

Fitting the pieces

Independent Audit's approach to effective risk and control

You know the feeling. You spend inordinate amounts of time, trouble and money on risk management and control systems – and yet things still go wrong. And then you're told that the solution is to have more of what didn't do the job last time...

The Three Lines of Defence

You almost certainly use the three lines of defence model – because almost everyone does – the first line of defence being line management, the second line being Risk and Compliance and the third being Internal Audit. (Other flavours are available. Unfortunately.)

Whilst by no means perfect, the three lines model does provide a useful conceptual framework for thinking about the roles and responsibilities of each of the lines. In particular, it highlights how the effectiveness of each line is dependent on the activities and positioning of the other two.

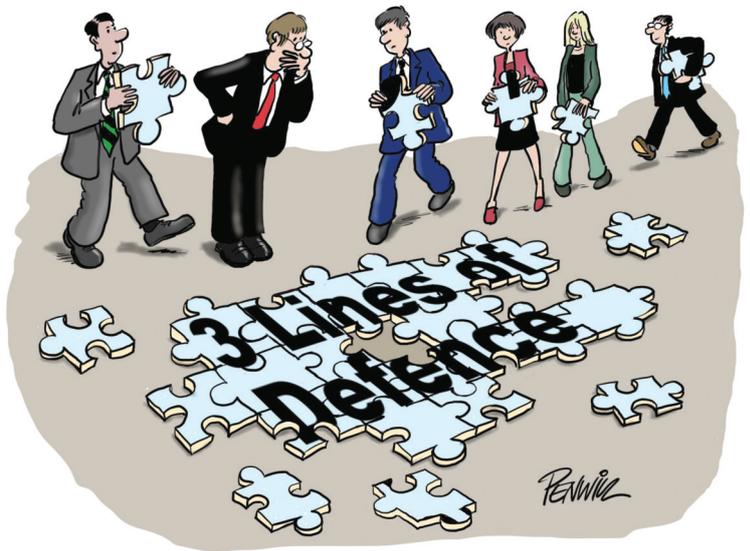
In effect, each of the three lines is a piece of a jigsaw puzzle. Whether each piece is the right size and shape depends on the size and shape of the hole it needs to fill, which in turn depends on the other pieces. If you try to define each bit separately – as many (most?) businesses do – you end up with something that ticks boxes on checklists and corresponds to all sorts of nicely designed frameworks, but is capable of containing lots of gaps and overlaps.

Unfortunately, you probably won't notice the gaps until something goes wrong, but you'll notice the overlaps every day because they're a nuisance.



The 'three lines of defence' system for controlling risk has been adopted by many banks with the active encouragement of the regulators. It appears to have promoted a wholly misplaced sense of security. Fashionable management school theory appears to have lent undeserved credibility to some chaotic systems. Responsibilities have been blurred, accountability diluted, and officers in risk, compliance and internal audit have lacked the status to challenge front-line staff effectively. Much of the system became a box-ticking exercise whereby processes were followed, but judgement was absent. In the end, everyone loses, particularly customers.

Parliamentary Commission on Banking Standards



Out of control controls?

Recognise any of these symptoms? If so, it's worth us having a chat:

- Unwieldy management structures and diffuse accountability
- Tendency to define a good control system as one which focuses on risks, rather than good outcomes
- Every control appears to be 'key'
- Cost of control going up but costs of operational losses and rework not going down
- Internal Audit and Risk Management seen by the business as competing in the same space
- Documented procedures for every eventuality (except the one that's about to happen)
- Excessively detailed control reports obscuring the line of sight to the things that matter most (wood for trees)
- Risk and control assessments which have become an end in themselves
- Internal Audit and Risk Management focused on compliance with procedure more than on achievement of good outcomes
- Incremental accretion of control as management reacts to incidents by introducing additional controls



Case study

Our client, a major financial services firm, had a mature, fairly well developed three lines of defence model in place. However, both Risk Management and Internal Audit were going through separate, un-coordinated transformation programmes, leading to Audit Committee concerns over duplication of effort and gaps in coverage.

Given the client's extremely low tolerance for operational risk and the Audit Committee's concerns, Independent Audit was asked to come in and advise on a governance strategy for the business.

Our approach was to spend time understanding the weaknesses within the existing governance arrangements before developing a governance strategy to address the Audit Committee's concerns, including clarifying roles, responsibilities and boundaries between the first, second and third lines of defence. Key to this was:

- Linking, in the minds of management, the achievement of business objectives to having an effective internal control framework focused on outcomes
- First line management accepting full responsibility for risk management and internal control
- Challenging management to demonstrate that they had things under control, thus enabling them to become the primary source of assurance to senior management and the Audit Committee
- The second line becoming more facilitative – educating and challenging the first line around risk, rather than being a pseudo-audit team
- The third line taking a more strategic position, focusing on the adequacy of management (monitoring) controls and enabling it to step back from low-value detailed testing of processes and controls

The new governance arrangements – which got the regulator's seal of approval – have enabled the client to rationalise significant numbers of controls and bureaucratic reporting processes, including simplification of regulatory reporting.

So what's the answer?

The first step is to define the question we are attempting to answer (it always helps, we find!). In simple terms, what is causing the pain you are experiencing? From here, it should be possible to develop a way forward.

Using our 'un-consultancy' approach to consulting, we'll deploy a very small team of one or two highly experienced partner-level resources to work with a senior member of your management team to analyse your governance arrangements, assess how the monitoring and the lines of defence work together in practice, and identify the problems. And, critically, we will also provide you with the 'how'. That is, a practical, fit-for-purpose solution that addresses the weaknesses that will undoubtedly come to light.

Unlike other consultants, we won't try to give you 'one we made earlier'. Whilst we have seen and helped numerous clients address their governance concerns, we don't believe in a one-size fits all solution. Anything we develop with you will be bespoke to you – although the fundamental principles underpinning the solution will be tried and tested. Whilst that might mean we take a little longer to think about and develop our solution, it does mean that what you get will be appropriate and practical.

Strong, executive level sponsorship is a necessary pre-requisite. But with that, we can help management and the control functions see this as something that is being done with them and for them, not done to them. This much improves the likelihood of getting the buy-in necessary for real improvement.

And since we only use a small team, our solution will probably cost you significantly less than if you went elsewhere.

Want to find out more?

To discuss your concerns and understand how we might be able to help, contact:

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