The Financial Sector: risks, controls and assurance after the financial crisis

Track A

ECIIA Conference 2009

The Financial Sector: risks, controls, and assurance after the financial crisis

Daniel Nelson
Assistant Director, Office of Internal Audit
International Monetary Fund

This presentation and its slides represent solely the personal views of the presenter and nothing here should be attributed to the IMF, its Executive Board, or its management

NIHIL EST DIFFICILE VOLENTI

Outline

- Main causes of the financial crisis
- Main lessons-learned from the financial crisis
- Internal audit’s own lessons-learned

Financial Crisis

- Timeline:
  - Summer 2007: early signs
  - 2008: economic slowdown, bank failures
  - Sep 2008: Lehman Brothers collapse
  - 2009: “The Great Recession”
- “Mark-to-Market” potential losses range from 7 to 11 percent

Four Underlying Factors

- Macroeconomic: credit boom and complex instruments
- Market discipline failures: improper incentives, and off-balance sheet tools
- Policy: weak regulatory oversight
- Risk management: not integrated in the business, model (not data) driven

Lessons-Learned from the Financial Crisis

- Emphasis on G-20 coordination
- First steps: fiscal stimulus; stronger IMF; and central banks' interventions
- Second phase: further IMF reform; financial sector (international) regulation reform and coordination
- Looking forward: coordinated exit strategies

Lessons-Learned (for internal audit)

- Our collective perspective as internal auditors is key
- Illustrative examples can point to themes for discussion and development
- The case of AIG

What Happened?

- Takeover of AIG by US Gov (Sep 2008) to prevent systemic financial meltdown
- CDSs combined with CDOs + high volumes: lucrative, but risky business
- AIGFP
- Collateral cash crunch

Some Causes (internal audit related)

- No internal audit access to AIGFP
- No ERM access to AIGFP
- Unclear responsibility for internal control
- Weak oversight by Audit Committee

Lessons-Learned Checklist

- Scope/coverage/mandate of internal audit adequate?
- Internal controls clear to all?
- Risk management up to speed?
- Is there an independent “escape valve” that internal audit can go to?
- Internal audit staff: skill set appropriate?

Other emerging themes

- Shorter audit planning span
- Quicker and more flexible responses to changing demands
- Reporting timely, clearly, concisely, convincingly (clear value)
- Incident responses/focus audit resources on high risk areas

Other emerging themes….

- Audit assurance “shelf life” shorter
- Audit more in tune with business changes
- “Market” incidents (or in other orgs): do we know if they happened to us (and where) too?
- Deep-dive risk reviews/periodic in-house risk surveys

Four other areas to consider

- Risk management: take into account velocity, preparedness, and resilience
- “Back to basics”: focus on cost savings/efficiencies, fraud weakness
- Regulatory compliance: bound to increase
- Compensation: source of risk?

Thank you