



# Oil & Gas / Mining Industry trends, inspection approaches and considerations

Elective session 11

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## Presentation overview

- ❑ O&G and Mining use similar IFRSs (e.g, IFRS 6 [*Exploration for and Evaluation of Mineral Resources*]);
- ❑ Reserves – the primary driver of a company’s value – are prepared by experts and have wide impact on financial reporting. Generally, audit and inspection implications are similar (e.g., ISA 540 [*Auditing accounting estimates*]);
- ❑ The following slides discuss specific trends, nuances, and inspection challenges in each industry.

# Oil & Gas – Agenda

## 1- Industry

- Industry overview
- Industry Trends
- Inspection take away points

## 2- Reserves and Resources

- Reserves Definitions
- Inspection take away points

## 3- Upstream

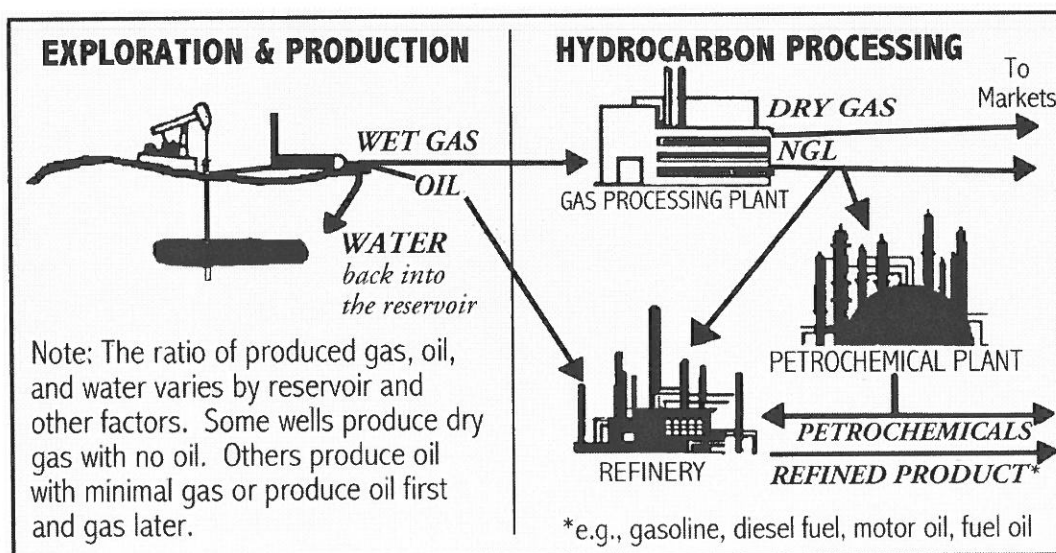
- Accounting Overview
- Inspection take away points

## 4- Midstream and Downstream

- Inspection take away points

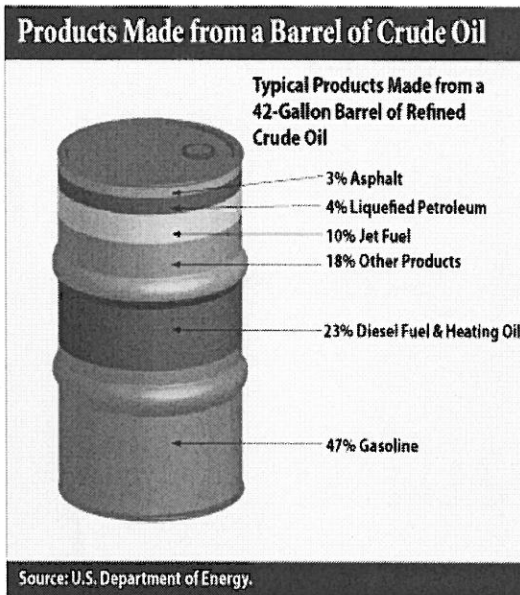
## Industry overview

# Petroleum Production and Processing Schematic



1 Extracted from petroleum accounting principles (PWC)

## Oil refining and gas processing (Midstream)



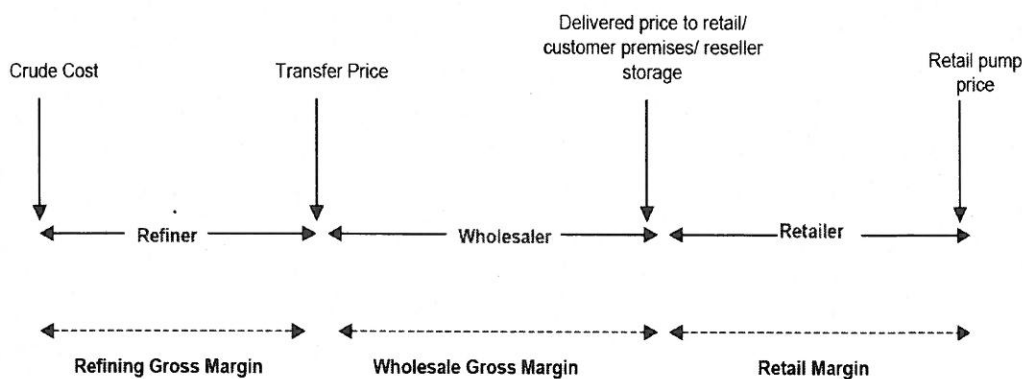
Raw gas is being processed in gas processing plants in to the following products:

Natural-gas - Transported by pipelines or by ship as LNG (liquefied natural gas). Normally sold under long-term contracts.

- Sulphur- Spot Sale
- Ethane- Spot Sale
- Natural-gas liquids (NGL): propane, butanes and pentanes plus. - Spot Sale

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## Oil Marketing down the chain (Downstream)

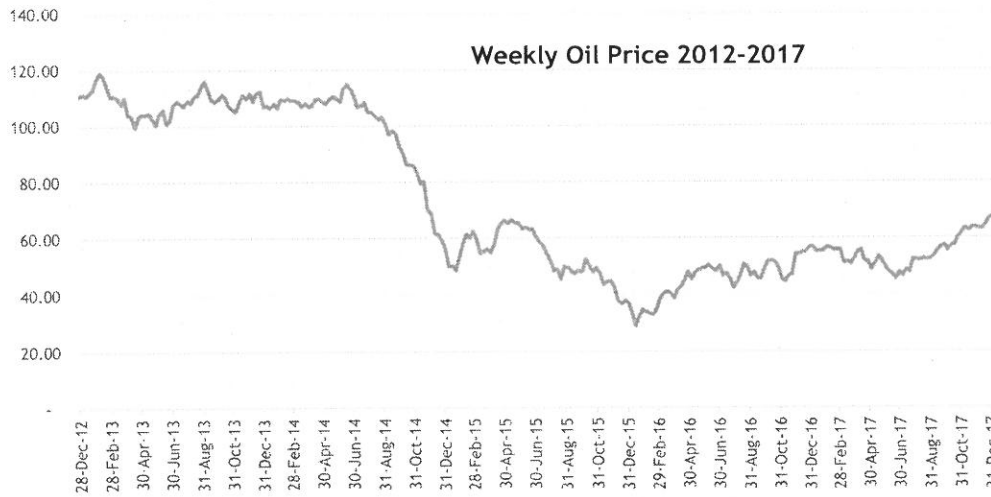


**Total Marketing Margin = Wholesaler margin + Retailer Margin**

Source: Deutsche Bank

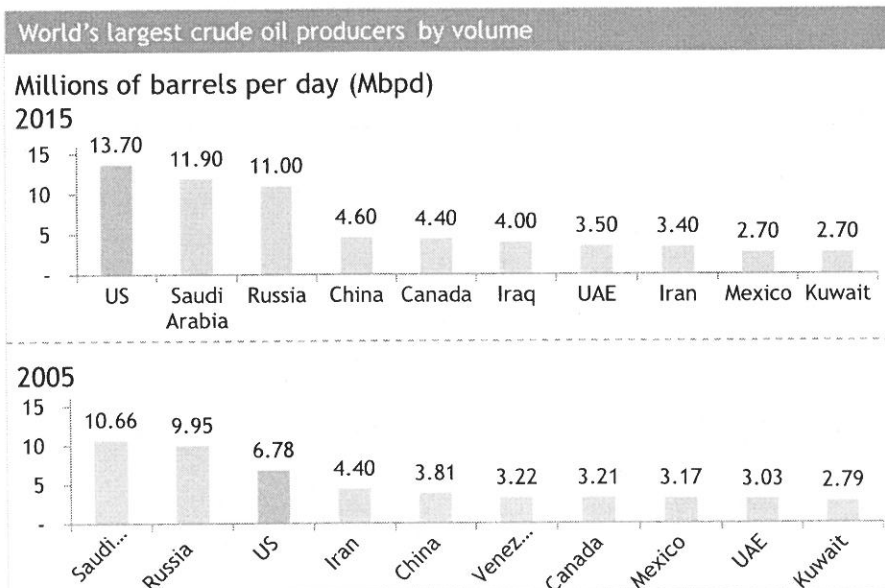
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## Oil Prices 2012-2017 significant decline in oil prices



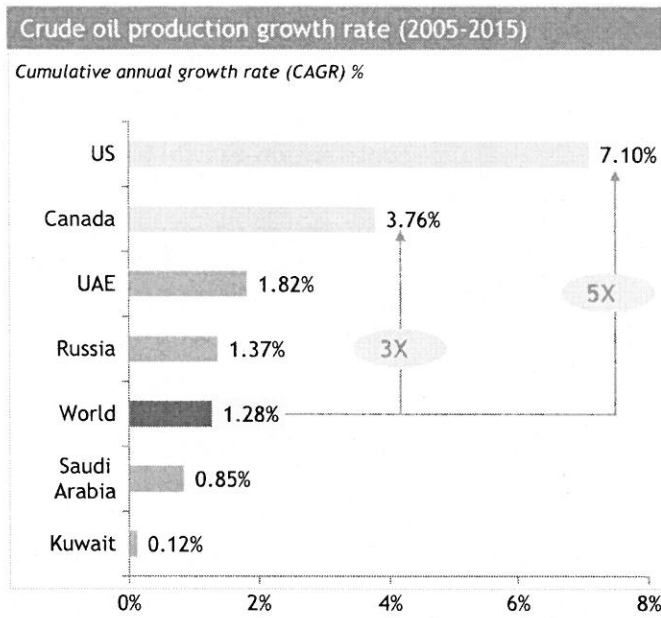
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## Which are the world's largest crude oil producing countries?



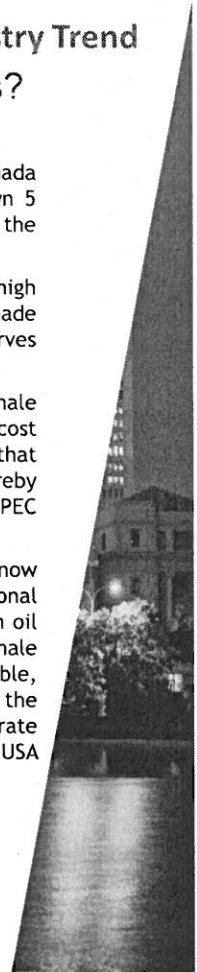
- USA has now become the top crude oil producer in the world beating Saudi Arabia and Russia.
- This is a result of the significant advancement in shale oil exploration technology in North America.

### At what rate is crude oil production growing in these countries?

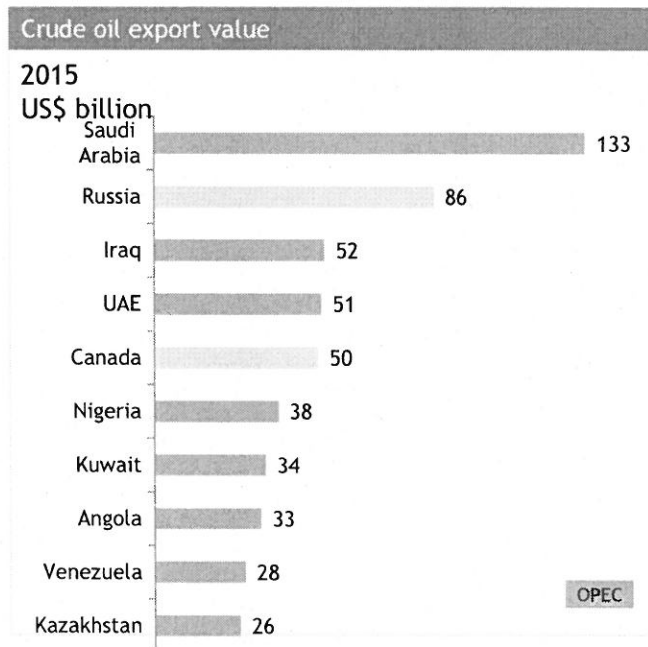


- In the past decade, US & Canada crude oil production has grown 5 times and 3 times faster than the world average, respectively.
- This was facilitated by the high global oil prices that made development of shale reserves commercially viable.
- Huge investments in shale technology is also brining the cost of drilling shale oil closer to that of conventional oil, thereby putting further pressure on OPEC nations.
- OPEC, led by Saudi Arabia, is now focusing on retaining international market share. The steep fall in oil prices is likely to make many shale oil exploration units unviable, thereby driving them out of the market and slowing down the rate of oil production growth in USA and Canada.

Source: BP Statistical Review 2015, International Energy Agency, CNNMoney - <http://money.cnn.com/interactive/news/economy/worlds-biggest-oil-producers/>

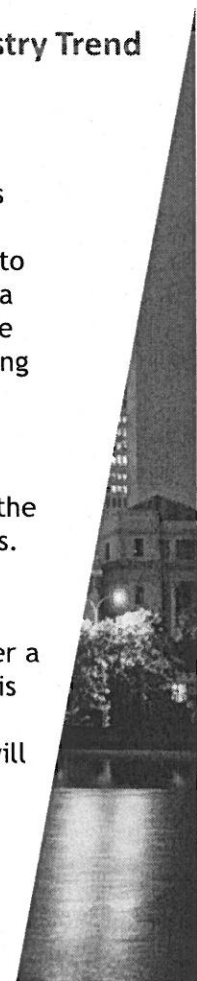


### Which are the largest crude oil exporting countries?

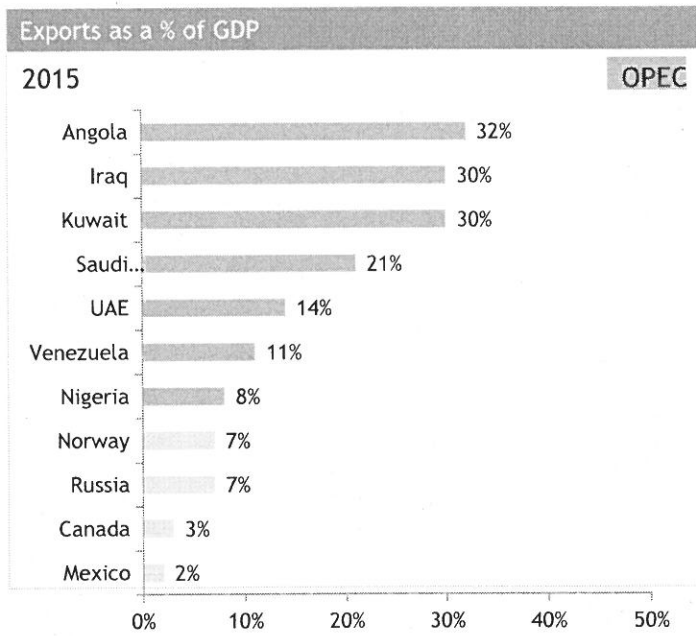


- In spite of losing its position as the top crude oil producer to the US, Saudi Arabia is still the top crude oil exporter by a long margin.
- OPEC countries continue their dominance among the top crude exporters.
- From 2016, US has started exporting crude oil again after a gap of 40 years. It is expected that US crude oil exports will grow significantly over the next few years.

Source: [www.worldstopexports.com/](http://www.worldstopexports.com/)



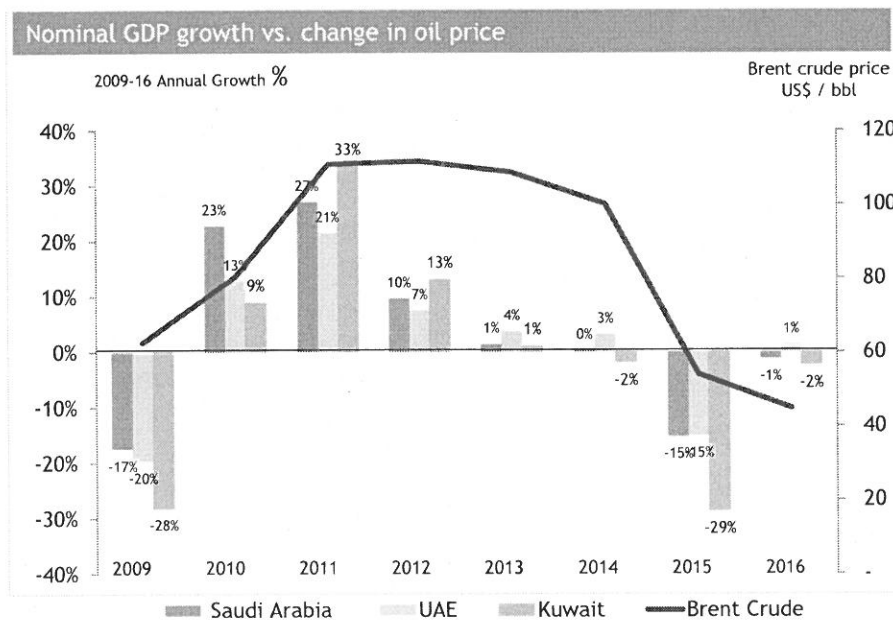
### What share of the GDP comes from oil exports?



- The sharp fall in oil prices has led to a significant reduction in oil's contribution to GDP of the country.
- The reliance on oil exports is far greater for OPEC nations than non OPEC exporters.
- This also means that in the event of an oil price crash, the economies of OPEC nations are impacted more severely than those of non OPEC exporters.

Source: IMF, [www.worldstopexports.com](http://www.worldstopexports.com)

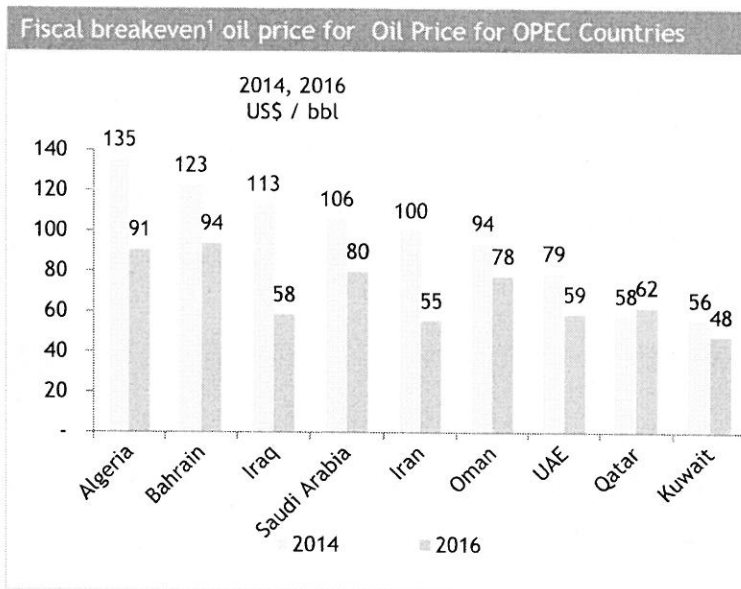
### What is the impact of crude oil price on GDP growth?



- The GDP growth of GCC countries is highly correlated to oil prices.
- Countries can see their economy (GDP) grow or shrink by a massive 20-30% per annum depending on the oil prices.

Source: IMF, Bloomberg

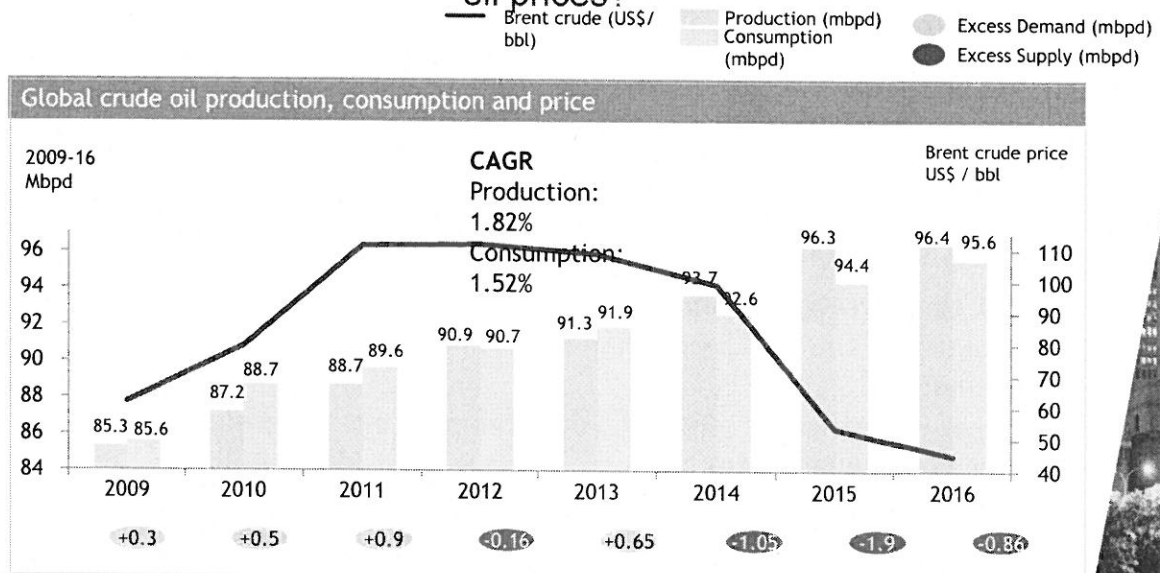
## At what oil price do opec countries achieve fiscal breakeven?



- Given the forecast for continued low oil prices over the next few years, GCC countries are looking at ways to reduce the government expenditure, thereby lowering breakeven oil prices and budget deficit.
- Most GCC countries are reducing subsidies on fuel, utilities, etc., delaying non-essential capital expenditure and optimizing costs through organizational restructuring and streamlining employee count in government entities.
- The budget break-even price of oil for UAE was US\$ 59 per barrel in 2016 and it has done well to rein in costs and bring down the fiscal breakeven oil price.

<sup>1</sup> Fiscal breakeven oil price is the price at which the government revenue of a major oil exporting country is equal to its government expenditure.  
Source: Bloomberg

## What is the impact of global oil production and consumption levels on oil prices?



- When crude oil consumption is greater than production, oil prices rise and vice versa.
- Over the past decade, oil production has grown faster than the demand for oil. The anticipated slowdown in consumption (due to China's slowing economy) and the recent fight for market share by oil producers, has led to a supply glut resulting in a crash in oil prices.

Source: International Energy Agency; BP Statistical Review 2015; Bloomberg

## Understanding the entity and its environment

Did the engagement team obtain an sufficient understanding of the

- Industry, regulatory and other factors
  - Oil reserve reporting - oil reserves are at the heart of everything.
  - Specific accounting issues, including disclosures
  - Industry specific tax issues as well as any tax implications of foreign operations
- Nature of the entity and its operations
  - Degree of vertical integration
  - The type of assets and the markets it operates in
  - The key contracts regulating its assets and operations
  - If it has upstream activities, whether the entity is an operator or non-operator and the related risks and controls that go with it.
- Has the auditor identified the significant risks associated with the engagement?

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## At the heart of everything

- Information about quantities of oil and gas reserves and changes therein is essential for users to understand and compare oil and gas companies' financial position and performance.
- Although reserves are considered unaudited, they have a pervasive effect on the financial Statements:
  - Impairment considerations - Key input in cash-flow projections
  - DD&A calculation - Oil & Gas properties are amortized using the unit of production method
  - Proved reserve estimates impact the timing for expensing field remediation and abandonment costs
- IFRS does not have specific disclosure requirements for reserves, however different standards imply that such disclosure is required. Furthermore public companies are typically required to give certain supplemental information, according to listing rules etc.

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## Reserve definitions - Society of Petroleum Engineers

Three tiered reserve levels

- Proven reserves (P1)
  - At least 90% probability that the quantities actually recovered will equal or exceed the estimate.
- Probable reserves (P2)
  - At least 50% probability that the quantities actually recovered will equal or exceed the estimate.
- Possible (P3)
  - At least 10% probability that the quantities actually recovered will equal or exceed the estimate.

RESERVES ARE NOT EASY STATISTICS BEST LEFT TO PETROLEUM ENGINEERS, BUT RATHER INHERENTLY IMPRECISE AND, JUST AS IMPORTANT, SIGNIFICANTLY INFLUENCED BY THE MANAGER'S FINANCIAL AND NON-FINANCIAL INPUT

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Reserves & Resources  
Inspection Take away

## ISA 540 Using the work of a management expert

Entities often engage a third party reserve engineering firm to prepare the oil and gas reserve estimates and sometimes also the impairment analysis.

The inspector should see to it that the engagement team has not just assessed the:

- Qualifications of the specialist
- Relationship of the specialist to the issuer

But also:

- Performed procedures to obtain an understanding of the methods and assumptions used by the specialist
- Performed procedures to test the data that was provided to the specialist by the issuer

ISA 540 guidance on auditing accounting estimates applies in full to an impairment analysis performed by an independent reserve engineering firm.

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## Inspection implications

Has the engagement team performed sufficient procedures to ensure that inputs employed in the reserve estimates are reasonable and consistently applied?  
Typical procedures can include:

- Analyzing and developing understanding for the different estimates if more than one.
- Comparing key financial inputs such as estimated future net revenues, taxes other than income taxes, OPEX and CAPEX estimates to last year's reserve calculation, including inquiring management for explanations of the variations and reconciling to actual approved budgets.
- Comparing CAPEX estimates etc. with filed development plans.
- Reconcile price inputs with external sources.
- Reconciling ownership interests employed to actual source documents.
- Compare estimated future production with actual historic production curves.
- Testing consistency in input and outputs with the entity's DD&A and abandonment cost estimates.
- Actively utilizing the knowledge of the industry and the entity in testing the assumptions, including reserve classification systems

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## Considerable variation in industry accounting practice

- For many issues there is no uniform industry practice
  - In developing their practices under IFRS companies have often borrowed from both US GAAP and SORP (UK).
  - A tendency from entities and their auditors to say that everything goes until IASB develops an IFRS for the oil & gas industry.
- IFRS 6 "Exploration for and Evaluation of Mineral Resources"
  - Not an "industry standard" and never will be
  - Narrow in scope only dealing with exploration and evaluation assets
    - Both full cost and successful efforts methods allowed
    - Must develop accounting policy for which cost to capitalize and what CGU to apply for impairment purposes
  - All other E&E accounting aspects scoped out and other IFRS's apply
  - Reclassification of E&E assets when technical feasibility and economic viability demonstrable - IAS 16 and IAS 38.

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## Considerable variation in accounting practice

DD&A - Production unit method (IAS 16 & IAS 38):

- Which reserves should be used in nominator & denominator?
  - Proven or proven & probable
  - Developed or developed & undeveloped. If undeveloped are included - should then estimated future development costs be included?
  - Working interest or entitlement
  - Relevant IFRS concepts from IAS 16 / IAS 38: depreciable amount, useful life, pattern of consumption of future economic benefit

### Impairment

- Unit of account - The individual field is typically the CGU.

## Considerable variation in accounting practice

Other significant issues - Find solutions under other existing IFRS's

- Revenue recognition - Entitlement method vs. Sales method
  - Accounting for imbalances as over-/underlift - both measurement and presentation issues
- Royalties & Taxes
  - Whether it is an income taxes included in the scope of IAS 12 "income taxes". Part of revenue or not
- Accounting for joint ventures and production sharing agreements
- Business combinations
- Is the transaction an asset purchase or a business combination

# Asset purchase or Business combination

- ▶ Is it a business combination?
- ▶ A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or economic benefits...
  - ▶ A business consists of inputs and processes applied to those inputs that have the ability to create output.
  - ▶ Outputs are not required for an integrated set to qualify as a business. Hence, neither income nor production need exist.

- ▶ Significant accounting differences
- ▶ In an asset purchase transaction the acquisition cost is allocated between the identifiable assets and liabilities based on their relative fair values:
  - No goodwill is recognized
  - Deferred tax normally not recognized
    - Due to the initial recognition exemption in IAS 12.
  - Transaction costs are generally capitalized
  - If settlement in shares then IFRS 2 Share-Based Payments apply

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## Upstream Inspection Takeaway

### Key inspection considerations

Has the auditor performed sufficient and appropriate procedures to ensure that the entity:

- Has developed detailed accounting principles including all industry specific issues relevant for their business
- Discloses these principles with sufficient detail in the Financial Statements
- Applies the stated accounting principles in a consistent manner

Last but not least - does the shoe fit and give a true and fair view of the business?

## Inspection issues

- Over Lift / Under Lift
- Cut-Off procedures
- Statutory Auditors Coverage and Sampling Techniques
- Analytical Procedures
- Finished goods costing and cost allocation
- Lifting's Audit-3<sup>rd</sup> Party evidence (Bill of Ladings)
- Attending inventory counts
- Revenue & Inventory Reconciliation
- Physical and financial purchase and sales contracts
  - IAS 39 contract analysis and valuation

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## Oil & Gas – Relevant IFRS

- IFRS 6- Exploration & Evaluation for mineral resources
- IFRS 3 Business Combinations
- IAS 16 Property Plant & Equipment
- IAS 36-Impairment of Assets
- IAS 38-Intangible Assets
- IFRS 16/IAS 17- Leases
- IFRS 10/IAS27- Consolidated financial Statements
- IAS 12 Income taxes

# Oil & Gas – reference sources

- BP Statistics report;

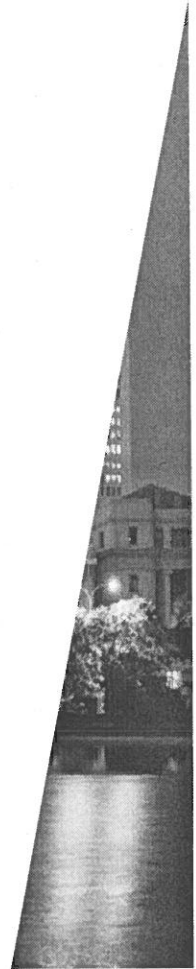
<https://www.bp.com/content/dam/bp/en/corporate/pdf/energy-economics/statistical-review-2017/bp-statistical-review-of-world-energy-2017-full-report.pdf>

- EY Oil & Gas Outlook

<http://www.ey.com/gl/en/industries/oil---gas/ey-2018-outlook-of-oil-and-gas-analyst-themes>

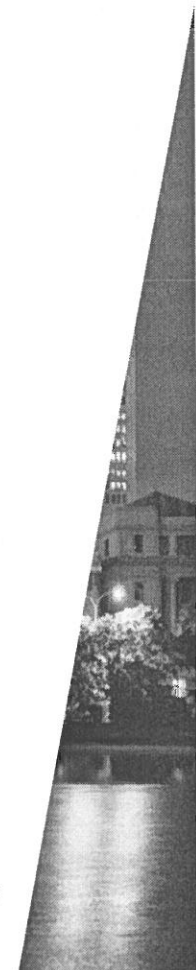
- PWC Oil & Gas Outlook

<https://www.strategyand.pwc.com/trend/2017-oil-and-gas-trends>



# Mining – agenda

- I. Industry overview
- II. Inspection overview
- III. Specific inspection considerations
- IV. Mineral reserves and resources
- V. Common guidance
- VI. Take away points
- VII. Reference sources



## Mining – industry overview

- ❑ Providing competitive shareholder returns [2016 – commodity price];
- ❑ Maintaining cyber security [2016 – social license];
- ❑ Maximizing digital productivity [2016 – access & replace reserves];
- ❑ Finding new world commodities [2016 – Labour / skills shortage].

*Note the overall uptick in the market.*

**Source:** *Big Four Mining Surveys*

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## What else happened in mining – 2017?

- ❑ It was better than 2015 and 2016
  - ▶ Prices stabilized / increased. (However, this depended on which metal was taken out of the ground.)
- ❑ Demands are up
  - ▶ China has approximately 70% of global iron ore demand and 40% of copper demand;
  - ▶ Lithium and cobalt are currently the “it” commodities (batteries !) and at the other end of the spectrum is thermal coal.

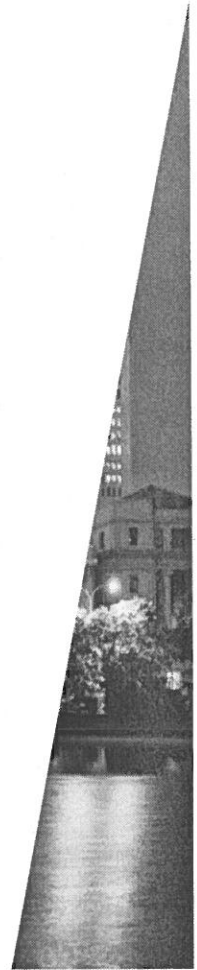
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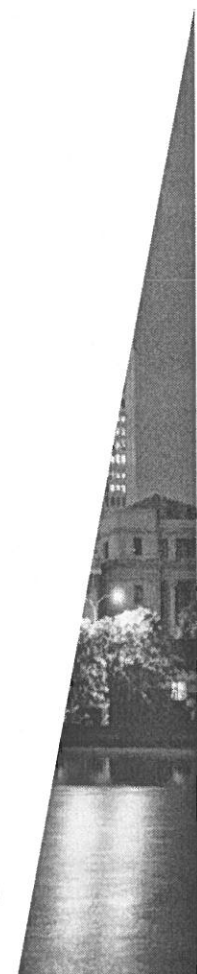
# What else happened in mining – 2017?

- Balance growth and financial discipline
  - ▶ Convince the market to play the long game;
  - ▶ Squeeze more values out of existing assets;
  - ▶ Control operating costs;
  - ▶ Mothball marginal projects / exit non-core assets.
- Alternative financing arrangements are more widespread to attract capital
  - ▶ Assess based on contracts' facts & circumstances.



## Mining – inspection overview

1. Use of FV accounting estimates (e.g., in impairment calculations, in acquisitions, in conversion rates from Resources to Reserves, etc.);
2. Extent of audit work required when relying on management's expert (e.g., \*Technical Reports) or auditor's expert (e.g., internal valuation expert);
3. Auditing alternative financing arrangements (e.g., streaming arrangements);





## Mining – inspection overview

4. Auditing reversals of impairment losses;
5. Allocation between OpEx (P&L) and CapEx (Balance Sheet);
6. Adequacy of group audit instructions;
7. Use of non-GAAP measures as KPIs.

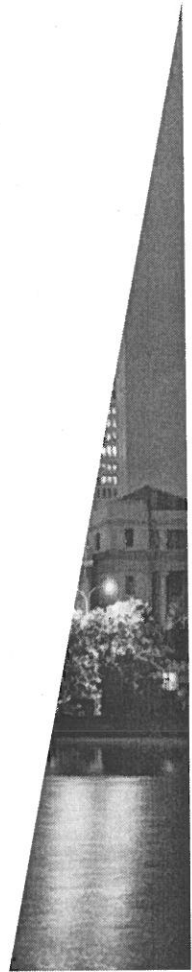
## Mining impairment considerations

- Are indicators of impairment and/or reversal of impairment appropriate under IFRS 6 for Exploration & Evaluation (EE) assets or IAS 36 for non-EE assets ?
- Have estimates of recoverable amounts (e.g., valuation models and inputs & assumptions) been appropriately assessed under ISA 500 for relying on management's experts, ISA 620 for using auditor's experts and ISA 540 for auditing accounting estimates ?

# Mining impairment considerations

## □ Management's experts (e.g., geologists) are used to estimate mineral reserves & resources in Technical Reports:

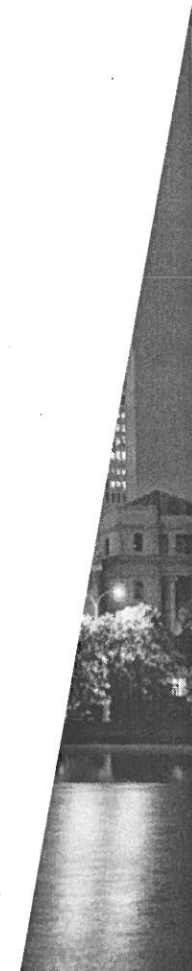
- ▶ Has competency of the expert been assessed against professional qualifications, reputation, etc. ?
- ▶ Has objectivity of the expert been assessed against ownership interests in company & property, compensation arrangements (e.g., bonus on increasing reserves), etc. ?
- ▶ Has an understanding of the expert's work been obtained by discussions, reviewing contracts, compared to prior work (if applicable) or source of data for consistency, etc. ?



# Mining impairment considerations

## □ Challenges on valuation models and inputs & assumptions:

- ▶ Has an auditor's expert (e.g., valuation) been used to assess appropriateness of models, discount rates, etc. ?
- ▶ Have commodity forward prices (a key driver of value) been compared to third party forecasts, current long-term contracts (e.g., streaming contracts), macro assumptions, etc. ?
- ▶ Have Production, OpEx and CapEx been compared to current period actual results, management approved budgets, life of mine models, etc. ? Are there "spikes" (upward or downward) not supported by production schedules ?



# Mining impairment considerations

USD	2018 outlook	Dec. 31, 2017	Dec. 31, 2016	Dec. 31, 2015
Gold / oz.	\$1,300	\$1,300	\$1,250	\$1,060
Iron ore (62 Fe) / MT	\$60	\$71	\$45	\$56
*Uranium / lb.	\$31	\$22	\$30	\$34
Copper / lb.	\$3.00	\$2.77	\$2.21	\$2.13

# Mining impairment considerations

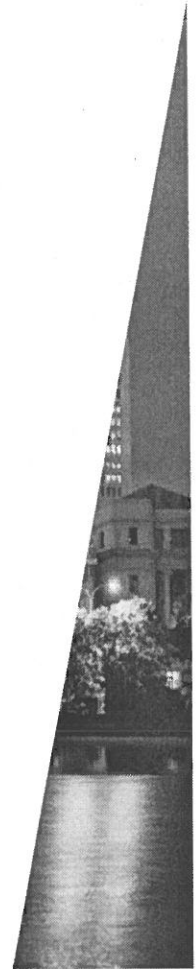
## □ Forward commodity price considerations:

- ▶ Previous slide is Scotiabank 2018 commodity price index;
- ▶ However, there are many price outlooks (e.g., London Metals Exchange, World Bank, etc.). Does the company consistently use same pricing source(s) or different ones each year ?
- ▶ Does the company have long-term contracts at lower/higher prices ? If yes, have these prices been reflected in the valuation model ?
- ▶ Outlook prices may be in a different currency than the company's functional currency. What is the foreign exchange impact on the valuation model ?

# Mining impairment considerations

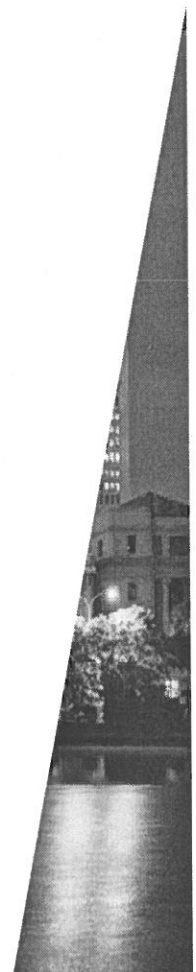
## □ Mineral reserves and resources considerations:

- ▶ Does the valuation model include just mineral reserves or mineral reserves and resources?
- ▶ When mineral resources are used as inputs in a valuation model, has an *appropriate discount* been applied to reflect their lower geological confidence ? (This is typically known as “value beyond proven and probable or VBPP”.);
- ▶ Discount on price – copper reserves may be valued at \$3/lb. whereas VBPP for copper resources may be at \$0.05/lb; or
- ▶ Discount on quantity – conversion rates from Resources to Reserves should be property-based rather than the company’s average rates.



# Mining revenue considerations

- Is there an internal “marketing operation” ? If yes, how were external trades recorded to facilitate revenue recognition under IAS 18 ?
- For direct third party sales, are there other contract terms to consider (e.g., provisional pricing terms) ?
- Are sale transactions supported by complex IT systems and other IT-dependent applications ?

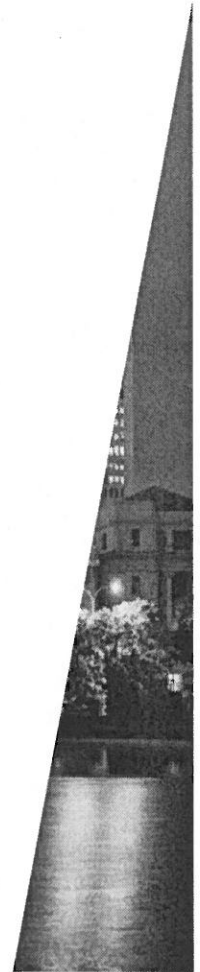


# Mining revenue considerations

## □ Streaming arrangements (Producer):

- ▶ Is it a “commodity” arrangement where the Producer will deliver a set quantity of the commodity to the Investor (i.e., settle with commodity from Producer’s operations) ?
- ▶ Is it a “debt” arrangement where the Producer has to provide cash or another financial asset if physical delivery is not met ?
- ▶ Is it a “sale” arrangement and a contract to deliver future services (e.g., extraction, refining, etc.) ?
- ▶ Is the determination of above arrangements based on review of signed contracts ?

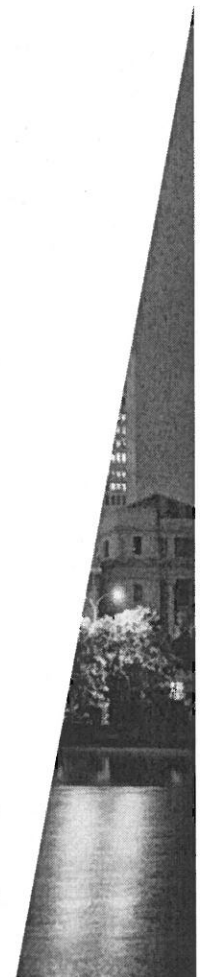
Revenue recognition is different for each arrangement.



# Mining revenue considerations

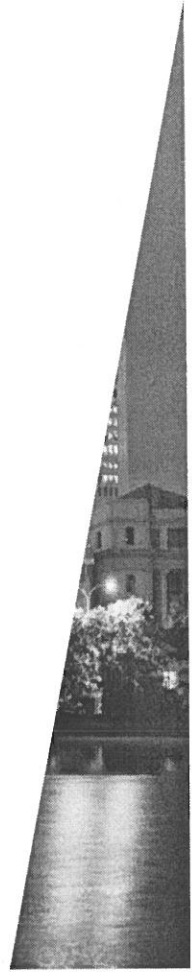
## □ Provisional pricing arrangements:

- ▶ Has revenue been recognized when risks and rewards transferred (typically at delivery date) ?
- ▶ At each subsequent period-end, has the transaction been marked to market with changes recorded in revenue ?
- ▶ Has the company hedged the transaction ? If yes, is the matching derivative fair valued at each period-end and matched against the transaction ?
- ▶ Is the above transaction electronically initiated, processed and recorded ? If yes, are substantive procedures alone sufficient to capture the completeness and accuracy of the transaction ?



## Mineral reserves and resources (MRMR)

- ❑ Reserves (2 categories) – estimates of Proven & Probable reserves prepared by a Qualified Person or QP (e.g., geologist) at high levels of geological confidence;
- ❑ Resources (3 categories) – estimates in addition to reserves at decreasing lower levels of geological confidence [Measured > Indicated > Inferred], also prepared by a QP.



## Mineral reserves and resources (MRMR)

- ❑ Similar to O&G reserves, MRMR are key to financial reporting and related audit / inspection implications;
- ❑ Estimates of MRMR are [i] communicated to the public through Technical Reports and [ii] subject to regulatory rules (e.g., OSC) and guidelines (e.g., CIM).



## Mining technical reports (3 types)

1. Feasibility Study (FS) – an *appropriately detailed* assessment of whether extraction is “reasonably justified / economically mineable” (i.e., highest confidence level provided by QP);
2. Pre-feasibility Study (PFS) – an assessment of a project’s technical and economic viability.

FS and PFS contain estimates of reserves & resources.

3. Preliminary Economic Assessment (PEA) –similar to a “marketing brochure” and contains only estimates of resources.

## Mining technical reports (3 types)

Technical reports are required by securities commissions upon:

- 1<sup>st</sup> time reporting in Canada (e.g., prospectus, take-over bid, offering memorandum, etc.); or
- Material\* change to a property’s MRMR.

*\*Materiality is not defined. General practice is to assess materiality of a property based on the company, which could change over time.*

## Common key IFRSs

- IFRS 6 [*Exploration for and evaluation of mineral resources*]
  - ▶ Assess impairment for Exploration & Evaluation (“EE”) assets (i.e., IAS 36 [*Impairment of assets*] not applicable);
  - ▶ Contain examples of expenditures that might be included in EE assets;
  - ▶ Reclassify EE assets when the technical feasibility & commercial viability of extracting a mineral resource are demonstrable (through filing of Technical Report).

## Common key IFRSs

- IAS 36 [*Impairment of assets*]
  - ▶ Assess impairment for non-EE assets, including goodwill;
  - ▶ Contain measurement criteria;
  - ▶ Provide guidance on reversing an impairment loss.
- IAS 16 [*PP&E*]
  - ▶ Units of production is typically used to estimate amortization;
  - ▶ Expected total production can be [a] Reserves or [b] Reserves + a portion of Resources to be converted into Reserves;
  - ▶ Updates to Reserves/Resources are changes in accounting estimates (IAS 8 [*Accounting policies*]).



## Other Mining guidance (non-authoritative)

Canada has a Mining Industry Task Force to share views on IFRS application issues. Select examples include:

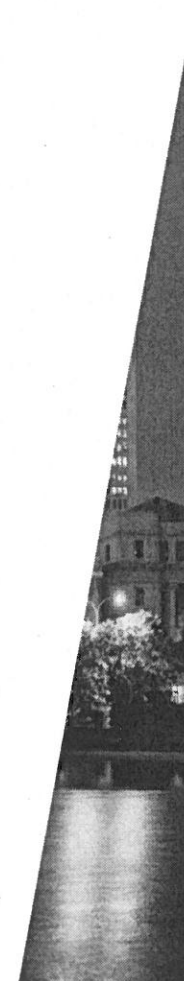
- ❑ Determining technical feasibility – June 2017;
- ❑ Reversal of impairment losses – July 2015;
- ❑ Accounting for streaming arrangements – July 2014;
- ❑ Asset acquisition vs. business combination – Oct. 2012.

Source: [www.cpacanada.ca/viewpoints](http://www.cpacanada.ca/viewpoints)



## Mining – take away points

- ❑ Commodity prices stabilized in 2017, leading to a better year than 2015 and 2016;
- ❑ Companies are focused on improving shareholder returns through higher productivity & lower costs;
- ❑ Inspection challenges included insufficient testing of [i] inputs & assumptions in valuation models for impairment & acquisitions and [ii] alternative financing arrangements.



# Mining – reference sources

- ❑ The Ontario Securities Commission Securities Act & relevant national instruments (e.g., NI 43-101) – [www.osc.gov.on.ca](http://www.osc.gov.on.ca);
- ❑ The Canadian Institute of Metals, Metallurgy and Petroleum standards and guidelines – [www.cim.org](http://www.cim.org);
- ❑ The Committee for Mineral Reserves International Reporting Standards – [www.criirco.com](http://www.criirco.com);
- ❑ Chartered Professional Accountants Canada viewpoints – [www.cpacanada.ca/viewpoints](http://www.cpacanada.ca/viewpoints).





# Root cause analysis

Elective session 2

Chris Hibbert, UK

Martin Samuelsen, Denmark

Imre Nagy, South Africa

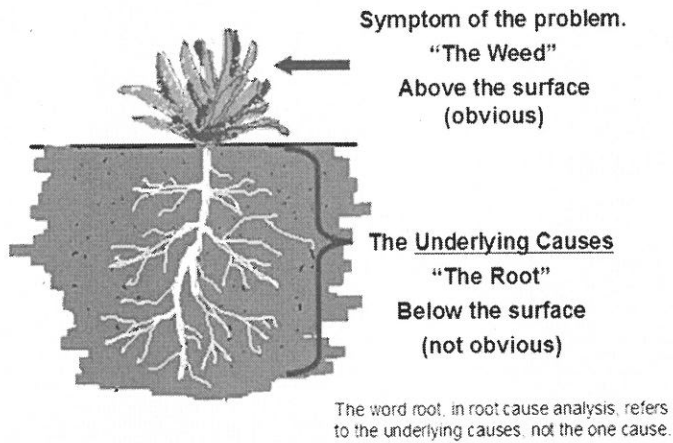
IFIAR INSPECTION WORKSHOP 20–22 FEBRUARY 2018 COLOMBO, SRI LANKA

## Overview of session

- ▶ Objectives of RCA
- ▶ GAQ WG discussions with firms
- ▶ Comparison of Big 4 firm processes
- ▶ Review of RCA in practice
  - ▶ UK
  - ▶ Denmark
  - ▶ South Africa

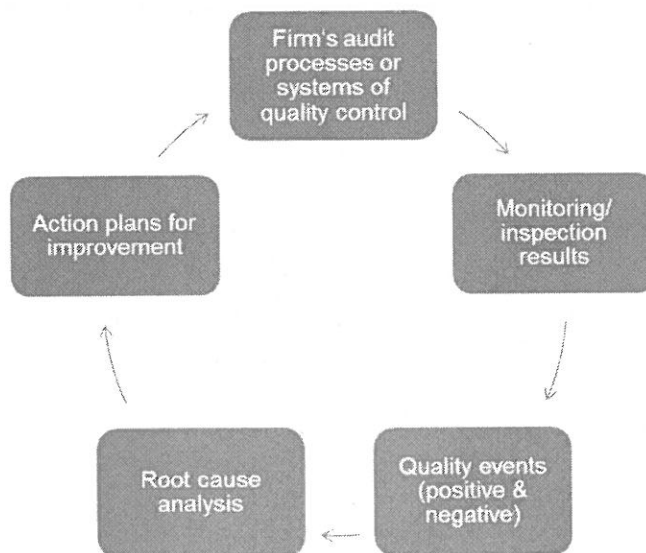
# Objectives of RCA

## Root Cause Analysis Basics



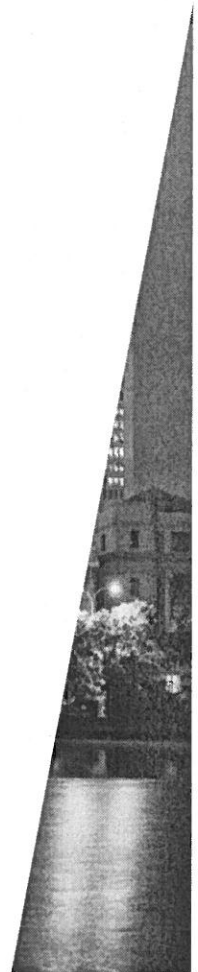
# Objectives of RCA

## Continuous audit quality improvement



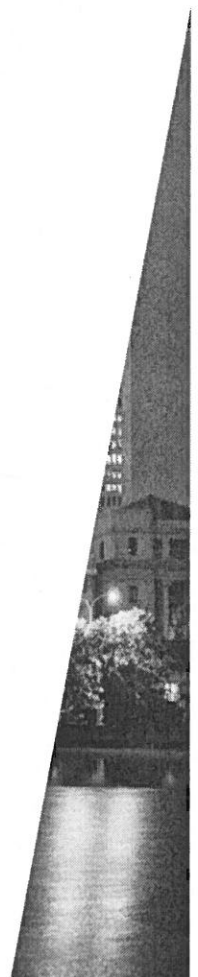
## GAQ WG – Discussion with firms

- ▶ Meetings between GAQ WG and Big 6 firms in recent years
- ▶ Increased formality of RCA processes and guidance by firms
- ▶ Questionnaires on RCA process updated annually by firms (available to IFIAR members on request)
- ▶ Latest guidance provided by firms (these can be obtained from local members firms)



## Comparison of Big 4 firms Global requirements

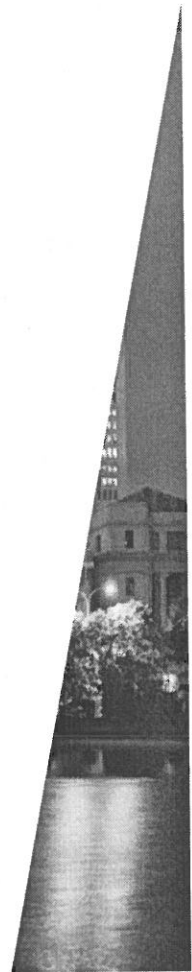
- ▶ All Big 4 require RCA to be performed by member firms
- ▶ The firms have informed us that at least all of the top ten largest member firms of each network carried out RCA in the last year



# Comparison of Big 4 firms

## Scope of RCA (1)

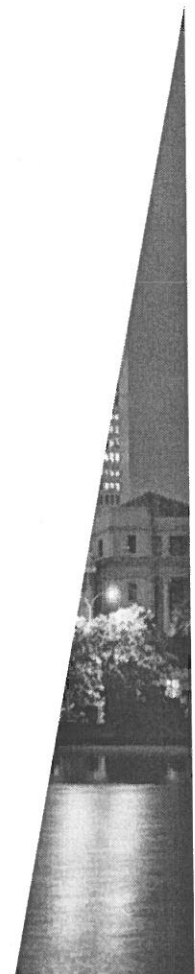
- ▶ Minimum requirements for performing the RCA vary by firm:
  - ▶ Where there is one or more audits rated with the lowest grade in the internal quality monitoring and significant deficiencies in external inspections
  - ▶ For individually significant findings
  - ▶ For any member firm that has not obtained the highest overall quality rating
  - ▶ The other firm doesn't specify the minimum requirements, but indicates that the scope of the RCA is determined by the nature and severity of inspection findings
  - ▶ All firms indicate that it should cover both internal and external inspection findings (for file reviews and firmwide quality control)



# Comparison of Big 4 firms

## Scope of RCA (2)

- ▶ Member firms can decide on the exact scope (regarding the extent of inspection findings to be covered in the RCA) and it is subject to judgment
- ▶ Other quality events (other than inspection findings) - three firms indicate in their guidance that other types of findings would be included, including financial statement restatements; one firm indicates these should be considered
- ▶ Themes - three firms indicate that themes should be identified across a number of reviews. One of these has detailed guidance on analysing the findings across auditing standard requirements in its guidance



# Comparison of Big 4 firms

## Scope of RCA (3)

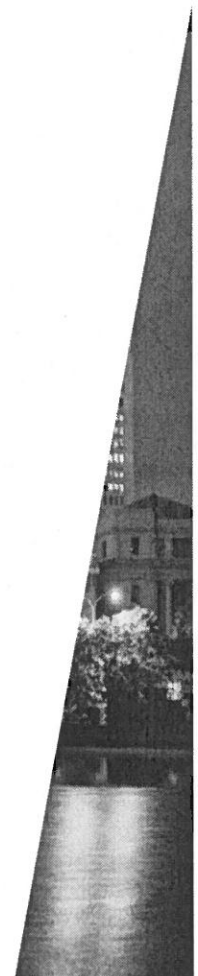
- ▶ The firms encourage coverage of positive quality events (i.e. good practice not just negative findings)
  - ▶ The guidance says a selection of positive outcomes is required to be included
  - ▶ “Included as part of global framework”
  - ▶ “Not required”, but included in guidance
  - ▶ “Process includes consideration of positive quality events”. Guidance includes separate section on how to apply process for compliant audits



# Comparison of Big 4 firms

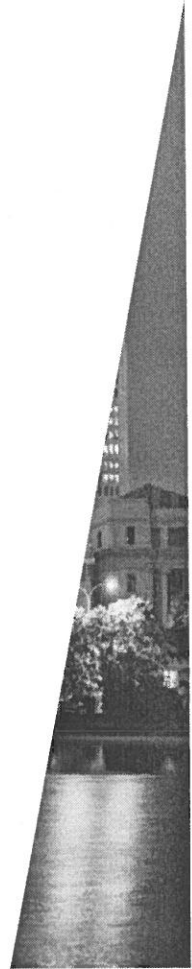
## Timing

- ▶ Timing requirements for completion of RCA varies by firm:
  - ▶ “Within 60 days of when an issue or topic is determined to require corrective action”
  - ▶ “Within 120 days of the quality occurrence”
  - ▶ No target date given, but the firm indicates the timing varies depending on the issues and can take 30-90 days or longer to complete
  - ▶ “RCA activities start immediately and while in the field”. No target date for completion of RCA for specific quality events, although quality improvement plans are due by 30 November of each year



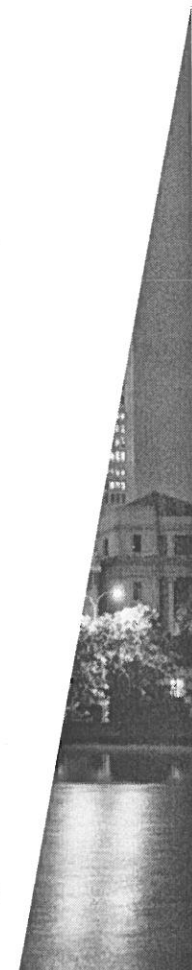
# Comparison of Big 4 firms Guidance by firms (1)

- ▶ All Big 4 firms have issued guidance and have enhanced them in the last year
- ▶ The timings of the latest guidance varies by firm:
  - ▶ March 2017 – enhanced
  - ▶ May 2017 – enhanced
  - ▶ June 2017 – enhanced
  - ▶ September 2017 – enhanced



# Comparison of Big 4 firms Guidance by firms (2)

- ▶ Are member firms required to follow the guidance? The responses to the questionnaires varied by firm:
  - ▶ “Expected to be followed”
  - ▶ “Mandatory for firms that meet the criteria” (i.e. when lowest grades)
  - ▶ “Effectively mandatory”
  - ▶ “Yes” as part of preparing quality improvement plans

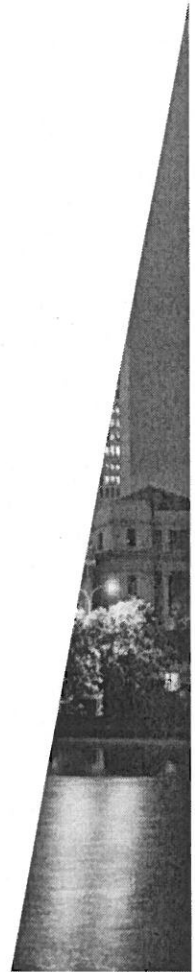




# Comparison of Big 4 firms

## Guidance by firms (3)

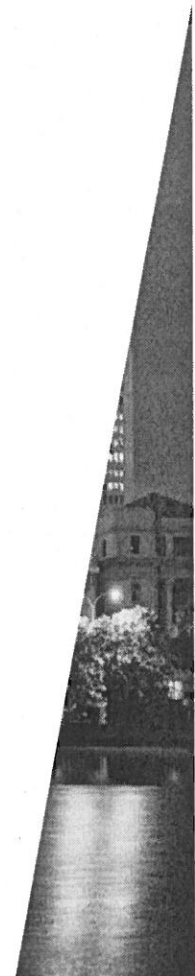
- ▶ Contents of guidance varies by firm:
  - ▶ One firm has included some of it's guidance in its training slides
  - ▶ One firm's guidance includes a separate toolkit with a number of templates
  - ▶ All include appendices, templates or other documents on conducting interviews and interview sample agendas



# Comparison of Big 4 firms

## Resourcing

- ▶ Member firms are responsible for carrying out the RCA. There is some guidance on the individuals who should perform the RCA:
  - ▶ Firms generally expect it to be performed by audit partners or directors
  - ▶ The firms sets out expectations of level of authority and experience, although guidance is brief
- ▶ Those involved in the RCA generally aren't involved in the internal monitoring of the same reviews:
  - ▶ One firm doesn't allow this, although says they can be consulted to clarify issues
  - ▶ One firm says the internal monitoring team has a limited role in the RCA
  - ▶ Two firms say the internal quality monitoring team can provide input into the RCA process



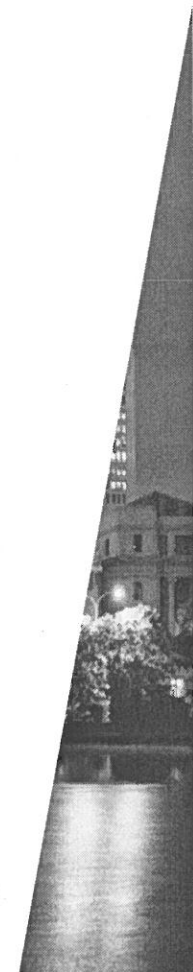
# Comparison of Big 4 firms Training

- ▶ Training varies by firm:
  - ▶ Regional workshops have been held for three of the firms
  - ▶ One firm has provided training through interactive webcasts
  - ▶ The global firms and/ or regions provide or co-ordinate the training



# Comparison of Big 4 firms What's included in RCA process (1)?

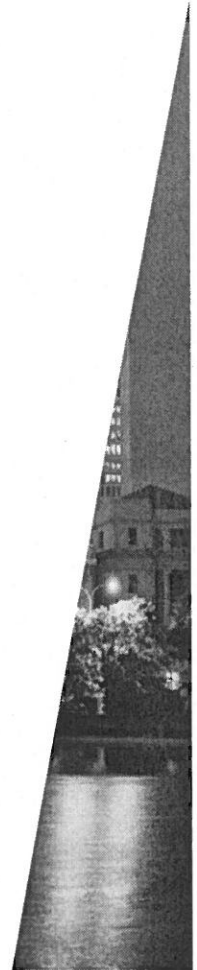
- ▶ Interviews with audit teams
  - ▶ Required or encouraged as part of process by all firms. Guidance on how to conduct them in all firms' guidance, with templates
  - ▶ Little guidance on who should be interviewed (audit partner, EQCR, manager and junior staff)
  - ▶ Two firms also suggest focused group interviews in their guidance
- ▶ Review of AQIs
  - ▶ Encouraged with suggested AQIs in guidance (which vary by firm)
  - ▶ Mainly covering time related information (e.g. hours by partner and manager)
  - ▶ Guidance limited in this area
- ▶ Other areas included in process
  - ▶ One firm suggests completion of surveys in its guidance
  - ▶ Another firm includes an analysis of themes by auditing standard



# Comparison of Big 4 firms

## What's included in RCA process (2)?

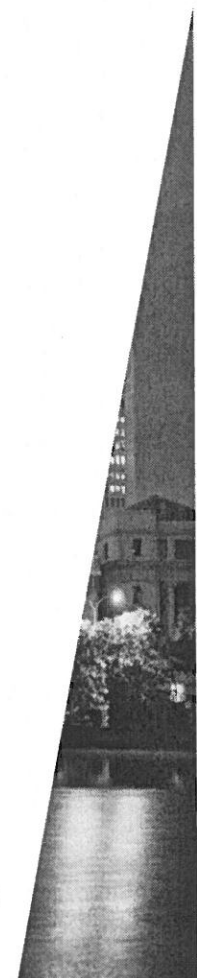
- ▶ Does the guidance provide the methodology to determine the root causes?
  - ▶ One firm sets out a number of techniques, including “coding and categorization” and “the five whys”
  - ▶ One firm incorporates RCA methodology into its system
  - ▶ The other firms provide guidance on how to categorize the causes, although there is limited guidance on the methodology to follow to determine the root causes, once the data has been collated from analysis, interviews etc



# Comparison of Big 4 firms

## Monitoring and reporting

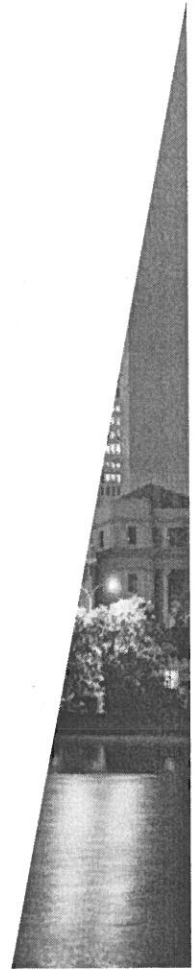
- ▶ Monitoring of RCA
  - ▶ RCA is the responsibility of each member firm
  - ▶ The firms monitor at a global level (as well as at national and regional level)
- ▶ Reporting of RCA results required by global
  - ▶ Two firms have a system to collate results for internal findings (one for external)
  - ▶ Others include templates to document the RCA findings, but not clear how communicated to global
- ▶ RCA findings incorporated into quality improvement plans?
  - ▶ Yes, required to be included in plans by September of each year and plans required to be updated quarterly
  - ▶ To be included in action plans within 120 days of quality occurrence”
  - ▶ “Generally yes” (no deadline given)
  - ▶ Yes, required to be incorporated by November each year



## Comparison of Big 4 firms

Observed practices in RCA processes (at one or more firms)

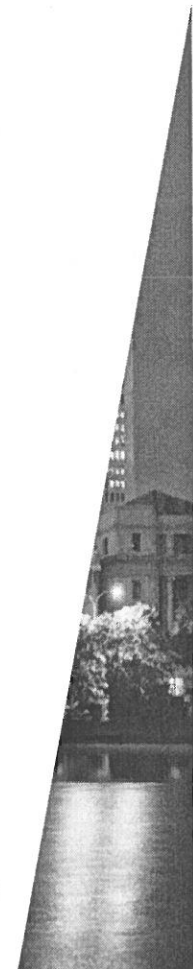
- ▶ Clear explanation of the different steps and how they fit together
- ▶ Use of examples in guidance in demonstrating how it would be applied in practice
- ▶ Guidance on how to review positive quality events
- ▶ Timing requirements/ deadlines for completion of RCA
- ▶ Separate tool kit setting out a number of templates
- ▶ System to record and collate RCA findings
- ▶ Regional workshops for member firms
- ▶ Regular calls between “RCA champions”
- ▶ Separate global RCA team to monitor consistency of RCA across member firms



## Review of RCA in practice

UK – thematic review scope and timing

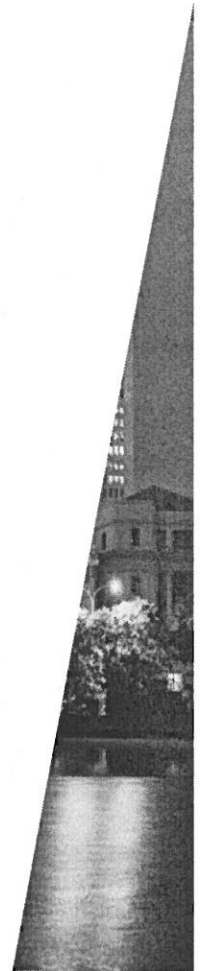
- ▶ We reviewed the six largest UK audit firms in 2016
- ▶ We compared the RCA processes undertaken by those firms, as well as the output of those processes, covering the RCA performed for external and internal inspection findings
- ▶ We published our report in September 2016



# Review of RCA in practice

## UK – thematic review findings (1)

- ▶ Most firms did not prepare a formal plan or timetable at the start of the process
- ▶ The total time spent by firms on RCA varied significantly
- ▶ There were a number of differences between the processes for investigating causes for internal and external inspection results
- ▶ Some firms (but not all) provided guidance and training to those performing the RCA
- ▶ All firms considered the results arising from internal and external audit inspections in their RCA, in particular poor quality audits, and generally the inspection themes arising from other audits



# Review of RCA in practice

## UK – thematic review findings (2)

- ▶ The firms considered interviews with audit teams to be the most important part of the RCA. They did not involve anyone outside the audit practice (such as behavioural or other specialists). The interviews were often only with the audit engagement partner and audit manager only
- ▶ Most root causes identified by firms related to the knowledge or behaviours of individuals on audits
- ▶ We found examples where the RCA had affected positively the actions to address the underlying issues by ensuring that the actions focused on the identified causes
- ▶ The RCA processes and results were not communicated in the firms' transparency reports at the time



# Review of RCA in practice

## Denmark – Comparison for Big 4

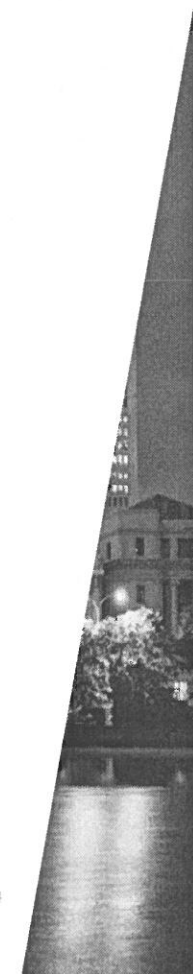
- ▶ During late 2017, we requested the Big 4 to complete a questionnaire regarding the use of RCA
- ▶ The questionnaire was based on the one developed by the FRC
- ▶ We analysed the results to gain knowledge of the use of RCA in the audit firms in Denmark
- ▶ The results are not to be published as confidentiality was a main condition for the questionnaire



# Review of RCA in practice

## Denmark – Comparison for Big 4

- ▶ Findings – positive examples:
  - ▶ RCA has been formalized recently (less than 4 years)
  - ▶ Within all four firms, priority, training and guidance, seems to be effective
  - ▶ Independence from audit teams required in all firms
  - ▶ RCA output seems to have impacted the action plans to address the findings going forward
  - ▶ No root causes identified in relation to the tone at the top or culture of the firm
  - ▶ The firms are planning to take steps to improve the RCA

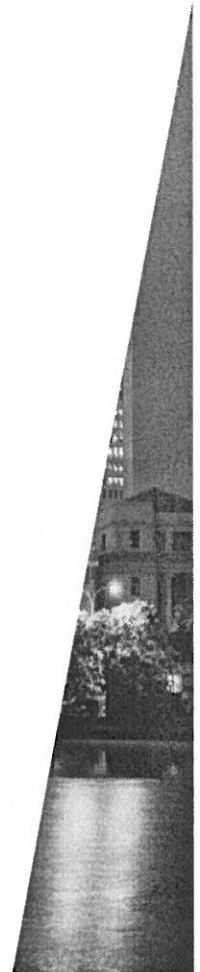


# Review of RCA in practice

## Denmark – Comparison for Big 4

### ► Findings – negative examples:

- Planning on RCA has not been fully implemented
- Deadline for completion not set in one of the firms
- Specific criteria for involvement of RCA reviewers not required in all firms
- Quality events to identify factors that contributed to high-quality audits not covered explicitly in all firms
- No self-assessment made by the audit teams
- No interview template in three of the four firms



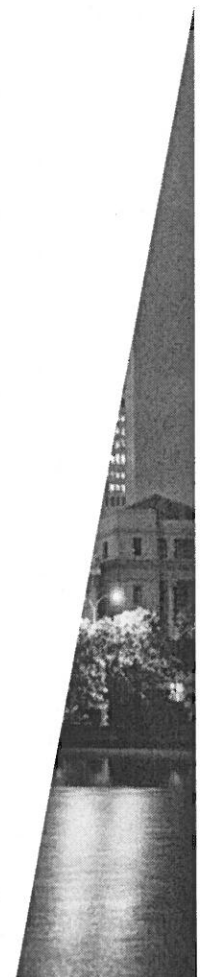
# Review of RCA in practice

## South Africa

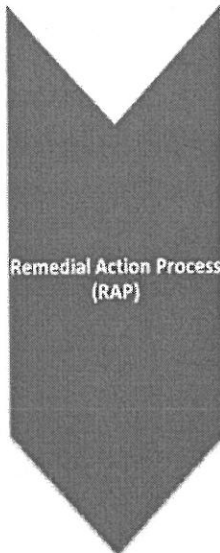
### Remedial Action Process (RAP)

### ► Objectives of RAP

- To prompt a notable improvement in Audit Quality by auditors on all their audits
- To strengthen the impact of Inspections by driving a reduction in recurring inspection findings
- To aid auditors to effectively identify and address the underlying causes of inspection findings
- The IRBA remains fully independent
- Firm leadership remains fully responsible (ISQC 1 par. 50)
- IFIAR Core Principle 11 states that audit regulators should ensure remediation of findings with the audit firm



# Review of RCA in practice South Africa Remedial Action Process (RAP)



- Unsatisfactory inspection outcome by the Inspections Committee prompts RAP
- Affected Firm/Partner required to perform a detailed Root Cause Analysis (RCA)
- Firm/Partner submit a written undertaking including a detailed RCA and Action Plan within 30 days
- IRBA review RCA and Action Plan and engage where necessary
- Follow-up inspections scheduled after 12-18 months
- Enhanced communication with firm Leadership/Partner around root causes
- Publish common findings and root causes in the Annual Public Inspections Report
- Feedback to other stakeholders, e.g. Audit Committees and professional body on Audit Quality Indicators (AQI) and common root causes
- Specific RAP - Specific Action might be required by Inspections Committee

# Review of RCA in practice South Africa Remedial Action Process (RAP)

## RAP Feedback – 2016/2017

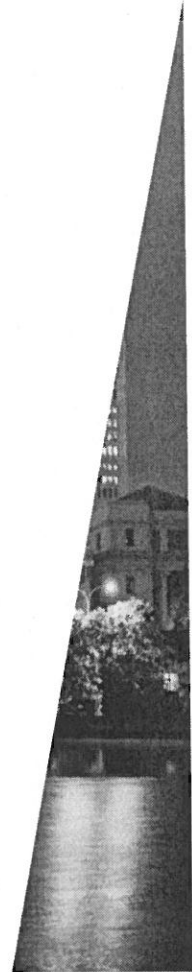
- ▶ The IRBA reviewed the RCA and Action Plans of those Auditors with significant inspection findings (Evidence-based)
- ▶ About 50% of the RCAs received were too vague and had to be re-submitted
- ▶ About 15% had inappropriate Action Plans that had to be re-submitted
- ▶ About 80% of audit re-inspections after 12-18 months showed improvements
- ▶ Auditors have been generally very positive about the initiative
- ▶ From 2017 in SA, Auditors must submit inspection reports together with RCA and Action Plans on inspection findings to Audit Committees of Listed Issuers



# Review of RCA in practice South Africa Remedial Action Process (RAP)

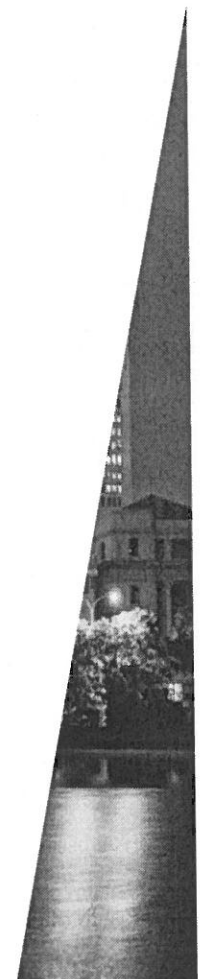
## Observations

- ▶ General misunderstanding of RCA by auditors
- ▶ Poor/no policy, methodology, criteria or skillset for structured problem solving
- ▶ RCAs addressed the symptom and not the real cause i.e. “lack of documentation” and “human error” cited - not the real root causes
- ▶ RCA not embedded in firm’s culture by Leadership (tone-at-the-top)
- ▶ Not appreciating that the requirements are necessary or important (requirements were not prioritized over other activities)



## RCA Key take away points

- ▶ RCA is an important aspect of audit quality and can help firms reduce the level of inspection findings
- ▶ There has been an increasing focus by the Big 4 firms - there are differences in approach between them
- ▶ There has been an increasing focus by audit regulators, with findings from local inspections on RCA processes
- ▶ The information in these slides will help IFIAR members identify which areas of the firms’ RCA processes to review in their inspections



# RCA

## Useful links

- ▶ [http://www.ifac.org/global-knowledge-gateway/audit-assurance/discussion/step-step-guide-root-cause-analysis?utm\\_medium=email&utm\\_source=transactional&utm\\_campaign=GKG\\_Latest](http://www.ifac.org/global-knowledge-gateway/audit-assurance/discussion/step-step-guide-root-cause-analysis?utm_medium=email&utm_source=transactional&utm_campaign=GKG_Latest)
- ▶ [http://www.ifac.org/global-knowledge-gateway/audit-assurance/discussion/root-cause-analysis-transforming-audit-quality?utm\\_medium=email&utm\\_source=transactional&utm\\_campaign=GKG\\_Latest](http://www.ifac.org/global-knowledge-gateway/audit-assurance/discussion/root-cause-analysis-transforming-audit-quality?utm_medium=email&utm_source=transactional&utm_campaign=GKG_Latest)
- ▶ <http://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/practical-help/quality-control/publications-and-learning-material/improving-audit-quality-using-root-cause-analysis.ashx>
- ▶ <https://www.frc.org.uk/getattachment/dc0bba94-d4cd-447c-b964-bad1260950ec/Root-Cause-Analysis-audit-quality-thematic-report-Sept-2016.pdf>
- ▶ <https://www.irba.co.za/guidance-to-ras/inspections/administration> (Click on PPTX Root Cause Analysis - Information Session and Case Studies)
- ▶ <https://www.irba.co.za/ebook/39/>





# Inspection of bank audits - advanced

## Elective session 4

Astrid Blankenheim (Germany)

Bill Harland (USA)

Andrew Meek (UK)

Martin Schmidt (Switzerland)

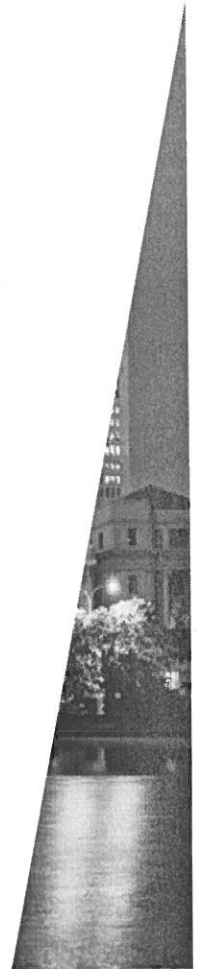
IFIAR INSPECTION WORKSHOP 20 – 22 FEBRUARY 2018 COLOMBO, SRI LANKA

## Disclaimer

The views expressed are those of the speakers and do not necessarily reflect the views of the audit regulator, its members, or staff.

# Banking Advanced

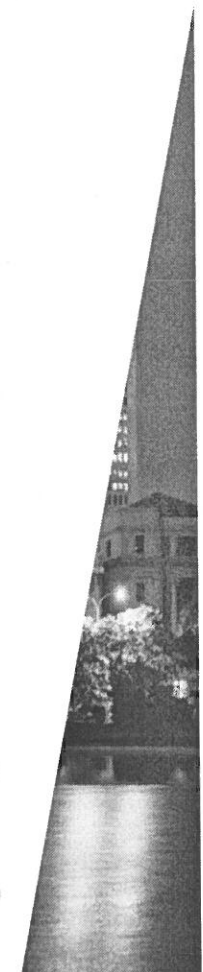
- ▶ **CEAOB Financial Services Task Force**
- ▶ **IFRS 9 implementation update**
- ▶ Sampling dilemmas
- ▶ Information provided by the entity (IPE)
- ▶ Loan loss provisions and deposits
- ▶ Conduct provisioning
- ▶ Participant case studies



## IFRS 9 implementation update

### Overall:

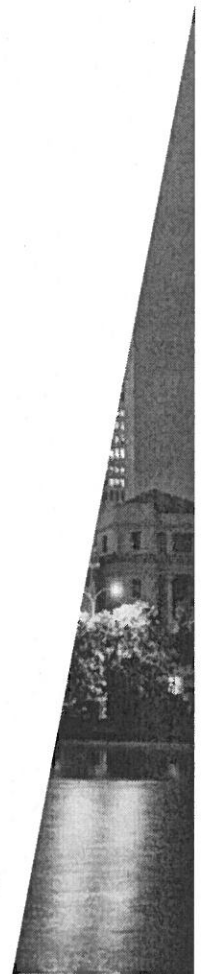
- ▶ The motivation of the IASB for changing from IAS 39 to IFRS 9 had the following considerations:
  - ▶ IFRS 9 will bring greater clarity regarding the criteria for classification and measurement
  - ▶ Fuller and more timely recognition of credit losses for assets measured at amortised cost
- ▶ However, these improvements do not necessarily come without costs and authorities may want to remain ready to support or adopt policies that might ameliorate these costs
- ▶ The following slides will demonstrate challenges regarding the implementation of IFRS 9 for the implementing institutions / banks and for the auditor, who is auditing financial statements under the new regime in 2018 for the first time



# IFRS 9 implementation update

## Main challenges for banks:

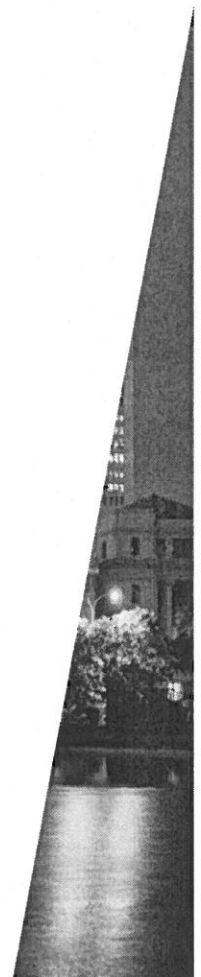
- ▶ Manage the transition from IAS 39 (rules, disclosures, etc.)
- ▶ Define an appropriate governance
  - ▶ On risk and accounting closing processes
  - ▶ On the control framework
  - ▶ On management estimates
- ▶ Ensure consistency of methodology across the different subsidiaries
- ▶ Implement data remediation plans and set standards for data quality in the longer term
- ▶ Implement a comprehensive process architecture and perform adequate parallel runs and IT testing



# IFRS 9 implementation update

## Main challenges for auditors:

- ▶ Audit the accounting estimates
  - ▶ Identification of estimates
  - ▶ Understanding of how the estimates are made and monitored
  - ▶ Assessment of controls over the estimates
  - ▶ Audit procedures and evaluation
- ▶ Evaluate the data relevance, reliability and quality
- ▶ Be able to assess any proxy and proportionality principles (potential standards for assessment, quality of implementation)
- ▶ Identify any outliers potentially preventing consistency in the standards application (across G-SIBs and across countries)
- ▶ Review the disclosures for the first time application (timing and granularity)



# Banking Advanced

- ▶ CEAOB Financial Services Task Force
- ▶ IFRS 9 implementation update
- ▶ **Sampling Dilemmas**
- ▶ Information provided by the entity (IPE)
- ▶ Loan loss provisions and deposits
- ▶ Conduct provisioning
- ▶ Participant case studies

## Case Study: Sampling dilemmas

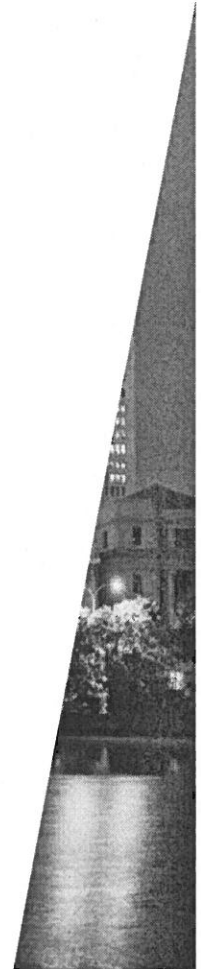
- ▶ Sampling dilemma if using non-statistical sampling methods when dealing with a loan portfolio

Type of loan	Amount	Materiality	Number of items	Sample size
All	25'000 Mio.	8 Mio.	25'000	1'250

- ▶ Methods to reduce sample sizes
  - ▶ Risk assessment and controls testing
  - ▶ Attribute testing
  - ▶ Dual purpose testing
  - ▶ Interim testing

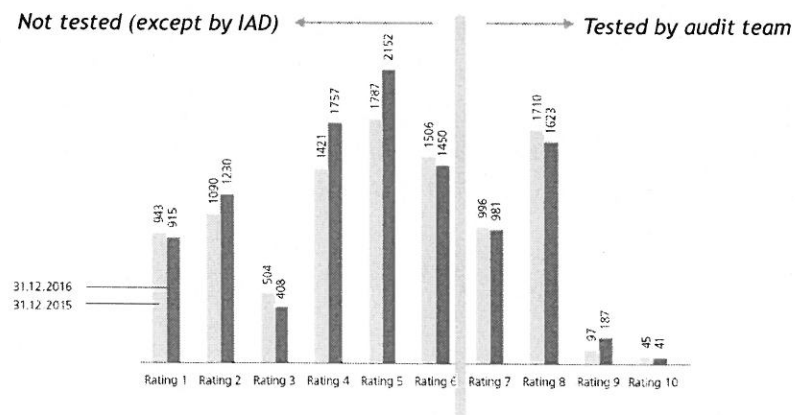
# Case Study: Risk assessment and controls testing

- ▶ Loans to customers around 77% of the balance sheet and “valuation” represents a significant risk
- ▶ Out of nine relevant controls covering also the assertion “valuation” two were audited in the prior year
  - ▶ Do you agree with the auditor's approach?
- ▶ The credit office (CO) monitors quarterly based on an IT-system report that the annual re-evaluation of impairment triggers is performed by the customer relationship manager. Audit evidence was gained by inspecting the mail-reminders sent by CO for two quarters
  - ▶ Do you agree with the auditor's approach?

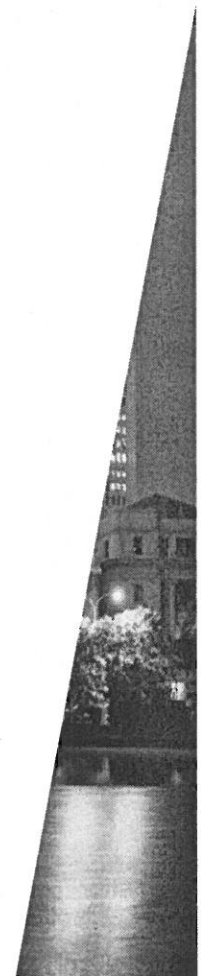


# Case Study: Risk assessment and controls testing

- ▶ Population: Loans under supervision and loans not under supervision. Rating system was not tested.

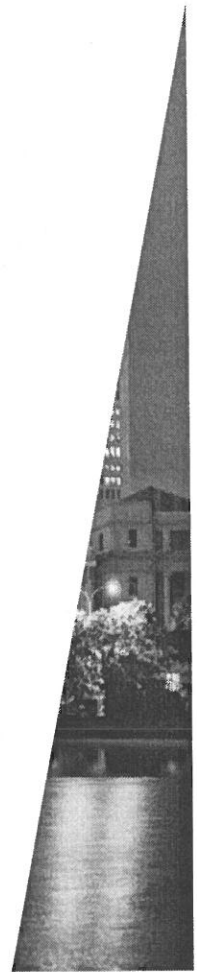


- ▶ Do you agree with the auditor's approach?



# Case Study: Risk assessment and controls testing

- ▶ Loan portfolio is split between loans under supervision (LUS) and loans not under supervision (LNUS) based on internal ratings. Five controls covering LNUS were tested by Internal Audit in one sample of 30 loans. The sample size is for non-significant risks as “valuation” for the LNUS is considered less risky
  - ▶ Do you agree with the auditor’s approach?
- ▶ No evidence on file of how the sample was selected, what the population consists of and who selected the sample
  - ▶ Do you see any issues with the auditor’s approach?



# Case Study: Attribute testing

- ▶ Aim of the test was the attribute “impaired” or “not impaired” taking into account: credit worthiness, financial standing, collateral value. Sample sizes for attribute or audit sampling are:

Attribute testing		Audit sampling	
Desired level of evidence	No exception tolerated	Planning Materiality as % of account balance	Level of assurance: Moderate
Moderate	30	1%	60

- ▶ Do you see any issues with the auditor’s approach?





# Case Study: Dual purpose testing

- ▶ Combining controls and substantive testing. Sample sizes:

Controls testing		Attribute testing		Audit sampling	
Fre- quency	Risk of failure: lower	Desired level of evidence	No exception tolerated	Planning Materialit y as % of account balance	Level of assurance: Moderate
More than daily	25 / 30	Moderate	30	1%	60

- ▶ What is the correct sample size?

# Case Study: Dual purpose testing

- ▶ Documentation of audit procedures in one excel-table
  - ▶ What would you expect to see?
- ▶ Testing performed at interim stage in July/August. For the remaining period interviews were held with control owners to confirm that the controls were applied throughout the year. Additional substantive testing was performed at year end
  - ▶ Do you agree with the auditor that sufficient evidence has been gathered?

# Banking Advanced

- ▶ CEAOB Financial Services Task Force
- ▶ IFRS 9 implementation update
- ▶ Sampling Dilemmas
- ▶ **Information provided by the entity (IPE)**
- ▶ Loan loss provisions and deposits
- ▶ Conduct provisioning
- ▶ Participant case studies

## Case Study: Information Provided by the Entity (IPE)

### Facts:

- ▶ Loans to banks and loans to customers around 50% of the balance sheet
- ▶ Significant risk identified around various aspects of the Allowance for Loan Loss (ALL)
- ▶ Audit team performed a control test which was designed to validate certain assumptions used to calculate ALL ranges for certain collectively-assessed loans (default assumptions). This included validating the underlying data used in developing these assumptions

# Case Study: Information Provided by the Entity (IPE)

Facts: (continued)

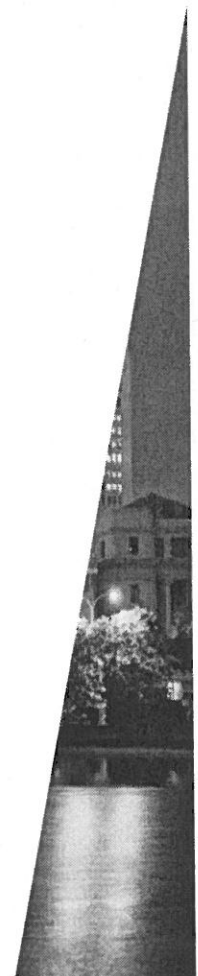
- ▶ Details on control testing
  - ▶ Obtained and read the reports that document the basis for the issuer's determination of default assumptions
  - ▶ Inspected minutes of Review Committee meetings to confirm committee approval of the assumptions
  - ▶ Inspected documentation indicating the approval of the default assumptions by VP-Risk
  - ▶ Obtained and read reports that document the results of the review performed by the VP-Risk (final default assumptions)



# Case Study: Information Provided by the Entity (IPE)

Questions:

- ▶ What audit procedures do you expect to be performed related to the reports and information used in the control?
- ▶ What audit procedures do you expect to be performed related to the assumptions used in the operation of the control?
- ▶ Considering the answers to questions 1 and 2, would there be any effect on the nature, timing, and extent of the substantive tests?



# Banking Advanced

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## Case Study: Loan Loss Provisions Case and Questions

### Facts:

- ▶ Loans to banks and loans to customers around 84% of the balance sheet
- ▶ Audit team performed test of design and implementation / test of operating effectiveness of controls for the process of credit business
- ▶ Substantive testing: sample of 50 single loan engagements selected on a risk basis (across both performing and non-performing loans)
- ▶ Where the auditor identified a potential need for impairment, the value of the collateral was considered further

# Case Study: Loan Loss Provisions

## Case and Questions

### Facts: (continued)

- ▶ For each audited single loan engagement, the auditor filled out an evaluation sheet
- ▶ The valuation of the collateral (mortgage) was stated: “valued by auditor”

### Questions

- ▶ What do you expect as documentation for the valuation of the collateral (mortgage) for the loan engagement with no impairment need?
- ▶ What do you expect as documentation for the valuation of the collateral (mortgage) for the loan engagement with an identified impairment need?
- ▶ What audit procedures and documentation are you expecting if the valuation of the collateral (mortgage) was performed by a management expert engaged by the bank?



# Case Study: Deposits

## Case and Questions

### Facts:

- ▶ Bank with deposits of around 57% of its balance sheet
- ▶ Auditor identified a significant risk around accuracy of the deposits
  - ▶ Planned audit objective: accuracy of the customer deposits
- ▶ The auditor performed test of design and implementation / test of operating effectiveness of controls
  - ▶ Identified internal controls are related to the account opening, reference bank accounts and handling of special terms concerning account openings
  - ▶ The auditor has not identified nor tested any internal controls, which would relate to remittance or direct debit
- ▶ Substantive testing:
  - ▶ Matching general ledger with sub-ledger
  - ▶ Use of the work of internal audit, who sent out negative customer confirmation letters. No contradictory evidence was received



# Case Study: Deposits

## Case and Questions

### Questions:

- ▶ Is there enough audit evidence?
- ▶ Which of the following requirements need to be complied with in order to perform negative customer confirmation letters as a substantive procedure
  - ▶ A. Test of controls
  - ▶ B. No significant risks
  - ▶ C. Homogeneous population
  - ▶ D. The auditor assumes that the confirmation letter will be acknowledged by the addressee
  - ▶ E. All of the above
- ▶ Possible other audit procedures?

# Case Study: Deposits

## Variation of the prior case

### ▶ Variation A:

- ▶ Bank with deposit around 90% of its balance sheet
- ▶ Auditor identified significant risks on deposits
- ▶ Performed the following audit procedures:
  - ▶ Design of the process deposits but no test of controls
  - ▶ Substantive testing: matching general ledger with sub-ledger and use of work of internal auditor: negative customer confirmation letters

### Questions:

- ▶ Is there enough audit evidence?
- ▶ Possible other audit procedures?

# Case Study: Deposits

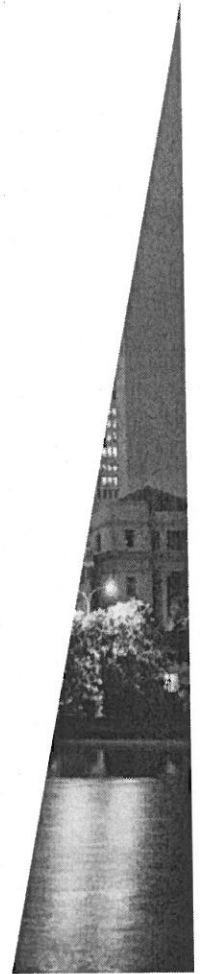
## Variation of the prior case

### ► Variation B:

- Bank with deposits around 80% (EUR 500 millions) of its balance sheet
- Performance materiality set at EUR 350 millions and deposits set as non-significant
- No test of controls
- Substantive procedures performed:
  - matching sub-ledger with general ledger
  - analytical procedures

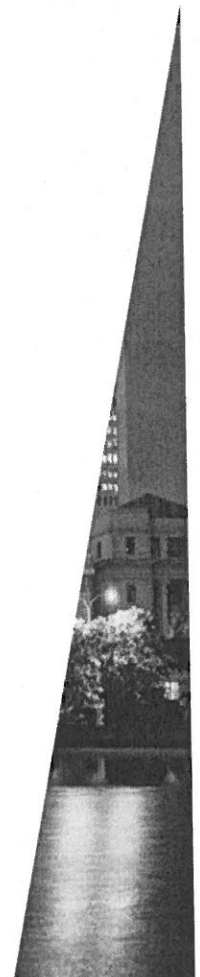
### Questions:

- Is there enough audit evidence?
- Possible other audit procedures?



# Banking Advanced

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# Case Study: Conduct Provisioning (UK)

## Case facts - background

### Facts:

- ▶ £X million (approximately 10 times materiality) provision for mis-selling of payment protection insurance (PPI)
- ▶ The primary assumption is the level of upheld complaints
- ▶ The Bank's internal audit team had noted in June 2016 that the system for handling complaints (including a historical data complaints database, which had been updated during the year) needed improvement
- ▶ The data on the complaints database was extracted via SAS and used as inputs into a spreadsheet model

# Case Study: Conduct Provisioning

## Case facts – audit approach

### The audit team:

- ▶ Tested completeness and accuracy of the complaints database
- ▶ Observed the SAS code that was used to extract information from the complaints database
- ▶ Input management's data and assumptions into its own model to re-calculate the year end provision
- ▶ Benchmarked some assumptions in the conduct provisions with those used at other banks
- ▶ Compared actual to forecast complaints for total PPI complaints received and upheld by the Bank in 2016



# Case Study: Conduct Provisioning

## Case facts – further information

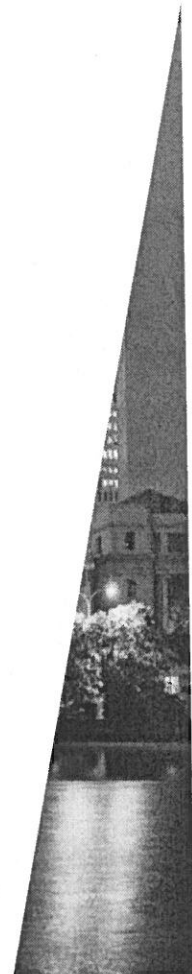
*All sounds pretty reasonable so far. Additional facts:*

### (a) Completeness and accuracy of the complaints database:

- ▶ The audit team did not assess the design of the complaints controls
- ▶ The audit team's testing of the quality review control over the database focused on whether the procedures had been followed

### (b) SAS Code:

- ▶ The SAS script extraction testing was to observe the extraction process



# Case Study: Conduct Provisioning

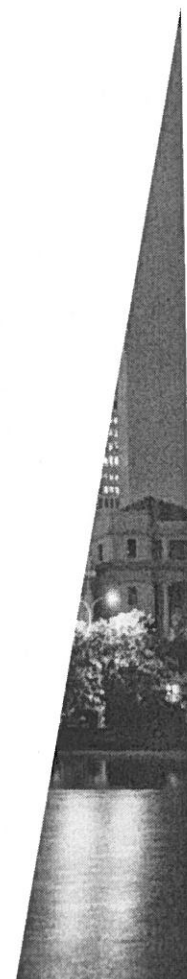
## Questions

(c) Benchmarking – Benchmarking and forecast vs actual comparison both lacked granularity

(d) Sensitivity analysis – no analysis was performed of the impact on the provision on flexing the key assumptions in the model

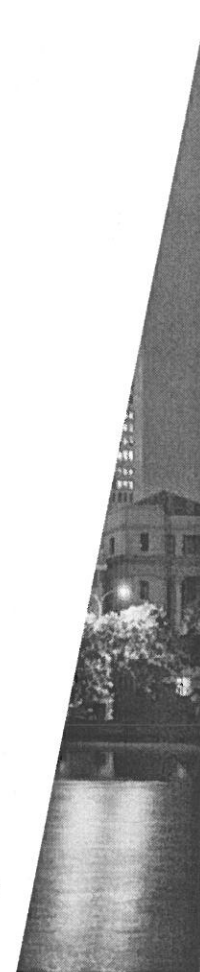
### Questions:

- ▶ How significant do you consider the weaknesses identified to be, in the context of the procedures planned and performed?
- ▶ What other procedures might the audit team have undertaken given the significant risk of the conduct provisioning?



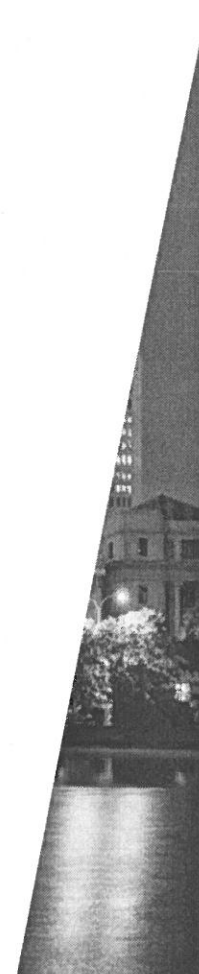
# Banking Advanced

- ▶ CEAOB Financial Services Task Force
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- ▶ Sampling Dilemmas
- ▶ Information provided by the entity (IPE)
- ▶ Loan loss provisions and deposits
- ▶ Conduct provisioning
- ▶ **Participant case studies**



# Banking Advanced

- ▶ Thank you very much for your cooperation!!!
- ▶ Looking forward to see you next year





# Key challenges and potential solutions with a smaller regulatory environment

Elective session 7

Naweed Lalani - Dubai

Asha Ahamath – Sri Lanka

IFIAR INSPECTION WORKSHOP 20–22 FEBRUARY 2018 COLOMBO, SRI LANKA

## Discussion Today

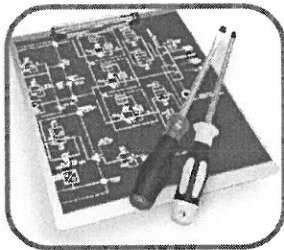
- ▶ Smaller Regulators Task Force
- ▶ Work Streams
  - ▶ Capacity Building
    - ▶ Interaction with GPPC Firms
- ▶ Key Takeaway Points

# Smaller Regulators Task Force



Members

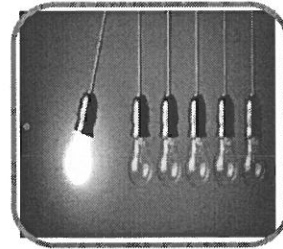
There is no specific definition of what is considered a smaller regulator; however the members of the TF are those with small number of inspectors.



Technical Training



Capacity Building

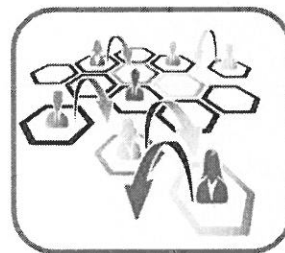


Leadership Development

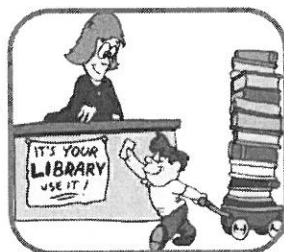
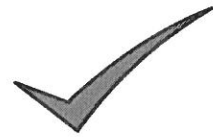
# Capacity Building



Skills Database



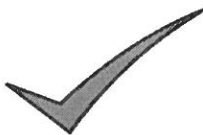
Secondments Register



Resource Library



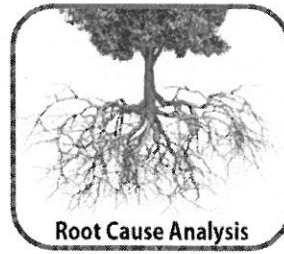
Interaction with GPPC Firms



# Interaction with GPPC Firms



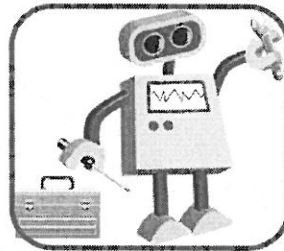
Audit Quality



Root Cause Analysis



Cooperation

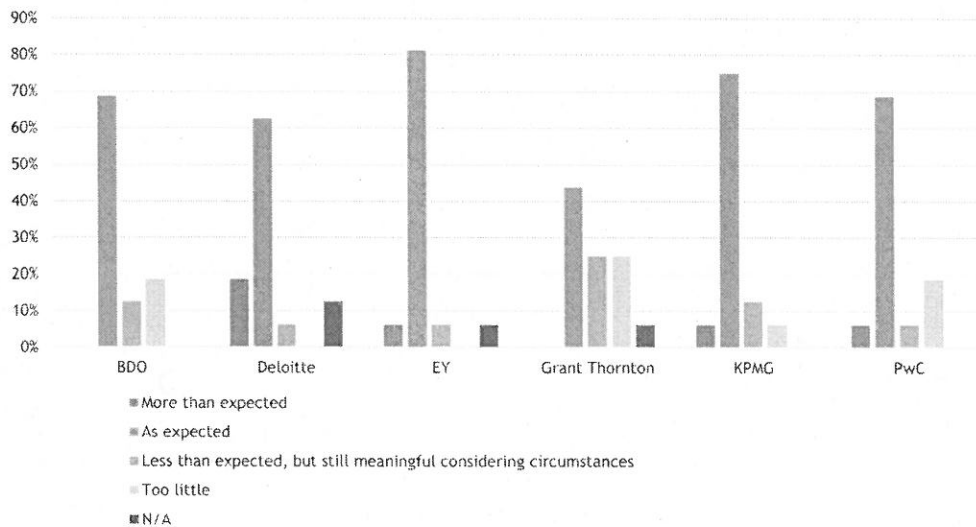


Technology

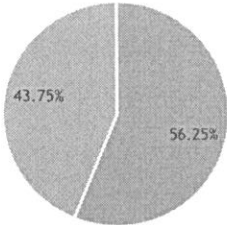
# Audit Quality – Pulse Test

Based on a short survey of 23 smaller regulators. 70% response rate

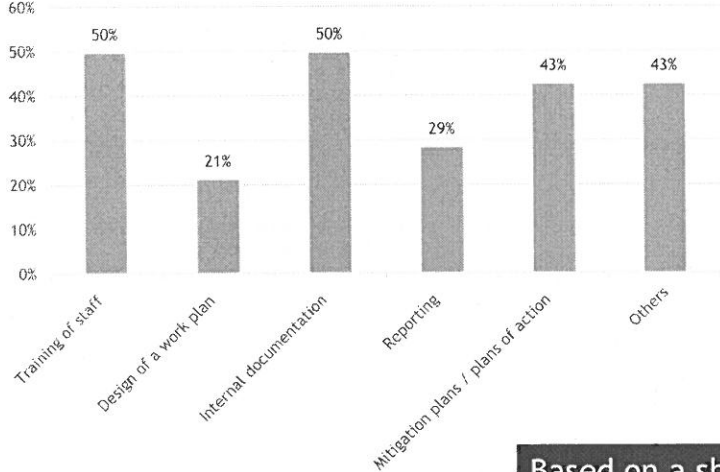
Progress of GPPC Firms



# Root Cause Analysis



## Challenges

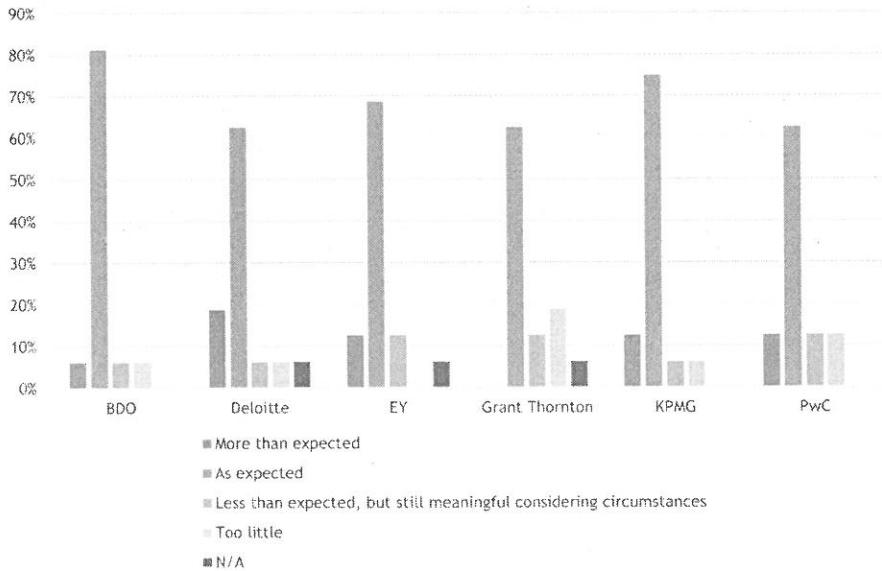


- Others**
- ▶ Our firms do not do RCA. How can we encourage them?
  - ▶ Fees
  - ▶ Monitoring
  - ▶ Change Management
  - ▶ It's too much jumping to resolutions not really looking at the root cause

**Based on a short survey of 23 smaller regulators. 70% response rate**

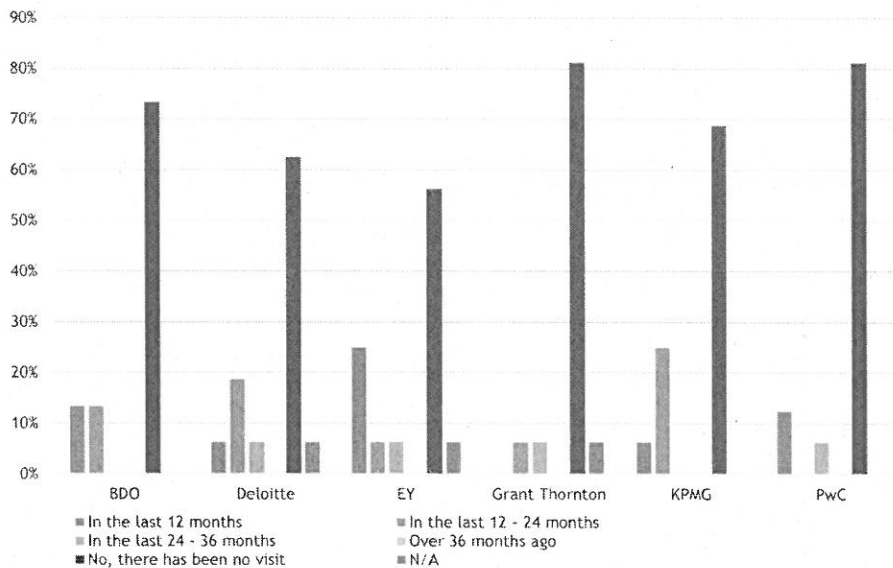
# Cooperation

**Based on a short survey of 23 smaller regulators. 70% response rate**



# Delegation Visits

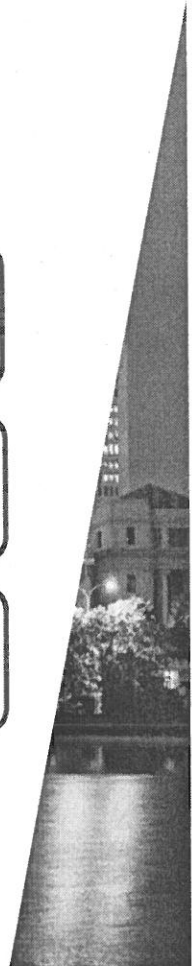
Based on a short survey of 23 smaller regulators. 70% response rate



## How can we increase the cooperation?

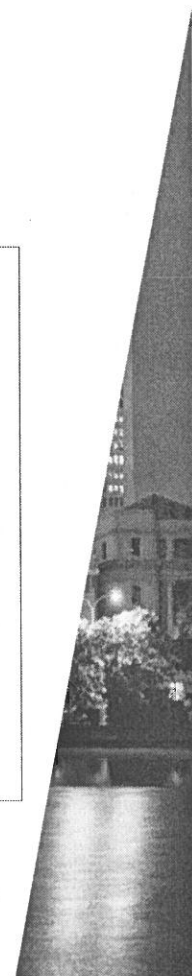
- ▶ Participating in Firm's Trainings / Events
- ▶ Informal meetings with Assurance and Risk Management (conducted out of inspection cycles)
- ▶ Meeting the Firm's Global leadership at IFIAR's Plenary meetings
- ▶ Regular conference calls with the Global teams on their plans for your jurisdictions

# Technology in Audit - Quiz

# Technology in Audit – Challenges and Solutions

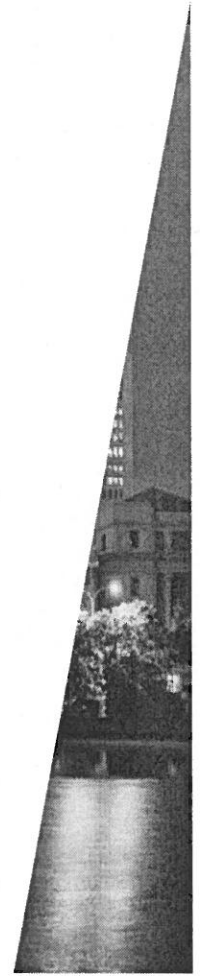
Challenges	Solutions
▶	▶
▶	▶
▶	▶
▶	▶
▶	▶





# Key take away points

- ▶ There are similar challenges facing the smaller regulators. We can leverage from the experience of each other.
- ▶ Collectively, we should be working closely with the Global Audit Quality (GAQ) Working Group to enhance our interaction with GPPC Firms.



# Useful links

- ▶ [www.ifiar.org](http://www.ifiar.org)
- ▶ <http://www.ey.com/home>
- ▶ <https://www.pwc.com/>
- ▶ [https://www2.deloitte.com/global/en.html?icid=site\\_selector\\_global#](https://www2.deloitte.com/global/en.html?icid=site_selector_global#)
- ▶ <https://home.kpmg.com/xx/en/home.html>
- ▶ <https://www.bdo.global/en-gb/home>
- ▶ <https://www.grantthornton.com/>

