs internally before it is opened up to regulatory scrutiny.

Progress and outcomes of these reviews are often a hot topic at industry forums arranged by trade associations, e.g., UK Finance, Building Society's Association, etc., or forums for specific professional disciplines. It would be good practice to make use of these discussion opportunities to informally benchmark your firm's review findings at a high level (ideally, under the Chatham House rule) to ensure that the firm has broad consistency with a consensus of peers.

Key considerations:

- Has the IA function implemented an effective reporting function to the AC and management to monitor progress and circulate observations on a timely basis?
- Are we using available opportunities to appropriately benchmark findings and proposed responses with peers?

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

Should your firm be asked to participate in a thematic review, the key to delivery is appropriate preparation and planning throughout the review. This includes making sure that there is a clear understanding of the scope, an appropriately resourced team with the right knowledge, skills and experience to deliver the review and a robust internal audit delivery approach.

Careful planning is also needed to ensure that meeting the demands associated with a regulatory driven review does not compromise the delivery of assurance to other areas of high risk on the Internal Audit Plan.

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IFPR: WHAT CAN IA TEAMS LEARN FROM THE FCA'S THEMATIC REVIEWS

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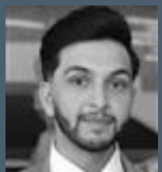

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INVESTMENT FIRMS PRUDENTIAL REGIME (IFPR)

What can IA teams learn from the FCA's thematic reviews?

BACKGROUND

The FCA has recently performed multi-firm thematic reviews to assess the progress firms have made with the implementation of the Investment Firms Prudential Regime (IFPR), particularly focusing on the category of Fast Growing Firms (FGF). The Regulator's feedback in its 'IFPR implementation observations' shows that there are a few important areas for firms to improve upon.

IFPR THEMATIC REVIEWS

The review focused on firms' ICARA, capital adequacy, liquidity adequacy and wind-down planning. The following concerns were highlighted:

- The publication highlighted that firms which operated 'Group ICARA' processes gave insufficient consideration to firm-specific risk and harms.
- Firms that operated an ICARA process on a 'consolidated basis', rarely supplemented this with solo ICARA processes as required by MIFIDPRU.
- ICARA assessments were not sufficiently integrated with the wider suite of risk management documentation.
- Wind-down planning remains an area where firms are struggling to implement appropriate processes. The FCA particularly highlighted that most wind-down plans reviewed did not assume a position of financial stress and did not provide a comprehensive analysis of wind-down requirements, trigger points, financial and operational metrics, a clear methodology and a granular cashflow forecast.
- Inaccurate regulatory reporting due to incomplete data submissions.

FAST-GROWING FIRMS (FGF) REVIEWS

The FCA reviewed 25 firms including CFD providers, wealth managers and payment services firms that experienced fast growth over a 3-year period. The feedback identifies the following concerns in addition to those listed above:

- Risk management frameworks and governance arrangements have not kept pace with the growth of business activities.
- Assessment of financial resources did not consider growth and, therefore, was not commensurate to the increasing risk of harm to customers.
- Inadequate stress testing or scenario analysis that did not consider the impact of a material decrease in the rate of growth.
- Wind-down plans lacking operational analysis and consideration of group dependencies.

FCA'S EXPECTATIONS

In its feedback, the FCA expressed an understanding that the volume of regulatory change brought about by the IFPR requires substantial effort from firms to land successfully and, therefore, achieving full compliance may need additional time. The FCA has provided a helpful list of expectations based on what it has observed as being areas of concern or in need of improvement.

- Firms must continually assess and manage the risks arising from their activities and hold adequate financial and non-financial resources to mitigate potential harm.
- Risk management practices should not remain static and must evolve in line with macro economic changes and business growth.

INVESTMENT FIRMS PRUDENTIAL REGIME (IFPR)

What can IA teams learn from the FCA's thematic reviews?

- Governance arrangements and the resourcing of risk, compliance and audit functions must remain proportionate and fit for purpose.
- Prudential consolidation and relevant requirements must be fully understood and applied according to the relevant MIFIDPRU rules.
- Adequacy of financial resources must remain a priority for firms, and must be proportionate to the size and complexity of the business.
- Stress testing and scenario analysis are important to ensure that firms have a clear understanding of the internal or external events that may be detrimental to the business and helpful to test financial resilience.
- Liquidity risk management must be structured within effective policies, controls, contingency funding plans that allow an accurate assessment and calculation of liquid assets requirements.
- Wind-down plan must be robust and follow the structure in the FCA guidance within the WDPG sourcebook. Firms should also consider the FCA's feedback provided in TR22/1, that focuses on the consideration of group-wide dependencies.
- Regulatory reporting must be accurate and based on the correct methodology for the underlying calculations.

The FCA's expectations should not come as a surprise; however, it is important to prioritise the areas of greatest concern over the coming months.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

- The FCA have stated that they will continue with their multi-firm reviews. IA teams should be thinking about running FCA style 'mock tests' on their firms' ICARAs focussing on capital, liquidity and wind-down giving consideration to group arrangements and growth of business activities.
- Governance and risk management remain amongst the FCA's highest concerns. In-depth thematic reviews of governance arrangements and assessment of risk management processes should be included as regular items in IA plans.
- Wind-down plans remain at the forefront of FCA's regulatory agenda. IA teams should ensure that firms prioritise their wind-down planning processes accordingly and take the appropriate steps to make their wind-down plans credible and operable.
- The importance of providing accurate and complete regulatory submissions continues to be stressed by the FCA. IA teams should consider regulatory reporting as a high priority at least throughout 2023.
- The proposed changes from FCA CP22/26 prompt a reassessment of firms' compliance with the rules once the Handbook has been formally updated. Testing the regulatory environment and financial resilience may be based on different assumptions, which should be taken into account when planning the actual scope of any such testing from Q2 2023 onwards.

FOR MORE INFORMATION:

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