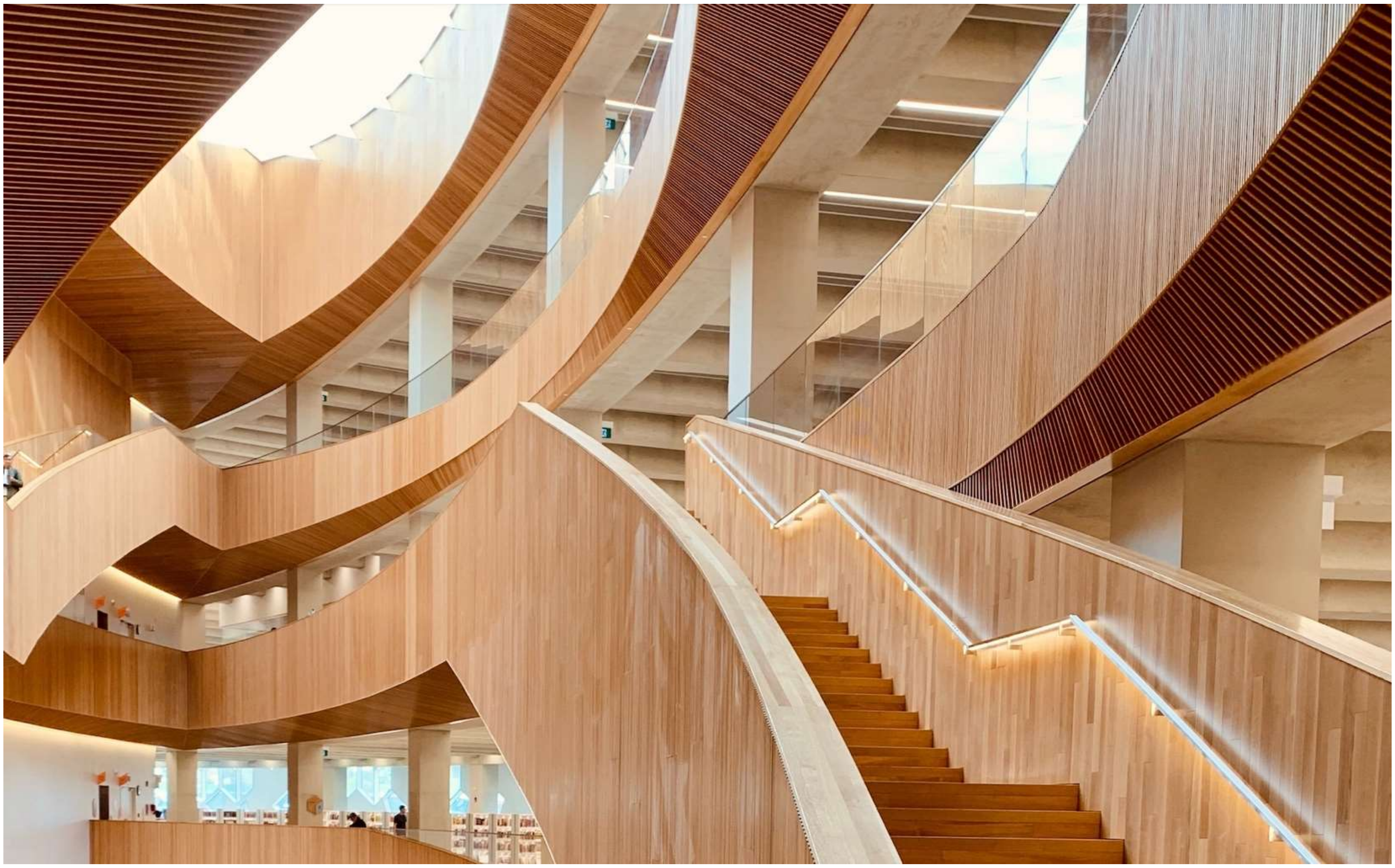

Thought Leadership

Insight creates value

Looking Back on My Experiences in Internal Audit

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Eight years ago, I was working as the head of internal audit at a foreign bank subsidiary. One day, the CEO asked if I was interested in leading the compliance department. It was an intriguing opportunity. Moving from the third line of defence to the second line meant that I would be closer to business decisions. It also meant that I would need to be more involved in developing, and sometimes even owning, controls to mitigate risks. It didn't take me long to make the decision to accept this challenge, and what a journey it has been!

As an auditor, I always enjoyed learning about different business processes at the firm. Earlier in my career, I intentionally sought out opportunities to work on assignments in different business units. This experience helped me tremendously in my compliance career, as I brought with me not only a control mindset, but also cross-functional business knowledge. That said, like other business units, I am being audited now. This provided me with new perspectives, perspectives I believe would have informed my own work and made me a better auditor had I known them before.

One thing I learnt is that management often knows where the most important risks and control gaps lie. They don't need auditors to tell them. Further, they are frustrated when audit findings are not aligned with what they see as the important issues to address. The question is, why isn't this information conveyed to the auditors at the beginning of the audit, or better, while the audit is being planned? More often than not, these are issues they are not ready to tackle yet, and they hope they can address it quietly on their own later down the road. In other words, catch me if you can.

> ### How can we solve this inherent tension between auditors and auditees?
>
> If you have the right audit culture at the firm, all you need to do is to ask in a smart way. Instead of general questions on what they think can go wrong, identify a series of relevant risk scenarios, and ask "What if this happens?" or, "What do you have in place to prevent this?" Ask if there are additional, significant risks you have missed. Most importantly, ask them to let you help. If the issue is truly important, internal audit can help the business get the resources it needs by escalating the issue to the right level of senior management.

Another realization that I came to was that too often, I was following an established work plan and writing up auditees over so-called "low-hanging fruit," – small losses that already occurred, instances where procedures had not been followed, and policies and procedures that could be tweaked. However, I didn't spend enough time re-examining what had changed in the business, digging deep to uncover the "we don't know what we don't know," issues. Keeping yourself busy with high-probability, low-impact issues can give you the false sense of security that you are doing a good job, while you remain oblivious to things that will have a big impact. Instead, you should ask the "so what" question a minimum of three times on every finding, so that you can fully appreciate the nature of the risk, and what kind of priority it should be assigned.

A common friction point internal auditors can have with management is the risk level. In my current role, I am sometimes perplexed by why auditors deem certain issues to be medium or even high risk. For example, financial institutions take regulatory risks seriously, but this does not mean any small errors in compliance should be treated as high risk.

A true risk-based approach calls for good judgement, and auditors need to be comfortable with making that call.

On the flip side of the coin, there are the big problems nobody talks about before they blow up. How do we become good at knowing what we didn't know before? We all want to learn from our failures. However, it matters what we learn from them. During the financial crisis of 2007-2008, certain banks got into subprime mortgage because they were trying to avoid the mistakes they made with loans to companies like Enron and WorldCom. They were seeking loan assets with both a good credit rating and a good return, preferably also insured to boot. It seemed too good to be true, that's when some "innovative financial engineering" came up with a perfect candidate. We all know what happened afterwards.

To learn from failures, we must know where we failed.

Internal Audit is often called in to do post-mortems. In such exercises, do not just ask how management let this happen, ask also why Internal Audit did not detect it earlier? As auditors, we sometimes find convenient answers for ourselves – for example, we don't have the resources or the expertise to stay on the cutting edge of innovation.

Looking back at my auditing career, I think it has been immensely valuable in my growth. It gave me a panoramic view of the organizations that I was fortunate to work for, by providing exposure to such a wide variety of business processes. With the knowledge I have now, there are things I would have done differently as an internal auditor, and I hope you find my reflection from the other side of the fence useful.

About the Author

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Simon Zou is the Deputy Chief Compliance Officer at Community Trust Company. He held different compliance leadership positions in the past, including the Chief Compliance Officer of the Canadian subsidiary of an international bank. Prior to his career in compliance, he was a senior internal audit manager at a major Canadian bank, before taking on the role of Head of Internal Audit at Industrial and Commercial Bank of China (Canada).