Operational Risk and Internal Controls

Bank Analysis and Examination School
Operational Risk

Arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses.
Components of a Control System (COSO)

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring
Internal Controls and Risk Management

- Board Oversight
- Policies & Procedures
- Management Information Systems

- Internal Controls
Objectives of Internal Controls

- Safeguard Assets
- Accuracy & Reliability of Financial Stmts
- Operational Efficiency
- Compliance with Policies
Types of Controls

1 Competent, trustworthy personnel with clear lines of authority & responsibility,
Types of Controls

1. Competent, trustworthy personnel with clear lines of authority & responsibility,
2. Adequate segregation of duties,
Types of Controls

1. Competent, trustworthy personnel with clear lines of authority & responsibility,
2. Adequate segregation of duties,
3. Proper authorization procedures,
Types of Controls

1. Competent, trustworthy personnel with clear lines of authority & responsibility,
2. Adequate segregation of duties,
3. Proper authorization procedures,
4. Adequate documents and records,
Types of Controls

5 Proper record-keeping procedures,
Types of Controls

5 Proper record-keeping procedures,
6 Physical control over assets & records, and
Types of Controls

5 Proper record-keeping procedures,
6 Physical control over assets & records, and
7 Independent checks.
Assessing Operational Risk

- Level of Risk
- Quality of Risk Management
Assessing Operational Risk
Consider these questions:

- How well informed are BOD and senior management about bank’s operations?
- How capable are senior officers in managing their respective areas?
- Does senior management ensure that appropriate internal control policies & procedures are in place?
- Have written policies & procedures been developed?
Assessing Operational Risk
Consider these questions:

- Do the policies & procedures address material operational areas?
- Does bank’s MIS generate timely and meaningful reports for management and the BOD?
- Has an internal/external auditor been appointed?
- Is the auditor independent of operational areas?
Assessing Operational Risk
Consider these questions:

- Are segregation of duties and lines of authority adequate and enforced?
- Are audits conducted regularly?
- Are audit findings and recommendations reviewed and addressed by BOD and senior management?
Legal Risk

Arises from the potential that unenforceable contracts, lawsuits, or adverse judgements can disrupt or otherwise negatively affect the operations or condition of a banking organization.
Reputational Risk

The potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.
Questions?