

# Operational Risk Framework - Auditor's Perspective

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You only find out  
who is swimming  
naked when the  
tide goes out.

*--- Warren Buffet*



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# The Three C's

- Corporate Governance
- Culture
- Capability

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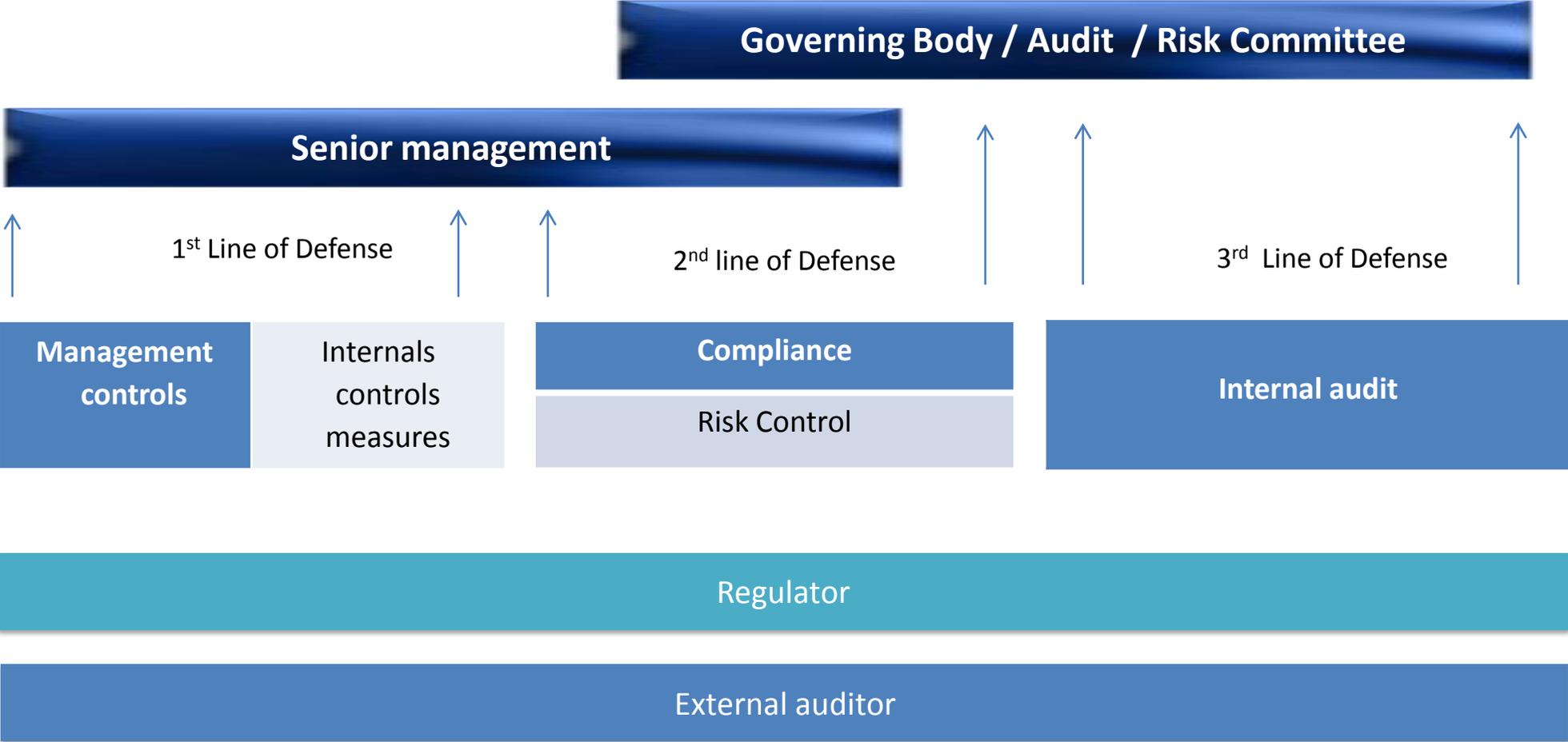
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# The Three Lines Of Defence



# Internal Audit in ERM

*Assurance as to key business risks are being managed appropriately and that the system of internal control is operating effectively.*

## Core Internal Audit Roles

- Assurance on risk management processes.
- Assurance that risks are correctly evaluated.
- Evaluating risk management processes.
- Evaluating the reporting of key risks.
- Reviewing the management of key risks.

## Legitimate internal auditing roles with safeguards.

- Facilitating identification and evaluation of risks.
- Coaching management in responding to risks.
- Coordinating ERM activities.
- Consolidating the reporting on risks.
- Maintaining and developing the ERM framework.
- Championing establishment of ERM.
- Developing risk management strategy for board approval.

## Roles internal auditing should **NOT** undertake.

- Setting the risk appetite.
- Imposing risk management processes.
- Management assurance on risks.
- Taking decisions on risk responses.
- Implementing risk responses on management's behalf.
- Accountability for risk management.

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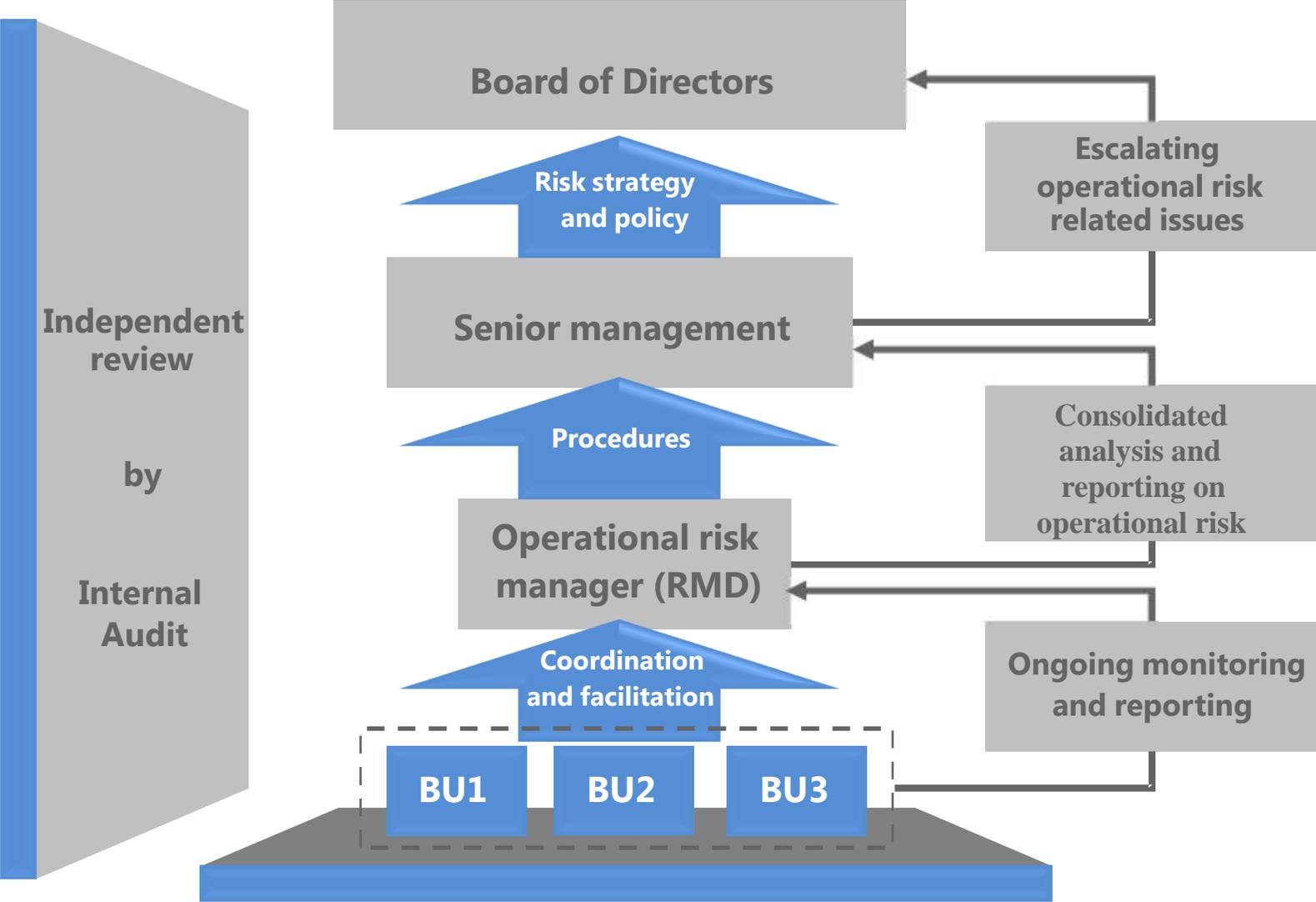
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# Framework – Operational Risk



# RCSA – Illustrative Risk Register

Risk statement outlining the cause and effect of the operational risk

Identification of key controls having significant impact on risks

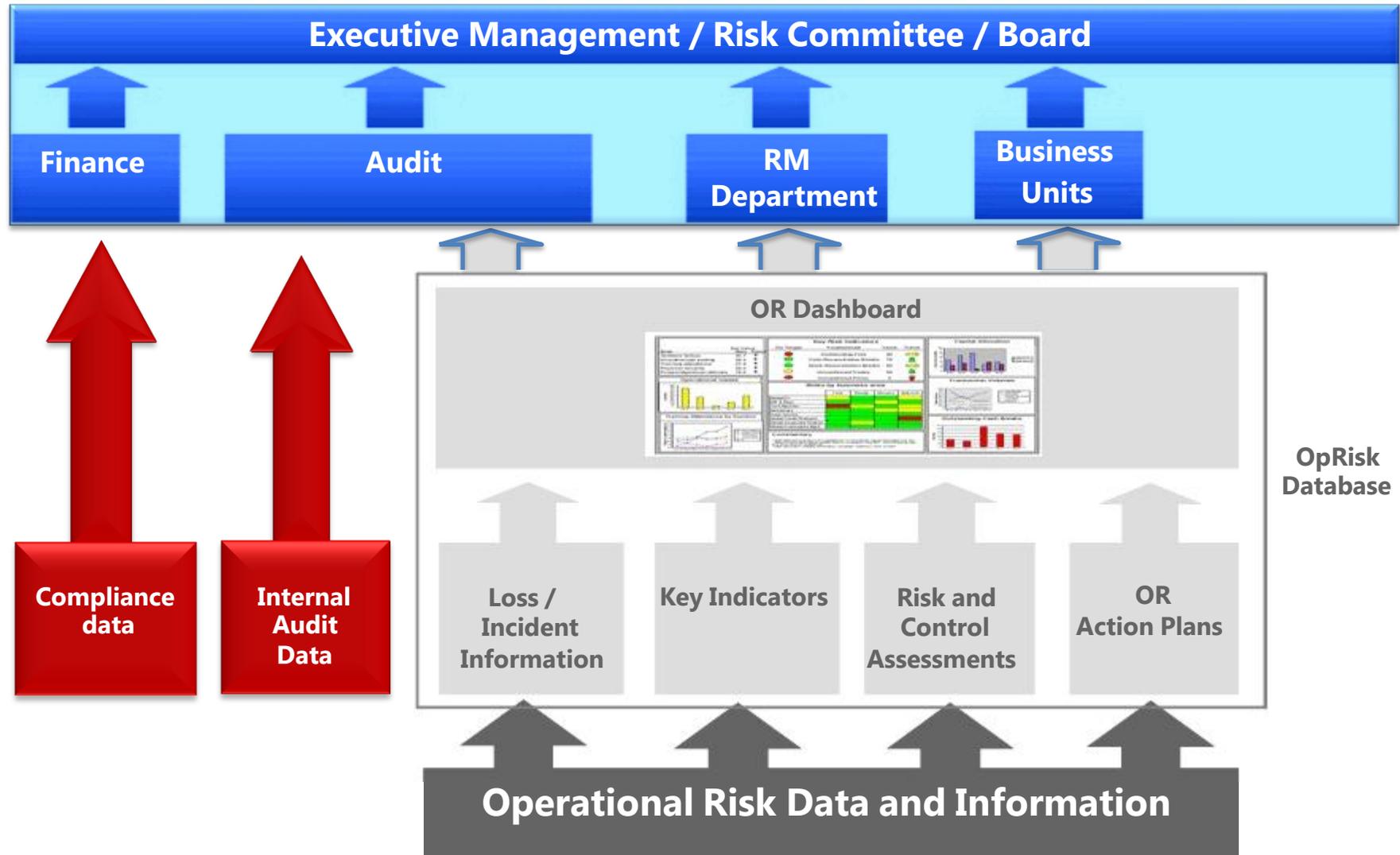
Assessment of probability of risk occurring and the financial impact assuming all existing control measures operate as designed

OPERATIONAL RISK MATRIX									
Business Line	Major Process	Activity	Base III Loss Event Type	Risk Statement	Controls		Risk Assessment		KRI
					Existing Control	Enhancements	Severity	Likelihood	
Operations Department	SWIFT messaging	Sending SWIFT messages	Transaction capture, execution and maintenance	Unable to send SWIFT message due to problems in systems, network etc.	Existing network is covered by a mirror network site. SWIFT is a standalone system		3	1	
			Transaction capture, execution and maintenance	Incorrect SWIFT message sent	Four levels check for ensuring accuracy of the SWIFT message		5	2	
			Unauthorized activity	Unauthorized SWIFT message sent	Two levels of password and authorization required		4	3	

Capture of existing risk controls that mitigate identified risk

Key Risk Indicators (KRIs) for providing an indication or an early warning of risk events

# Loss Data Collection and Reporting



# Management Action Plan: Decision Matrix



## Improve

- Areas of high inherent exposure with a low level of control must be a key priority for controls improvement activity.



## Monitor

- Areas of high inherent risk where controls are deemed adequate should be monitored.



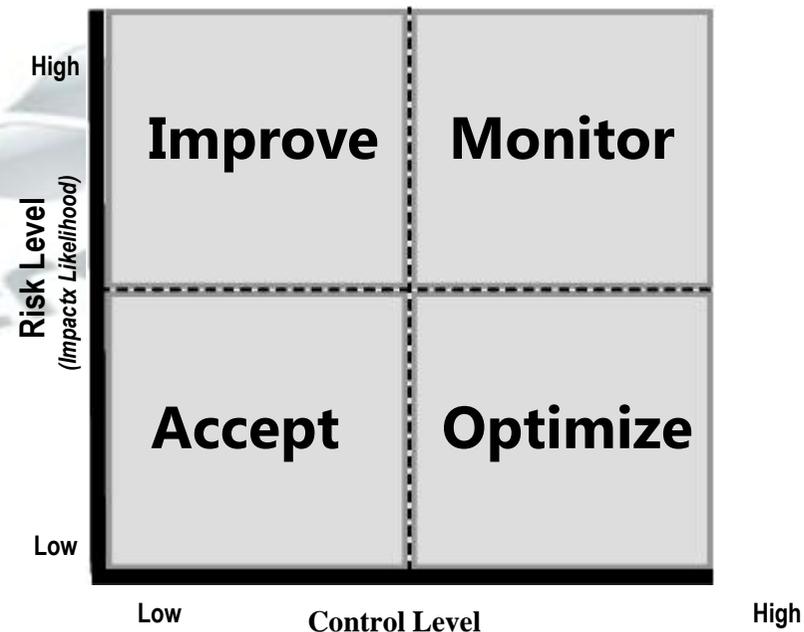
## Accept

- Risks with low inherent exposure that also have a low level of control may be consciously accepted by the organization.



## Optimize

- Areas of low inherent exposure with a high level of control may generate opportunities to optimize the process and control for efficiency.



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# Audit's Role – Regulatory Perspective

## Basel II Guidelines

- Framework review and assessment
- **Verification** of the Framework is done on a periodic basis and is typically conducted by the bank's internal and/or external audit
- **Validation** ensures that the quantification systems used by the bank is sufficiently robust and provides assurance of the integrity of inputs, assumptions, processes and outputs.

## SBP Consultative Paper

- Framework to include process of independent review and assessment including ORMS
- The validation activities conducted by internal audit provide opinion whether the capital held (or estimated) is fulfilling internal and supervisory purposes
- Results from verification and validation work should be documented and distributed Verification and validation reporting

## Central Bank of Bahrain

- Similar roles assigned to Audit w.r.t Operational Risk
- Detailed questionnaires for identification of gaps with Risk management frameworks adopted
- Once in 2 years validation of frameworks by third parties compulsory
- Central Bank monitors progress against Gap reports through monthly submission of progress reports

# Conclusion

- Effective Operational Risk framework needs all three defence lines working in coordination with each other
- Risk, Compliance and Internal Audit functions, should work as a seamless team with a single objective to improve risk management practices.