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RISK-BASED OPERATIONAL AUDIT

A solid case for stringent business

The case of risk-based operational audit has long been debated.But the question is, what is the best way to go about this?

BY ANGELA MHLANGA – COMPASS INSURANCE

Some of the key aspects to this debate have included: What is the importance and relevance of the audit considering that a company undergoes an external audit annually? What are the key elements to functional audit processes? And, of course, how to best create a structural framework from which to measure processes to ensure the audit actually negates risk and creates a fluid risk environment? In light of the recent economic recession, where it can be argued that risk management was not effectively applied, resulting in both indirect and direct losses from inadequate internal processes, people and systems, it is evident that measuring and managing risk is most certainly becoming an essential tool to effective business management.

THERE IS NO DOUBT THAT THE INSURANCE SECTOR NEEDS SPECIFIC OPERATIONAL AUDITS TO MANAGE RISK EFFECTIVELY

About the author

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CRITICAL FUNCTION

The function of a risk based operational audit is ultimately to review and manage the systems and procedures that govern a business by understanding the risks that attach to them. It aims to ensure these aspects work together effectively by creating agreed upon internal performance objectives, agreed upon standards and criteria for evaluating and assessing these objectives and finally to measure actual performance against targeted performance.

While these are all key elements, what is becoming ever more critical, is to report back timeously to relevant stakeholders to ensure that the company mitigates possible disasters/catastrophes. This will lead to more efficient and effective operations which will in turn lead to sustainable profitability and the ability to effectively identify and manage potential risks. This is ever more pressing in the insurance industry where much of the markets attention has already been given to credit risk; solvency risk and insurance risk - practitioners are now looking closely at operational risk and how to best manage this across the diverse insurance related business operations.

Within this sector, the operational audit plays a critical role. If we take for example how activities in a binder arrangement are managed - where the company has strict compliance rules which need to be adhered to, to manage risk for the principal, it becomes critical to have operational audits in place.

Furthermore, the size of the insured business and the level of complexity could certainly call for the need for an operational audit. In fact, anywhere where internal processes are a key component to managing business risk, paves the way for a possible audit.

THE INSURANCE CONTEXT

There is no doubt that the insurance sector needs specific operational audits to effectively manage risk. However, key areas that should be covered under such audits are investments, underwriting activities, claims handling activities, cash collection and payment activities. It is evident that core business functions are reviewed as part of the audit process however insurers need to also ensure that at every point in the business the operational audit process is undertaken with agreed standards and objectives in mind, resulting in consistency and accurate outcomes.

ADDING VALUE

Done correctly, an operational audit can have a strong, positive impact on the business. As the audit offers the decision makers an opportunity to identify areas that could present larger, more complex problems in the future, by identifying areas of risk and assisting in finding ways to mitigate this risk.

While risk management is a key element in this process, it also highlights areas where reduction in costs can be obtained, or even better, where elevated revenues could be obtained within the business. With this in mind, it should also be raised that these stringent audit processes enhance the companies' ability to simplify processes and ensure that staff are working smart and not hard - reducing lead times and maximising business proficiencies. Lastly, risk-based operational audits should lead to the elimination of company bureaucracy allowing for easier decision making within well understood parameters.

SUCCESSFUL RISK FRAMEWORK

There are a few vital elements to establishing a functional and successful risk framework.

1. Establish risk areas within the operations
Creating a diverse risk level structure, where the severity of risks impacting the business are isolated from one another, to assist the business in managing each risk in relation to its effect on the business. Through digesting the importance and consequences of these risks singularly instead of seeing them as one issue it helps create a platform for logical resolution.

2. Audits should be regular and consistent
The operational team need to see the approach not as one that can merely tick the boxes. While evaluating processes is important, the main focus of these audits is on managing risk, especially severe risks or

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processes

those that could potentially become severe. This process needs to comprise of tough interrogation of processes and requires pragmatic thinking to ensure each auditor is thinking "what if" in terms of risk identification.

3. Establish feedback touch points for the operational team and relevant stakeholders

Reports that are transparent, that are easy to read and assimilate will assist management to effectively run their organisations and play a critical role in the risk mitigation process. As such, companies need to ensure they have a fluid, consistent and easy to understand reporting and feedback process.

While a strong operational framework is certainly incremental in successful risk management, other aspects that work hand-in-hand with the framework need to be considered.

- Resources – ensuring you have the right people to conduct audits and run the operations will go a long way in ensuring success. The culture of continuously seeking to improve processes from the management team will also aid the operational audit process.
- Implementation of improvement areas – Reviews are crucial however without implementation they remain a "white elephant". So it is critical that sufficient efforts are made in ensuring controls are implemented through trained, motivated team members.
- Review – Track and reinvigorate processes and procedures to refresh the audit process and allow for innovation in the aim of effective risk identification and management.

Since operational risk is evident in every business, companies should look to undertake regular operational audits, cleaning the business from the inside out. People, processes and agreed standards need to be kept top of mind, ensuring they work together effectively and are following correct procedures in identifying and mitigating risk.

COMPANIES SHOULD LOOK TO UNDERTAKE REGULAR OPERATIONAL AUDITS, CLEANING THE BUSINESS FROM THE INSIDE OUT

Risk management can be a defining factor between a business' success and downfall, therefore companies should consider a viable risk management platform that addresses existing and potential risks and that offers a solid means of feeding this back to the relevant people to evaluate and resolve. A risk based operational audit can do just this... effectively! 35