

# Impact of the COVID-19 crisis on Internal Audit Functions of financial institutions

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## Introduction

The pandemic crisis that the world currently faces is a problem that disrupts the entire society as we know. It leads to concerns about the health and safety of loved ones. And also to concerns about what this means for the economy. Financial institutions are playing an important role to minimize the effect as much as possible. With a complete focus on ensuring a well-functioning financial system in these times of crisis, Internal Audit Functions are revisiting the role they need to play within their institution. Given the implications caused by the COVID-19 outbreak, financial institutions need to take immediate and appropriate actions, in order to support employees, key stakeholders and customers. The main goal must be to safeguard people while at the same time providing a stable financial system that can be relied on. To support financial institutions to stimulate the economy, the ECB is loosening the capital and operational requirements for the financial sector.

The COVID-19 crisis is a black-swan event that pushes companies into unknown territories. Companies uncover unforeseen risks and are uncomfortable with the changing landscape. Provided with the prospective of a total lock-down, companies need to be flexible and creative in order to manage the crisis. Adaptation and flexibility are required within all lines of defense. The purpose of this publication is to describe the challenges that Internal Audit Functions (IAF) are currently facing within the financial sector and to make recommendations on how to respond to these issues.



## Impact Audit Planning (annual audit plan)

The COVID-19 outbreak has shaken up the entire business operations of financial institutions. The businesses and 2nd line functions are understandably focusing on crisis management to ensure that financial institutions can remain playing their important role in society. Financial institutions are facing difficulties with regard to a distressed economy, (potential) difficulties in loan, mortgage and insurance payments, imposed travel limitations and potential shortfall in staff due to sickness. Financial institutions need to adopt to these unique circumstances in order to minimize the impact of the pandemic outbreak. Due to this, IAFs are currently revisiting the role they play within the institution.

### Reprioritization of activities

IAFs, in order to adapt to the new situation, need to reassess priorities as newly emerged immediate threats have to be taken into account. Based on our experiences, the trend is for senior auditors to be shifting to more of a consultative approach, participating in (sometimes daily) emergency committee meetings and generally being close to management. IAFs may bring more added value by engaging in more pro-active activities such as participating in key crisis meetings, advising the business on (temporary) changes and workarounds in the business operations, performing quick scans, limiting the audit scope to key aspects with a focus on providing assurance on the minimum level of controls that may not be compromised despite the crisis.



## Impact Audit Planning (annual audit plan)

Some IAFs increase their internal audit capacity to address more urgent matters and other risks. Increased risks relate to topics such as IT security risks, for instance due to the pressure to vastly increase remote working possibilities, cybersecurity, business resilience and/or cash flow and liquidity management. Financial institutions should revisit their network security response plans, especially when third parties are trying to exploit this situation with fraudulent practices, such as phishing. Business continuity management obviously is under heightened attention and as the current situation is one of the biggest real-life tests, audit is seen to add more value in supporting these processes from a consultative approach rather than overlaying that with an audit at this time.

The way of conducting audits has changed dramatically, mainly due to remote working. Although interviews and remote walkthroughs have been more efficient than expected, it is almost inevitable that planned audits are postponed, delayed or even cancelled. Changes to the audit planning may also be required to adapt to the reprioritizations or delays that occur within the business, due to key auditees not being available and/or project deadlines being postponed. From a supervisory perspective, regulators also indicate to consider rescheduling and in many cases already postponed on-site inspections and are extending deadlines for the implementation of remediation actions. To illustrate, the ECB Banking supervision is willing to provide both capital and operational relief to banks in reaction to the COVID-19 outbreak.

### Resourcing assessment

When reprioritizing and updating the audit plan, IAFs also need to reassess their resources, knowledge and capabilities. They should determine whether they have the tools and technology to perform the audit work remotely and secure and whether their auditors are sufficiently technology-savvy to perform the audits remotely. Furthermore, it should be determined whether the IAF has sufficient knowledgeable auditors available to assess increased IT (security), business resilience and/or cash flow and liquidity management risks.

The more, given the possibility that less auditors may be available if they would become sick or need to take care of family members or in case of prolonged travel restrictions. Therefore, financial institutions could consider the possibility of co-sourcing if they face a shortage in staff and/or a lack of particular expertise. Entering into local co-sourcing arrangements may also resolve the challenges due to the imposed travel restrictions.

### Training & Quality Assurance Review preparations

Reversely, in domains or locations with temporary overcapacity, the opportunity arises to focus on on-line staff training and Quality Assurance Review (QAR) preparations.



## Impact Audit Execution (individual audits)

The changing landscape also calls for flexibility during the execution of internal audits. The following factors should be considered in each of the internal audit phases in order to ensure that the IAF is still working effectively:

### Audit planning, pre-evaluation and engagement scoping

The planning phase should acknowledge limitations and restrictions financial institutions are facing due to COVID-19 crisis. The scope of the planned audits should be reconsidered in order to make sure that the audits are still relevant and essential for the business. The impact of the COVID-19 crisis on business processes must be taken into account when determining the scope of the engagement. This may result in certain topics being eliminated or added to the audit scope, also taking into account feasibility, as not all necessary systems and databases may be remotely accessible to auditors. At the same time, legal restrictions on data accessibility and transfer should be taken into account, especially when data access is needed from another country. The reference model / work program should be adjusted to the scope changes.

### Fieldwork

Auditors face unique challenges when conducting fieldwork where travel restrictions oblige them to work from home. At the same time, the travel



## Impact Audit Execution (individual audits)

restrictions cannot affect the quality of the work that needs to be done. Careful consideration is needed to determine whether all aspects of the fieldwork phase can be performed adequately on a remote basis, as auditors face restrictions when it comes to conducting interviews, accessing confidential data and verifying the authenticity of documentation. Furthermore, they face disruption in communication within the audit team.

Arrangements should be made that auditors can work remotely, have direct access to necessary data and have the right technology that enables them to verify the authenticity of documentation and to conduct interviews and meetings with relevant parties remotely.

Auditors also need to ensure that they have sufficient commitment from key auditees as literally they are out of site and verbal communication has to be arranged for. Getting specific questions answered in time may be a challenge and may be solved by ensuring sufficient back-up arrangements regarding key auditees, also as key auditees can become unavailable or less committed due to sickness or due to more urgent pressures on their availability.

A key activity for auditors is strong alignment with the auditee and to discuss findings as they arise. While working remotely, ensure to schedule meetings through platforms like Skype, Teams or Zoom to retain or even increase the level of interaction with auditees. Especially in these times, interaction and attention for personal circumstances is of great essence. Both from an audit acceptance but more importantly from a humane perspective. The latter obviously also holds for within the audit team, where the audit leader should ensure sufficient room to discuss personal needs and worries.

### Reporting

Communication is essential during the reporting phase of the internal audit. Audit teams must be clear and consistent in their communication. However, the protocols need to be revisited with regard to the frequency and the way in which the audit team reports to the auditee as sufficient interaction is essential. Focus should be on key risks rather than overloading a distressed

business with lower risk findings. Additionally, the audit team should acknowledge that management potentially has limited capacity to remediate these issues on short notice.

### Evaluation

When evaluating the audit performed, specific attention should be given to the challenges posed by remote working. Tops and tips relating to coordination and communication as well as team motivation and commitment should be identified and carefully assessed by management.

### Follow-up

Due to the shakeup of business operations caused by the COVID-19 crisis, management teams are devoting much of their attention to crisis management. As a consequence, auditees may struggle to implement the recommendations of the audit findings in time. Therefore, auditors should determine whether dispensation is permitted in order to have management focus on more urgent matters that threaten the business operations. As discussed in the fieldwork session, being provided with the necessary data and documentation to verify that the audit issue has adequately been solved poses a challenge and needs careful consideration.



## Considerations to be made while reassessing IAFs role in the institution

IAFs should consider the following business implications when updating their internal audit planning:

### Employees

Has management ensured the well-being of its employees while at the same time making adequate changes to enable employees to work efficiently remotely? The way the organization treats employees now, will have a massive effect on their wellbeing, and consequently on their loyalty and productivity.

### Customers

Is the organization devoted to provide continuity in its services to customers specifically in the event of increasing staff shortages? Will these meet the expectations of the clients?



## Considerations to be made while reassessing IAFs role in the institution

### Liquidity

Does the organization thoroughly understand its available capital and liquidity resources and is the resilience of these assessed also taking into account any changes in the regulatory environment?

### Suppliers and third party dependency

Has the organization assured that its third-party networks are resilient in these changed circumstances? Are third parties regularly assessed and monitored on business continuity, information security and other risk domains? Are adequate follow-up measures taken with respect to critical business operations?

### Communications and transparency

Does the organization effectively and regularly communicate with its key stakeholders (employees, customers, shareholders, regulators) as part of the crisis management to prevent disinformation and rumor? Is the organization transparent about the steps it takes to manage the impact of the pandemic? Financial institutions need to assess their digital communication capabilities and how to leverage these to communicate with customers and the broader marketplace.

### Scenario planning

Is scenario modelling and contingency planning expertise used to understand the challenges of the pandemic and how this will impact the interconnected financial system? Are new indicators incorporated, prioritized by the COVID-19 outbreak, into their decision making activities?

Beyond immediate actions, organizations should use this crisis as an opportunity to reflect on the ability to navigate a crisis and, going forward, consider actions to increase agility and become more resilient in the future. Moreover, organizations should rethink the way their employees collaborate with each other and with customers – within the office, regionally and globally. The internal technology could be improved by investing in technology upgrades, such as cloud-office and zero-touch models.

The COVID-19 crisis brings new challenges to IAFs in the financial sector. This publication surely does not provide you with all the answers for the new questions in these uncommon times. Let's make sure to connect and support each other in ensuring strong and value adding IAFs while our financial institutions and society at large are going through these times.

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