



AUDITING THE RISK MANAGEMENT FUNCTION AND BASEL II CALCULATION

Learning Objectives:

The key benefits will be that participants will systematically review all elements of risk management and consider the nature of the control environment that should be applied, leading to the development of audit programs suitable to the firm. Key issues to be addressed will include:

- The role and structure of the risk management department
- The audit of credit risk management
- The audit of asset and liability management
- The audit of liquidity risk management
- The audit of market risk management
- The audit of operational risk management
- Understanding and auditing different risk management instruments (options, forwards, futures, swaps)
- The audit of the process of calculating Basel II

Day 1

Auditing the Risk Management – Identify, Analyzing, and Managing Risk

- The structure of a risk management function
- What information would you require in advance of the audit?
- What are the skills you would need on the audit?
- How would you plan the audit?
- Risk versus return and its impact on capital
- Types of risk within a bank: when are they addressed
 - Credit
 - Market
 - Operational
 - Liquidity
 - Other Risks
- Identification analysis & control of risk
- An introduction to key modeling approaches:
 - VAR
 - Backtesting
 - Stress Testing
 - Simulation



Auditing Credit Risk Management

- Auditing of credit risk management environment
- Auditing credit granting process
- Auditing of Maintaining an appropriate credit administration, measurement, and monitoring process, including policies and procedures for:
 - Identification of risk factors
 - Measurement Techniques and Internal Risk Ratings
 - Credit Administration
 - Adequate monitoring and review procedures
 - Diversification
 - Concentrations and related party exposures
 - Risk Mitigation
 - Scenario analysis and stress testing
- Auditing of adequate controls over risk, including policies and procedures for:
 - Establishing limits and authorized products
 - Adequate disclosure requirements
 - Quantifying and allocating sufficient capital for its credit risk exposures

Auditing Asset & Liability Management

- The role of ALM
- Relationship to risk management
- The role of the ALCO
- Membership of the ALCO
- ALCO minutes
- Centralized or distributed treasury operations
- The role of the Treasurer
- Reporting to ALCO

Case Study: Develop an audit program to address the audit of the ALCO

Auditing Bank Capital Management

- The role of ALCO in bank capital management
- The impact on banks of changing regulations
- Managing Cash & Working Capital
- Liquidity Risk Management
- Forecasting Cash Flows
- Financing with Debt versus equity
- Maturity Profiles
- Fixed versus floating
- The question of mismatches
- Hedging approach and cost
- The risks of capital management
- Controls over bank Capital Management

Case Study: Develop an audit program to address bank capital management



Day 2:

Auditing Foreign Exchange and Foreign Exchange Risk Management

- Types of transaction
- Spot transactions
- Forward transactions
- Yield curves and valuation issues
- Translation exposure
- Currency options
- Hedging decisions
- The risk in foreign exchange risk management
- Controls over foreign risk management

Case Study: Develop an audit program to address the management of foreign exchange risk

Case Study: Develop an audit program to address the audit of foreign exchange transactions

Auditing Interest Rate Risk Management

- The impact of liquidity on interest rates
- Gap analysis and the maturity ladder
- Types and uses of the gap analysis
- Stress testing and the impact of rate shocks
- Simulation approaches
- Duration
- Convexity adjustments
- Repo – financing and liquidity operations
- The risk in modeling interest rate risk
- The controls over interest rate risk

Case Study: Develop an audit program to address the management of interest rate risk

Auditing the use of Derivatives, Forward Transactions, and Corporate Governance

- The role of the Board and senior management
- Knowledge and skills
- What is a derivative?
- The knowledge gap in audit
- Forwards and Forward Rate Agreements (FRNs and FRAs)
- Traded financial futures and options
- The pricing, modeling and risks of derivative activities
- The regulatory model risk requirements
- The documentation to support derivatives activities
- Auditing in an ISDA environment
- The transaction cycle
- Confirmation and Reconciliation
- The control over the use of derivatives
- Controls over trading activities



Day 3:

Rules, Regulations, and Stress

- Sensitivity analysis, stress testing, and scenario modeling
- What can go wrong in the practice
- The impact of Northern Rock on your audit approach
- The regulations of liquidity risk and treasury management
- The role of the central counterparty
- Counterparty credit risk
- The use of ratings
- Developing your ratings
- How will you judge what is material?
- Where will the audit concentrate

Case Study: Develop an audit program to address the following:

- The audit of counterparty credit risk
- The audit of stress testing and scenario modeling

Auditing operational risk

Internal audit of operational risk includes:

A sound risk management framework includes an adequate control environment and policies and procedures for measuring, managing, and controlling operational risk. This includes specifically:

- A documented operational risk strategy
- An adequate risk management structure
- Effective internal controls procedure and an MIS System
- Clearly defined policies and procedures for the active management of operational risk, which must include:
 - Establishing limits/indicators and authorized products and services
 - Ensuring allocation of adequate regulatory and economic capital for its operational risk exposure
 - Contingency Planning
 - Adequate disclosure requirements
- Clearly defined policies and procedures to measure and monitor the bank's operational risk exposures against its strategy. This would include:
 - Identification of risk factors
 - Adequate monitoring and review procedures
 - Control procedures and risk mitigation

Auditing Basel II calculation

- Audit of source data
- Audit of the calculation model
- Audit of reporting mechanism to the CBK.