

Audit and Model Risk



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Although every audit process is unique, the audit process is similar for most engagements and normally consists of stages:

Planning, Fieldwork, Audit Report and Remediation aka Validation.



Objectives

As an outcome of auditing, recommendations are provided to enhance weak internal controls.

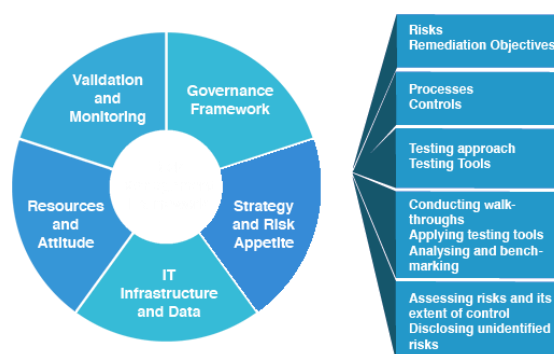
We investigate on instances of possible control weaknesses and highlight cases considered material for remediation.

Reconciliations of gaps in operating and design information are performed based on articulation of remediating actions.

Support in the monitoring of compliance backed up by industry standards and guidelines.

Planning and Fieldwork concerns multiple areas covering the three P's People, Processes, Products. For audits emphasizing Model Risk, suitability of Model design and operation is a key area to look at.

- *Have Governance Framework and Processes been designed sufficiently consistently?*
- *Have model risks been evaluated suitably through benchmarking and testing?*



The three C's – Cause, Consequence, Correction

Cause - Why did the issue arise?

Consequence - What risk emerged from the issue and what is the impact determined?

Corrective Action – What actions can be taken for remediation? What action is required for follow-up to resolve the issue?



The Audit Plan

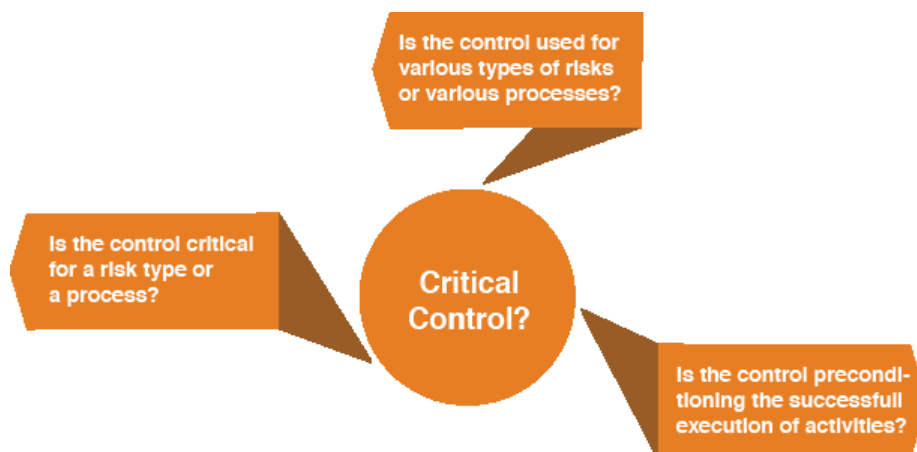
An audit is a report given from the analysis of particular business operation or functional area. Operations and functional processes are scrutinized alongside standards set by governmental, regulatory bodies, or the audited business itself. As part of the planning phase, relevant background information is gathered and the right points of contact are initiated. In addition, audit objectives, timings and scope are determined, in addition to timings of fieldwork and report distribution. Finally, an audit plan is generated with details made transparent.

Our effective audit plan captures the relevant:

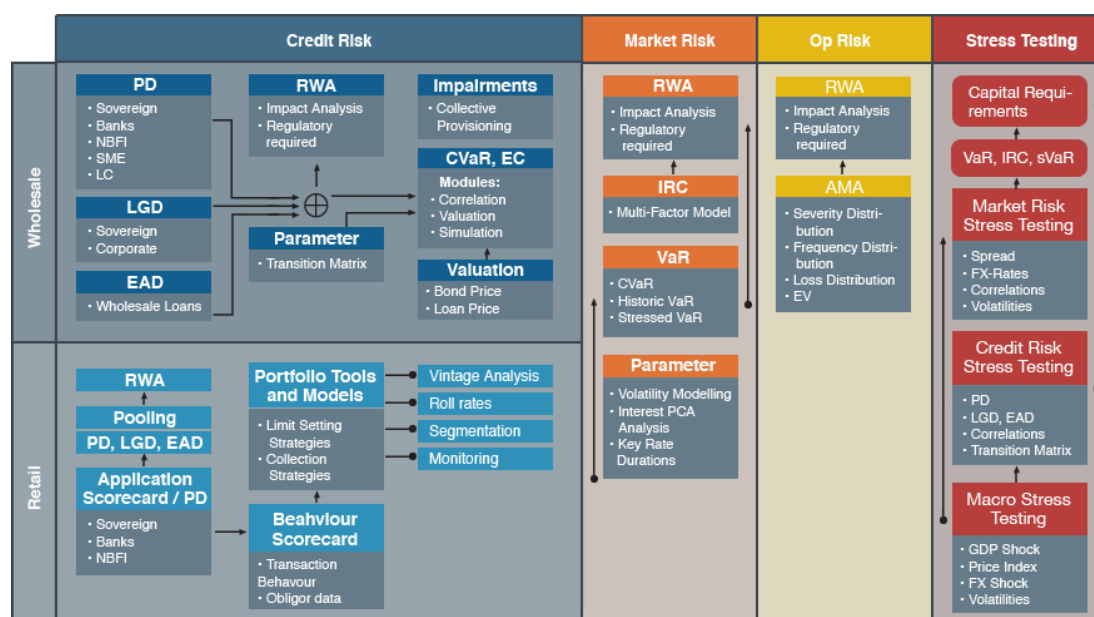
1. Evaluating the risk level.
2. Understanding your business model.
3. Engaging the stakeholders and tracing the key points of contact.
4. Developing a risk profile.
5. Considering external factors and emerging risks.
6. Identifying internal risks even those overlooked.
7. Assessing inherent and residual risks based on test plans.

The Fieldwork

Fieldwork is executed by auditors. The testing includes interviews with relevant contacts from the group of auditees. Regular status meetings are performed to maintain communication with stakeholders and auditees regarding audit progress. Audit potential findings and recommendations are discussed with the client when identified and as part of observations.



Use of quantitative models in decision making requires model risk management. The risk emerging from incorrect or misused decision models can be significant with negative impact on financial position, undetected emerging risk and detriments for customers and reputation. As a case in point, shown below a selection of risk models used by banks and other financial institutions that require an in depth model verification and a consistent governance framework for compliance.



The Report

Examples of Audit Findings

Technology Solution Gaps

Undetected Emerging Risks

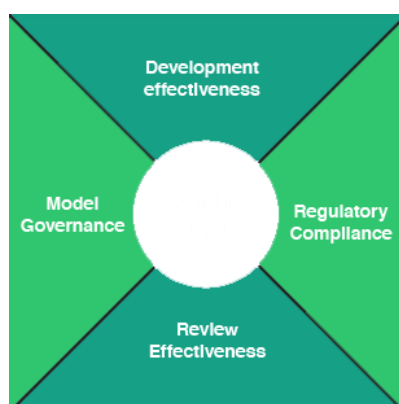
- Macro-economic shift
- Regulatory changes
- Technological failures

Inconsistent Policy and Framework

Lack of detail in Procedures

The deliverable for the audit is a formal report. We include a summary of the procedures and techniques used in the audit, a description of the findings, and suggestions for improvements.

Our final report will cover recommended propositions on enhancements to methodology and processes, including control monitoring and governance. Presentations are provided to the auditees and committee of the board of directors. Below shown an example from Model Risk auditing.



Examples of Audit Findings

Absence of Documentation

Model Risk Incidences

- Erroneous model design
- Estimation errors
- Wrong model usage
- Data limitations

Control Weakness

- Erroneous

Change in Competitive Position