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АУДИТ РИЗИКІВ БАНКІВСЬКОЇ ДІЯЛЬНОСТІ ВІДПОВІДНО ДО МІЖНАРОДНОЇ СИСТЕМИ ОБЛІКУ

Обґрунтувано теоретичні положення і розроблено практичні керівні принципи, що стосуються методів визнання та оцінки ризиків і визнання ризиків у структурі комерційних банків.
Найбільш значущими виділені одиничні і часткові ризики. Особлива увага приділяється конкретизації часткових ризиків, які безпосередньо визначають способи боротьби з ними.
Ефективний менеджмент вимагає поєднання методів впливу на процес управління ризиками. Особлива важливість надається теоретичним, методологічним і практичним аспектам визнання та оцінки системи управління ризиками.
Ключові слова: *банківський ризик, управління ризиками, внутрішній аудит, міжнародна система бухгалтерського обліку.*

Sarahman O., Shevchenko T., Koren M. AUDIT OF BANKING RISKS IN LINE WITH INTERNATIONAL ACCOUNTING FRAMEWORKS
The article justify the theoretical propositions and developing practical guidelines on methods for recognizing and measuring the risks and to determine the risk structure of commercial banks.
The most significant a single and partial risks are identified in the article. Special attention is paid to the concretization of a partial risk which directly determines methods to control them.
Effective management requires a combination of methods to make influence on the process of risk management. Distinctive importance acquire theoretical, methodological and practical aspects of recognition and measurement risk management system.
Keywords: *banking risk, risk management, internal audit, international accounting frameworks.*

Problem formulation. In connection with the global trend to increase the number of financial problems the banks have extraordinary relevance is the issue of risk management.

During the formation of the audit, as a new activity in Ukraine, the main attention of scholars and practitioners is paid to organization of audit according to international standards and creation of legal support to increase the efficiency of the domestic audit. One of the key points in this process is the audit of banking institutions. The country's banking system is an indicator of development of economic processes and requires a high level of protection from various risks. Therefore, in view of the global trend to increase the number of financial problems the banks have extraordinary relevance is the issue of risk management. Effective risk management in the Bank is ensured by the functioning of the internal control system in the Bank, the most important element of which is internal audit.

In banks risk management system is a mere formality because of the lack of integration between the planning system and risk management and the planned indicators of liquidity, profitability, competence is not differentiated between controlroom and internal audit. Difficulties arise also in matters of articulating the goals and objectives of risk management, the selection of adequate instruments of neutralization of the risks, organization of risk management, controls risks.

Analysis of recent research and publications. Problems of internal audit in banks and, in particular, audit of banking risks is considered in his scientific writings and publications of many domestic scientists like: A. M. Gerasimovich, L. M. Kondracka, A. I. Kireev, G. I. Spak, T. I. Farion, etc.

Scientists mentioned in their works a detailed account of the theoretical basis for the use of internal audit in banks, the methodology and the organization of its carrying out, the use of standards internal audit. But, today in Ukraine there are certain inconsistencies in the legislative regulation of activities of internal audit. In addition, the functioning of internal audit, as a form of control over the activities of banking institutions is not yet fully resolved, and therefore is relevant andrequires a deeper study.

Goal of this article is to disclosure features methods of audit of banking activities with consideration of international requirements related to risk management.

The main material. The main objective of internal audit is the decision of separate functional problems of management and inspection of information systems of the Bank, control of compliance of operations legislative and internal requirements of the Bank. Internal audit is an integral part of management control by the Bank.

Banks have to take risks all the time. Any bank has to take on risk to make money. This includes full-service banks like JPMorgan (JPM), traditional banks like Wells Fargo (WFC), investment banks like Goldman Sachs (GS) and Morgan Stanley (MS), or any other financials included in an ETF like the Financial Select Sector SPDR Fund (XLF).

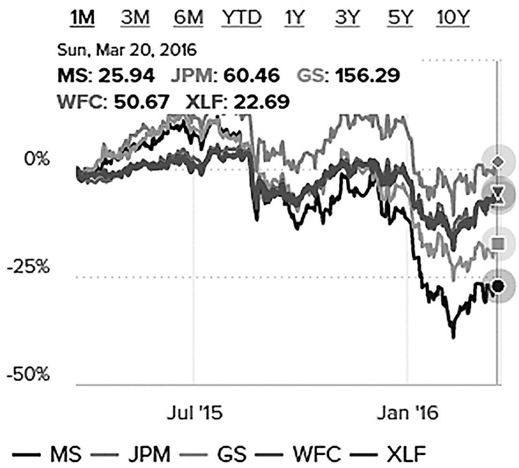

Figure 1. **Financials Performance for the last year**

Source: Market Realist

The risk arises from the occurrence of some expected or unexpected events in the economy or the financial markets. Risk can also arise from staff oversight or mala fide intention, which causes erosion in asset values and, consequently, reduces the bank's intrinsic value.

Banks face several types of risk. All the following are examples of the various risks banks encounter:

- Borrowers may submit payments late or fail altogether to make payments.
- Depositors may demand the return of their money at a faster rate than the bank has reserved for.
- Market interest rates may change and hurt the value of a bank's loans.
- Investments made by the bank in securities or private companies may lose value.
- Human input errors or fraud in computer systems can lead to losses.

To monitor, manage, and measure these risks, banks are actively engaged in risk management. In a bank, the risk management function contributes to the management of the risks a bank faces by continuously measuring the risk of its current portfolio of assets and other exposures, communicating the risk profile of the bank to other bank functions and by taking steps either directly or in collaboration with other bank functions to reduce the possibility of loss or to mitigate the size of the potential loss.

There are many types of risks that banks face. We'll look at eight of the most important risks:

Figure 2. **The 8 types of bank risks**

Source: BIS

The Basel II Accord, the most recent of these accords, focuses on three types of risk: 1) credit risk, 2) market risk, 3). operational risk.

The Basel Accord also recognizes that there are other types of risk that may include these different core risk types (see Figure 4).

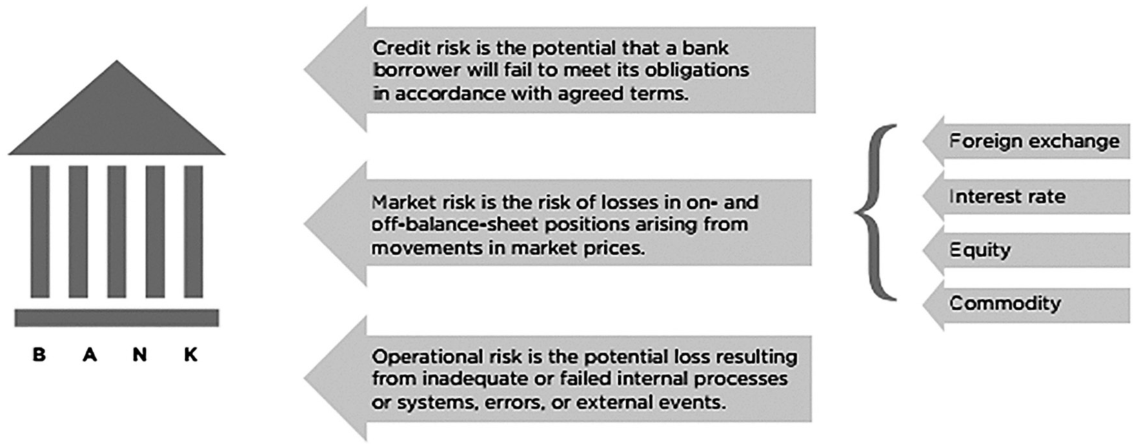

Figure 3. **Bank risks**

Source: BIS

Credit risk is the single largest risk most banks face and arises from the possibility that loans or bonds held by a bank will not be repaid either partially or fully. Credit risk is often synonymous with default risk.

Banks create provisions at the time of disbursing loan (see Wells Fargo's provision chart). Net charge-off is the difference between the amount of loan gone bad minus any recovery on the loan. An unpaid loan is a risk of doing the business. The bank should position itself to accommodate the expected outcome within profits and provisions, leaving equity capital as the final cushion for the unforeseen catastrophe.

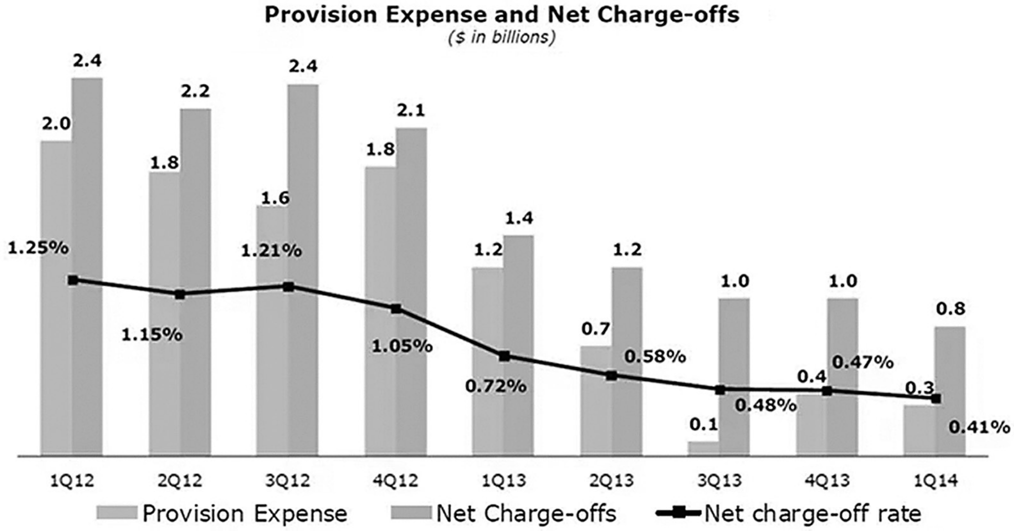

Figure 4. **Wells Fargo's provision chart**

Source: Wells Fargo

The components of market risk are as follows:

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.This definition includes legal risk, but excludes strategic and reputational risk.

The Basel Committee on Banking Supervision defines operational risk "as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputation risk."

Types beyond the three main types of risk – credit, market and operational – there are other risks banks face and must manage appropriately.

Liquidity risk relates to the bank's ability to meet its continuing obligations, including financing its assets. In conditions of tight liquidity, the banks generally turn to the Fed. Look at the chart above to see how financial institutions borrowed massively from the Fed during the subprime crisis of 2008–2009.

Figure 5. **Operational Risk Control Process**

Source: Bank of America

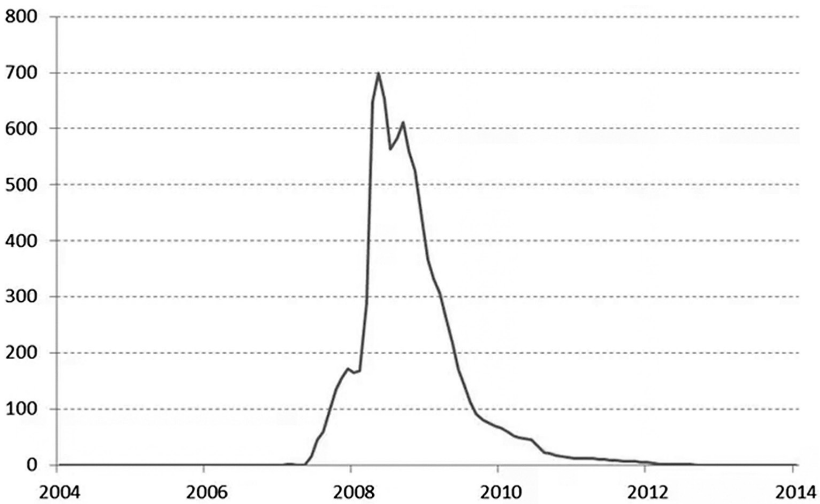

Figure 6. **Total Borrowings of Depository Institutions from the Fed**

Source: St. Louis Fed

Business risk is the potential loss due to a decrease in the competitive position of the bank and the prospect of the bank prospering in changing markets.

EXAMPLE In the mid-1990s, BestBank of Boulder, Colorado (USA), attempted to build its credit card loan portfolios quickly by issuing cards to many low-quality, "subprime," borrowers. Unfortunately, too many low-quality borrowers failed to pay their BestBank credit card debts. In July 1998, BestBank was closed after incurring losses of about USD 232 million.

This serves as a classic example of a bank seeking to grow its business by lending money to high-risk customers: Although the bank was apparently generating high returns for a period of time, it failed to adequately provide for and guard against bad debts in its business strategy.

In the heyday of cheap money in the 1990s and early 2000s, many banks were taking excessive leverage and earning supernormal profits. But most of it was a mirage. When the situation turned for worse from 2007–2008, many of the same banks that were on a roll fell flat on their face. Many of them had to take severe losses and bailouts from the government to keep afloat, while some were forced to close down.

Year	Bank failure cost to DIF	Number of bank failures Total: 490
2015 (estimated)	$894 million	8
2014 (estimated)	$398.8 million	18
2013 (estimated)	$1.165 billion	24
2012 (estimated)	$2.785 billion	51
2011 (official)	$7.945 billion	91
2010 (official)	$22.904 billion	157
2009 (official)	$38.732 billion	140

Figure 7. **Bank failures since 2009 to 2015**

Source: Federal Deposit Insurance Corp.

Reputational risk is the risk of damage to a bank's image and public standing that occurs due to some dubious actions taken by the bank. Sometimes reputational risk can be due to perception or negative publicity against the bank and without any solid evidence of wrongdoing. Reputational risk leads to the public's loss of confidence in a bank [8].

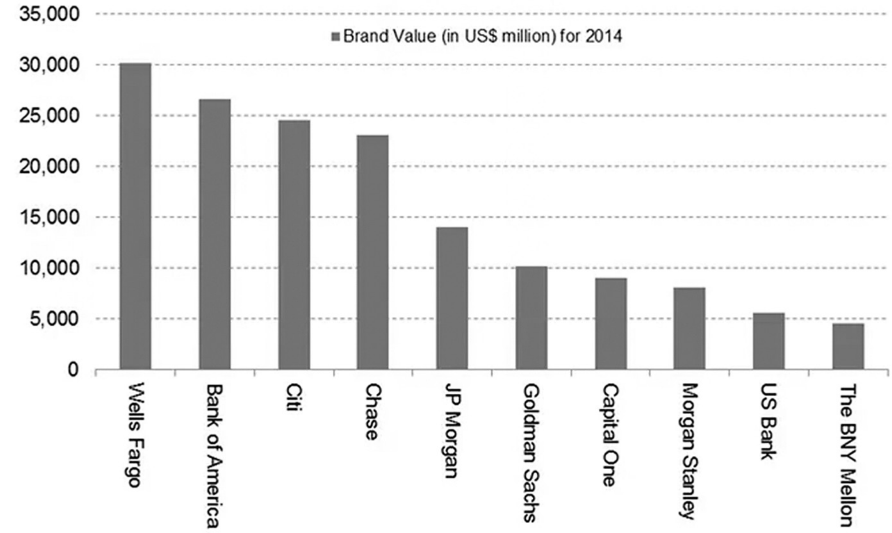

Figure 8. **Brand Value for 2014**

Source: Brand Finance

The three components of audit risk are:

(a) Inherent risk (the risk that material misstatements occur);

(b) Control risk (the risk that the bank's system of internal control does not prevent or detect and correct such misstatements on a timely basis); and

(c) Detection risk (the risk that the auditor will not detect any remaining material misstatements).

Inherent and control risks exist independently of the audit of financial information and the auditor cannot influence them. The nature of risks associated with banking activities, which are discussed in paragraphs 21–25 indicate that the assessed level of inherent risk in many areas will be high. It is therefore necessary for a bank to have an adequate system of internal control if the levels of inherent and control risks are to be less than high. The auditor assesses these risks and designs substantive procedures so as to reduce audit risk to an acceptably low level.

The risk of fraudulent activities or illegal acts arises at banks both from within the institution and from outsiders. Among the many fraudulent activities and illegal acts that banks may face are check-writing fraud, fraudulent lending and trading arrangements, money laundering and misappropriation of banking assets.

Fraudulent activities may involve collusion by management of banks and their clients. Those perpetrating fraudulent activities may prepare false and misleading records to justify inappropriate transactions and hide illegal activities. Fraudulent financial reporting is another serious concern.

In addition, banks face an ongoing threat of computer fraud. Computer hackers, and others who may gain unauthorized access to banks computer systems and information databases, can misapply funds to personal accounts and steal private information about the institution and its customers. Also, as is the case for all businesses, fraud and criminal activity perpetrated by authorized users inside banks is a particular concern. Fraud is more likely to be perpetrated at banks that have serious deficiencies in corporate governance and internal control.

When internal auditing or other monitoring activities are not sufficiently rigorous to identify and report control weaknesses, fraud may go undetected at banks. When adequate mechanisms are not in place to ensure that management corrects deficiencies reported by auditors, fraud may continue unabated.

The following table and discussion in this appendix provide examples of fraud risk factors.

	Deposit	Taking Dealing	Lending
Management & Employee Fraud	Depositors' camouflage Unrecorded deposits Theft of customer deposits or investments, particularly from dormant accounts	Off-market rings Related party deals Broker kickbacks False deals Unrecorded deals Delayed deal allocations Misuse of discretionary accounts Exploiting weaknesses in matching procedures Mismarking of book Collusion in providing valuations (Valuation rings) Theft or misuse of collateral held as security	Loans to fictitious borrowers Use of nominee companies Deposit transformation Transactions with connected companies Kickbacks and inducements Use of parallel organizations Funds transformation Selling recovered collateral held as security collateral at below market prices Bribes to obtain the release of security or to reduce the amount claimed Theft or misuse of collateral held as security
External Fraud	Money laundering Fraudulent instructions Counterfeit currency or drafts Fraudulent use of Check float periods (Check kiting)	Fraudulent custodial sales False information or documents regarding counterparties	Impersonation and false information on loan applications and subsequently provided documents Double-pledging of collateral Fraudulent valuations (Land flips) Forged or valueless collateral Misappropriation of loan funds by agents / customers Unauthorized sale of collateral

Source: built by author based on [4].

EXAMPLE. ABC is an audit and assurance firm which has recently accepted the audit of XYZ. During the planning of the audit, engagement manager has noted the following information regarding XYZ for consideration in the risk assessment of the assignment:

XYZ is a listed company operating in the financial services sector

XYZ has a large network of subsidiaries, associates and foreign branches

The company does not have an internal audit department and its audit committee does not include any members with a background in finance as suggested in the corporate governance guidelines

It is the firm's policy to keep the overall audit risk below 10%.

Inherent risk in the audit of XYZ's financial statements is particularly high because the entity is operating in a highly regularized sector and has a complex network of related entities which could be misrepresented in the financial statements in the absence of relevant financial controls. The first audit assignment is also inherently risky as the firm has relatively less understanding of the entity and its environment at this stage. The inherent risk for the audit may therefore be considered as high.

Control risk involved in the audit also appears to be high since the company does not have proper oversight by a competent audit committee of financial aspects of the organization. The company also lacks an internal audit department which is a key control especially in a highly regulated environment. The control risk for the audit may therefore be considered as high.

If inherent risk and control risk are assumed to be 60% each, detection risk has to be set at 27.8% in order to prevent the overall audit risk from exceeding 10%.

Working

Audit Risk = Inherent Risk × Control Risk × Detection Risk

0.10 = 0.60 × 0.60 × Detection Risk

0.10 = Detection Risk = 0.278 = 27.8%

Conclusion. There are numerous other aspects of banking that have not been covered in this chapter but will be briefly touched upon in later parts of the book – either directly or as part of a discussion about other topics.

Deregulation led to a relaxing of restrictive banking regulations in many countries around the globe. This allowed many banks to compete against each other and with other financial services providers with less direct government oversight and more freedom in how they structured their businesses. The theory behind the movement resulting in less oversight was that increased competition among banks would increase their bank efficiency. Deregulation puts market pressures on banks from organizations that offer similar banking services. Additionally, it was felt that banks would, in their own self-interest, effectively regulate themselves with little need for heavy-handed oversight from government regulators. The reasoning is that it is in the bank's self-interest to ensure they functioned properly to compete in an increasingly competitive world. However, as it became apparent in 2008, banks were unable to police themselves effectively. Their lack of discipline resulted in a virtual collapse of the global financial system. It has also become clear that many banks are now considered "too big to fail" due to their global connectivity and importance to the worldwide financial system. Now, governments are considering numerous banking regulation reforms and are, for the first time, considering adopting some type of cooperative system to allow for the rapid sharing of information among world financial regulators with the intent of more proactively addressing future financial servicesrelated risks and issues.

Thus, we can conclude that diversification of risk categories objectively necessitates an internal audit system. The Bank may develop a system of internal audit on a functional basis, business units, or mixed. Regardless of the principle of the formation of the internal audit service it should cover every category of partial risk and meets the basic requirements of risk management.

Further study of the topic is the development of knowledge and organizational models of risk management in the internal audit of banks.

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