



Testers Testing Testers

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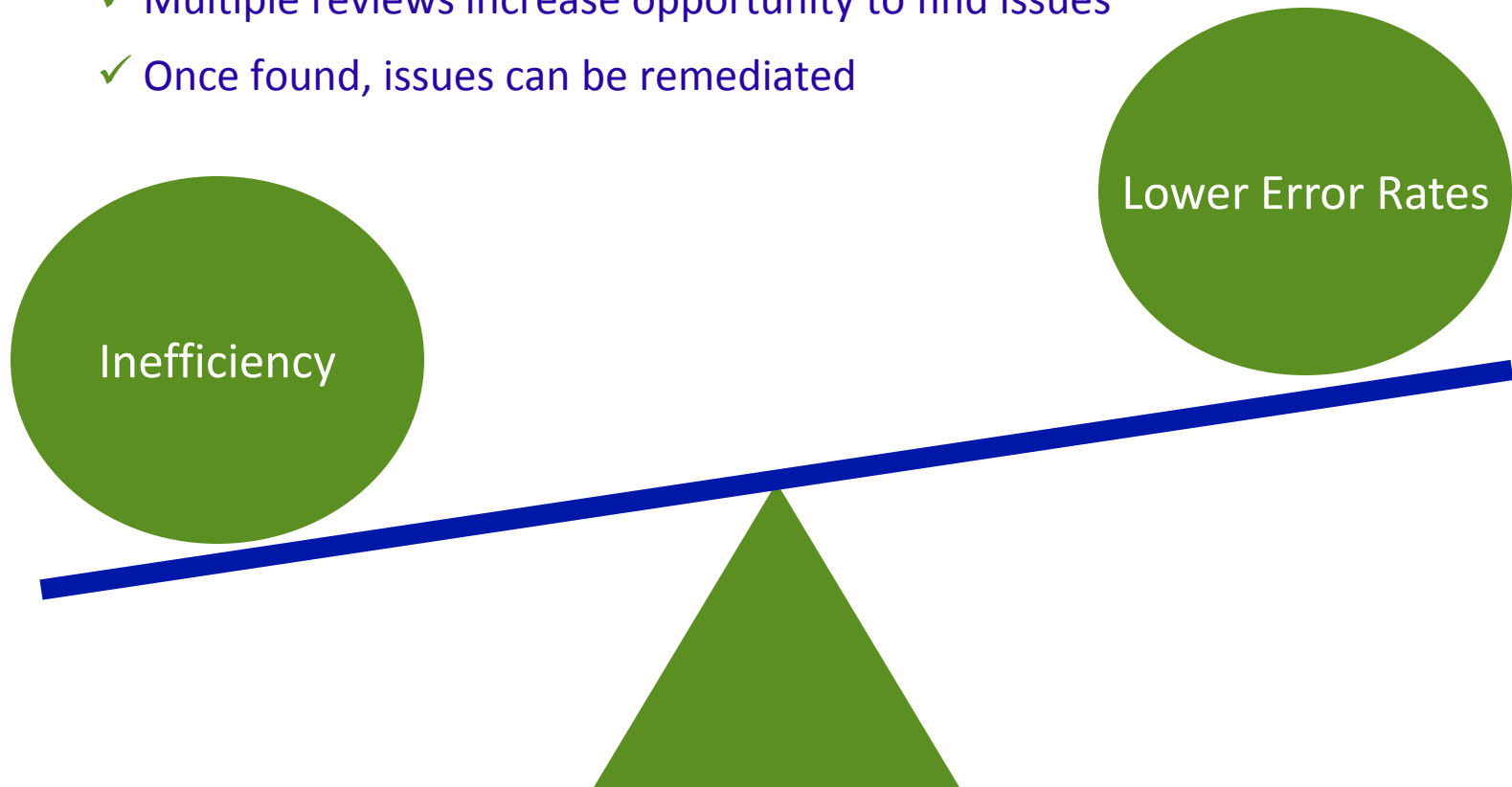
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Disclosure: The comments and opinions expressed in today's session are my own and not necessarily those of Fifth Third Bank.

Testers Testing Testers: Finding the Right Balance

- Redundant testing is inefficient:
 - ✓ Increased infrastructure and expense
 - ✓ Frequent disruption to frontline producers
- Lower error rates:
 - ✓ Multiple reviews increase opportunity to find issues
 - ✓ Once found, issues can be remediated



- Voltaire: “...the perfect is the enemy of the good”
- Shakespeare: “...striving to better, oft we mar what’s well”
- Pareto principle (80-20 rule): “Achieving absolute perfection may be impossible and so, as increasing effort results in diminishing returns, further activity becomes increasingly inefficient.”

Source: Wikipedia



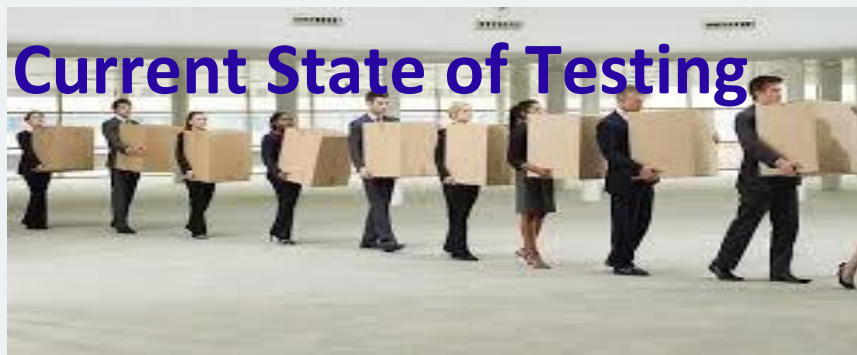
Providing Context: Why Do We Care About Testing?

Testing is an integral part of effective risk management.

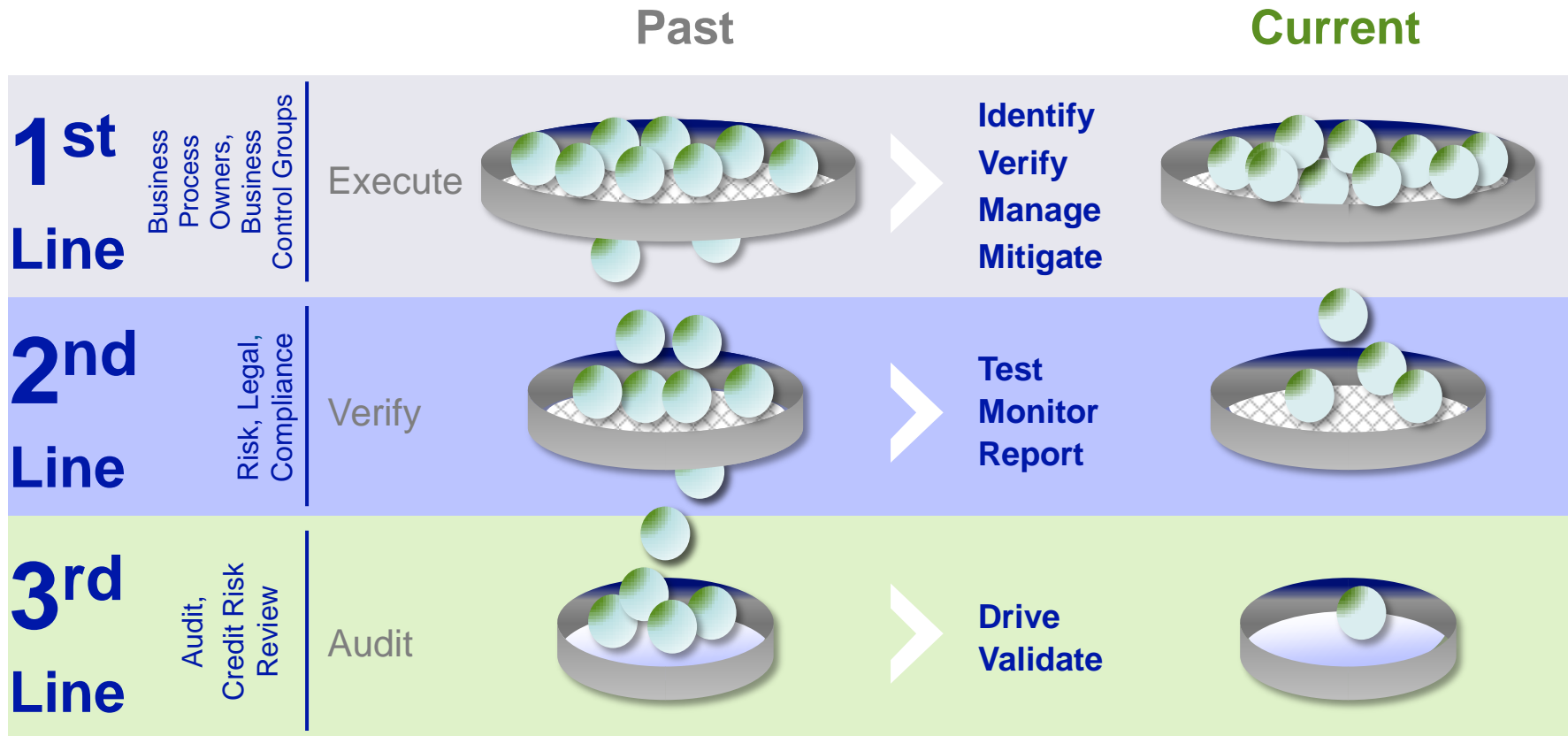
Effective risk management results in:

- Enhanced client experience
- Increased employee engagement & profit margin
- Improved shareholder value
- Strengthened audit & regulatory ratings

Current State of Testing



Testers Testing Testers: Current Model for Enhancing the Control Environment through Testing



- The model above relies on Testers Testing Testers
- Redundancy is expensive in number of FTE and disruption to the LOB

What Testing Is Redundant Today?

Investment Management & Trust Example

Administrative Review Process for Irrevocable Trust Accounts

First Line:

Ongoing Administrative Review Activity: performed annually

- Trust Officers perform an Administrative Review on each one of their trust accounts
- Management performs a Management Account Administrative Review (MAAR) for each Trust Officer based upon the following:
 - A Trust Officer with 1-19 accounts receives 1 MAAR per year
 - A Trust Officer with 20-39 accounts receives 2 MAARs per year
 - A Trust Officer with 40+ accounts receives 1 MAAR per quarter
- Business Controls performs 1 MAAR per Manager per year
- Business Controls performs Administrative Review Testing on a monthly basis

Business Process & Controls Group Administrative Review Analysis (RBPM): completed Q2 2016

Second Line:

Compliance Administrative Review Analysis: launched Q3 2016

Third Line:

Internal Audit Review: completed Q3 2016 with the majority of issues reported being self-identified.

In 2016, administrative review analyses were performed **by all three lines of defense**.

Leveraged Testing



Everything does not need to be tested. Leveraged testing *optimizes* the use of resources to promote better decision making in the control environment.

Goals:

- Test **close** to the activity
- **Reduce** overall LOB disruption
- Increase profit margin and shareholder **value** by reducing redundancy and optimizing staff utilization
- **Enhance** control environment by increasing capacity for additional testing in the first Line of Defense

- A globally-accepted inventory of controls and a consistent definition of inherent risk, residual risk and key controls are foundational to leveraged testing
- Appropriate process prioritization and Risk & Control Self-Assessment (RCSA) results are necessary to identify high risk processes that require key control testing
- The Line of Business (LOB) and Business Controls will test throughout the year and store results centrally, permitting all lines of defense to locate testing data and results with minimal disruption to the LOB







How Far Can We Go?



Leverage Compliance findings as inputs into Business Controls testing methodology:

- Align a high-risk process assessment schedule with Compliance testing to disrupt the LOB once
- Assumes that 1st and 2nd Lines of Defense agree upon the current risk environment (e.g. inherent risk, key controls)
- Recognizes that regulatory compliance testing is a subset of total testing to be performed

Considerations:

- | | |
|---|---|
|  Reduce LOB impact |  Practical challenge of aligning 1 st and 2 nd Line of Defense schedules |
|  Create further integration of Risk Based Process Management (RBPM) and RCSA |  Regulatory Compliance testing is limited to regulatory requirements; operational testing would still have to be performed by the 1 st of Defense |
|  Perform real-time testing | |
|  Create testing capacity in the 1 st Line of Defense | |

Shifting resources from Compliance to Business Controls to conduct both operational and regulatory compliance testing:

- Assumes necessary testing can be achieved on limited resources without adding FTE
- 2nd Line of Defense responsibilities:
 - Participate in the development and review of 1st Line of Defense testing methodologies
 - Perform independent sample testing to confirm results
 - Ensure overall testing meets regulators' expectations

Considerations:



Reduce LOB impact by sampling from BCG tests rather than performing additional, independent testing



Redeployment of Compliance testers to adjust for volume of testing in each line of defense may require fewer testers overall



Requires Compliance to rely on 1st Line of Defense testing results



Perceived loss of 2nd Line of Defense independence



Practical challenge of realigning 1st and 2nd Line of Defense roles, responsibilities and FTE



Potential regulatory expectation that 2nd Line of Defense should perform testing

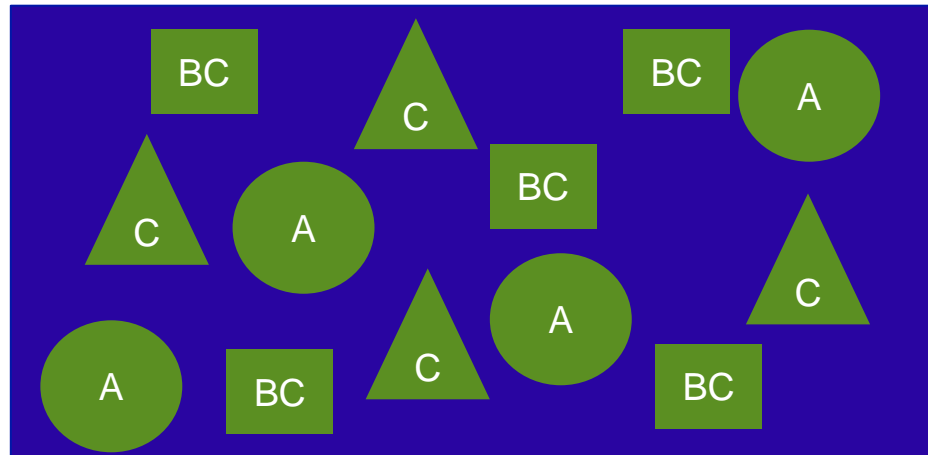
Building out additional monitoring functions can further enhance both Option A and Option B:

- Identify areas where key control indicators can be transformed from manual to automated tasks
- Invest in the creation of automated monitors that will generate and store ongoing and informative data queries
- Generate data that may not give insight into the quality of execution of a given control, but will illuminate other factors (e.g. system access recertification)
- A monitor may require significant investment to build, but once it is setup, manual sampling is reduced and greater efficiencies are realized by all Lines of Defense
 - For example, all lines of defense can pull the data queries of the automated monitoring functions to analyze test results, reducing LOB disruption

Leveraged Testing: Option C

Creating a Combined Assurance approach is the “utopian state” minimizing duplication of testing across the organization and maximizing testing coverage:

A = Audit
BC = Business Controls
C = Compliance



Considerations:

- | | |
|--|--|
| <ul style="list-style-type: none">  Increases executive transparency and insight  Minimizes testing duplication  Optimizes resources and testing coverage and reduces turnaround times to increase speed of resolution  Creates repeatable tests with similar processes across the business | <ul style="list-style-type: none">  Practical challenge of aligning priorities of all 3 Lines of Defense to avoid impacting independence or misalignment with regulatory expectations  Difficult to define a hybrid approach to risk assessment using historical and external data  Huge organizational and cultural shift  Large investment in current state research and future state implementation |
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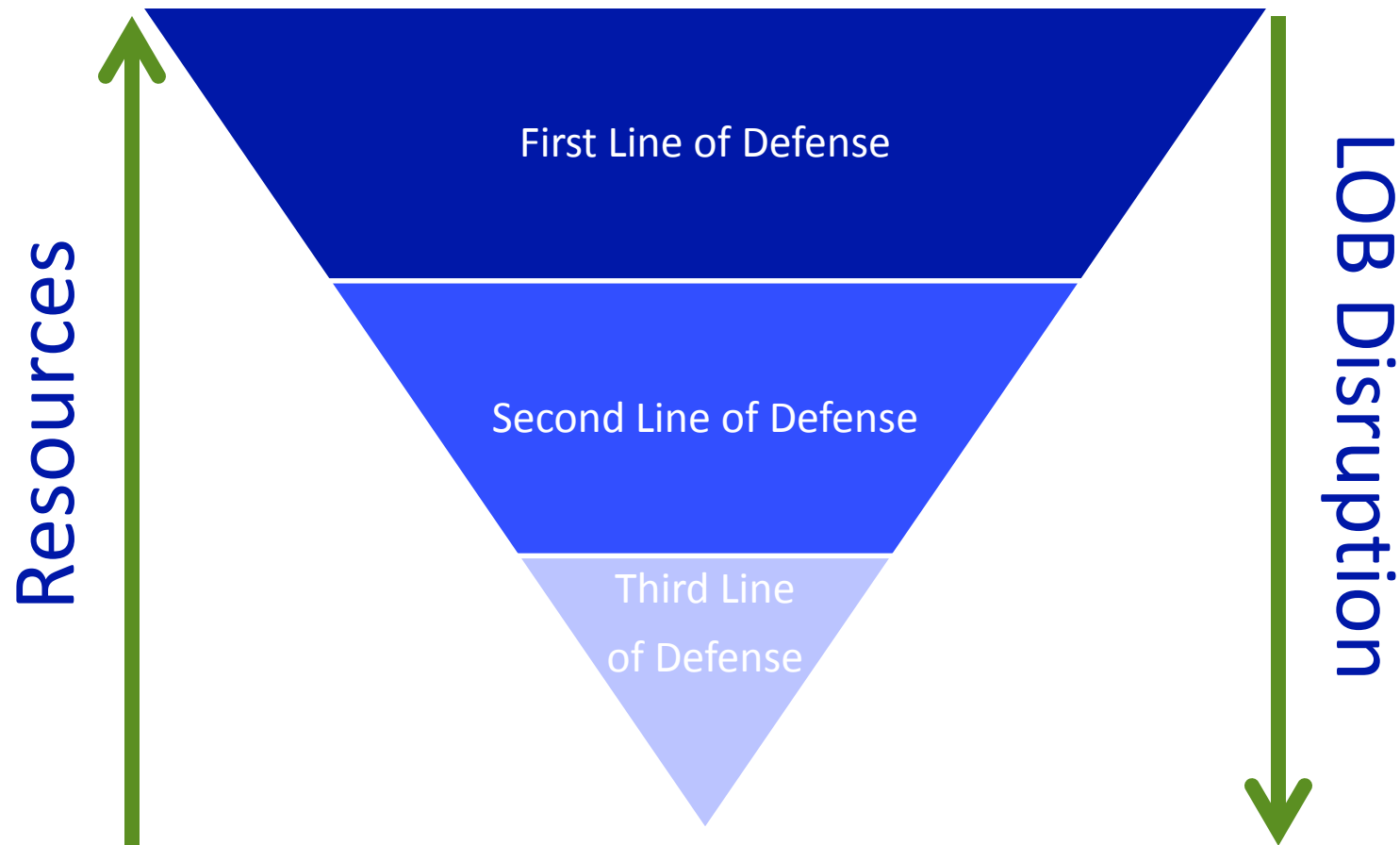
Option B meets all stated goals:

- ✓ Testing occurs in 1st Line of Defense
- ✓ When combined with the monitoring ideas, results in improved efficiency and minimizes redundancy
- ✓ Clearly defined separation of duties between the 1st and 2nd Lines of Defense, allowing for increased overall testing coverage
- ✓ Reduces overall FTE required for testing, saving expense

Impact on the Control Environment by Risk Type									Aggregate Impact on Business as Usual (BAU)
Credit	Regulatory Compliance	Legal	Liquidity	Market	Operational	Operational category (Optional)	Reputation	Strategic	
—	↓	↓	—	—	↓	—	—	↓	↓

Testers Testing Testers: **Future** Model for Enhancing the Control Environment through Testing

As testing resources redeploy to the First Line of Defense, LOB Disruption by Second and Third Lines of Defense greatly reduces.





Testing Leveraged Testing



Testing Leveraged Testing: Pilot Design

The goal of the pilot is to improve resource utilization across all lines of defense.



- One pool of testers in the first line of defense to produce one set of testing data, covering both operational and regulatory compliance testing
- Second line of defense responsibilities:
 - ✓ Participate in the development and review of first line of defense testing methodology and scope definition
 - ✓ Perform independent review of testing results for accuracy and integrity of reporting
 - ✓ Ensure overall testing meets regulators' expectations
 - ✓ Line by line review of procedures

Testing Leveraged Testing: Initial Steps

- Identify and compare current tests, looking for comprehensiveness and overlap
- Establish a testing methodology (reviewed annually) that will cover both operational and compliance testing, including sample size, material to test, how to report findings, etc.
- Determine testers and their responsibilities
- Develop supervision criteria
- Establish shared data storage site for test results
- Determine second line of defense independent reviewers and challenge methodology
- Establish protocol for written findings and recommendations

Mini-LOB for Pilot: Personal Trust Discretionary Distributions

- Selected discretionary distributions from trust accounts due to significant test script overlap
- 60 transactions were selected: 30 previously reviewed by Business Controls, 30 independently reviewed
- Compliance testing revealed a few errors missed by Business Controls
- In addition, Compliance reviewed the testing report generated by Business Controls, including the resulting self-identified issues and the proposed action plans
- Compliance recommendations to Business Controls:
 - ✓ Adjust test script to capture the issues missed (e.g. type of account, tax responsibility)
 - ✓ Reduce sample size to focus more time on each item tested

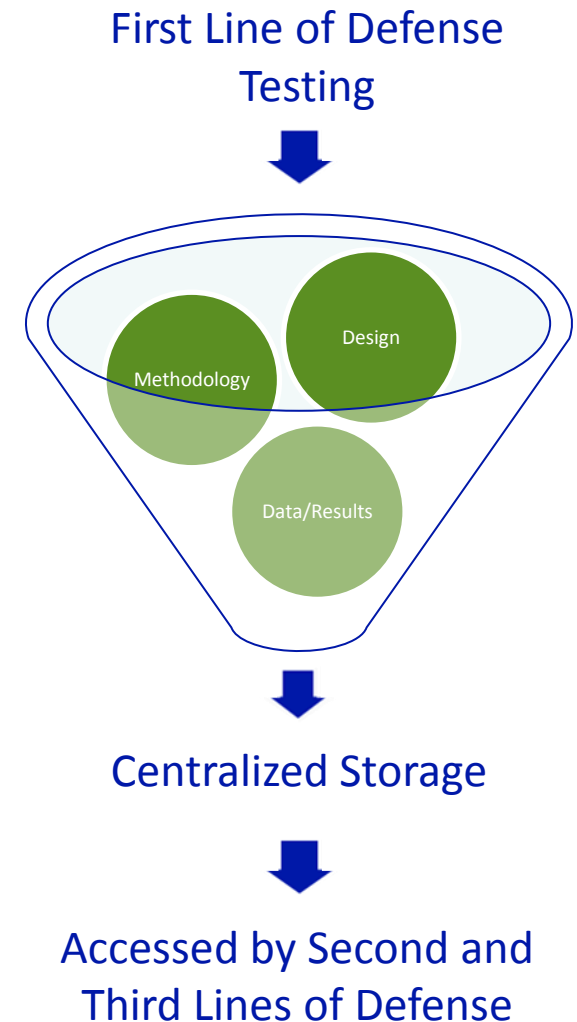
Bottom line: The goal is for Compliance to rely more on the ongoing monitoring performed by Business Controls. Depending on the quality of the Business Controls work, Compliance could reduce its sample size or testing frequency.



Leveraged Testing: The Dream State

Imagine a World Where:

- The majority of the testing is performed within the first line of defense;
- The test results are stored centrally;
- The second line of defense reviews the test design, policies and procedures and uses the centrally stored data to perform its review of the first line's tests;
- The third line of defense validates the work of the first and second lines by reviewing the centrally stored data and pulling independent samples.



Test close to activity

Enhance control environment by increasing capacity for additional testing in the first line of defense

Reduce overall Line of Business disruption

Increase profit margin and shareholder value

Group Discussion and Questions