Welcome to the White paper series on regulatory audits: Part 1

Regulatory audits in Switzerland: «What are auditors' expectations?"

Author: Audrey Milesi (Nov 2023)

This overview covers the ins and outs of auditors' expectations, the regulatory framework, the audit process, findings, and how management should handle them, all while emphasizing the importance of good preparation.

«What are auditors' expectations?" It's a question that keeps popping up at various events, webinars, and client meetings.

While the financial audits seem to be clear enough to auditees (that is, the organizations being audited), there appears to be a need to demystify the regulatory part. To put it plainly, **auditors expect** - as would, hopefully, Management **- that financial institutions and intermediaries have an organizational set up that is compliant with laws and regulations in place at the time of the audit**.

Regulatory audits can seem a bit overwhelming at first. They cover a broad range of topics that at first sight may not be (easily) quantifiable, such as governance and reputation/good business conduct. And areas that are heavily finance-related, such as liquidity and investment compliance.

Role of Compliance Officers

It is essential to acknowledge the role of **compliance officers**, typically **entrusted with coordinating the audit process**. Their responsibilities encompass the identification of the appropriate business owners and the effective communication of auditors' expectations regarding documentation. However, this task may appear cumbersome, partly due to an underlying challenge rooted in **a deficit of effective and transparent communication**. Often, auditors are relatively junior, possessing initial experience in financial audits but limited familiarity with the regulatory aspects. Conversely, organizations tend to undervalue the impact of regulatory audits when juxtaposed with financial audits, resulting in a relative lack of attention.

Framework in place

Crucially, **audits are not arbitrary exercises led by auditors**; rather, they are conducted within the confines of the established regulatory framework. In Switzerland, the Federal Act on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act, FINMASA) of 22 June 2007, particularly Chapter 3, "Supervisory Instruments" (Articles 24 to 29), delineates the foundational principles governing audits as a mechanism for oversight (FINMASA).

FINMA outlines on its page (FINMA and reg audit) the following:

"The auditing process assesses institutions' compliance with supervisory requirements and whether they can continue to adhere to these requirements for the foreseeable future. Audit firms are requested by the supervised institutions to carry out these audits, which are conducted in line with FINMA's specifications."

Furthermore, FINMA describes specific requirements for auditing banks, insurers, collective investments schemes, financial market infrastructures and FinTech and elucidates audit-related activities in its Circular 2013/3, "Audit." Note that this circular has been revised and FINMA provides both versions: the one valid until 31 December 2023 and the one valid from 1 January 2024. All documents pertaining to the conduct of the audit (circular and risk strategies) can be found on the webpage.

Additionally, Article 126 of the Collective Investment Schemes Act (CISA) of 23 June 2006 underscores the significance of audits in the realm of supervision. CISA

Auditors themselves are subject to regulation through the Auditor Oversight Act (AOA) of 16 December 2005. Auditor Oversight Act

It is noteworthy that EXPERTsuisse, the Swiss Association for Audit, Tax, and Fiduciary, issues audit recommendations ("RA"), often complementing the Swiss Standards on Auditing Financial Statements. These recommendations undergo timely updates following any alterations to FINMA's documents. It is worth noting that while these documents predominantly focus on financial audits, RA 70, specifically addressing regulatory audits, experienced its last update in 2020 following modifications to Circular 2013/3 (Access to RA 70).

It is advisable to follow these recommendations, even if they do not have the same binding force as the Swiss Financial Statement Auditing Standards.

Audit Structure

The audit process, at a high level, encompasses several key stages:

- **Preparation**: This phase entails risk analysis and the formulation of an audit strategy.
- **Opening meeting**: An initial meeting sets the stage for the audit.
- **Audit**: The substantive audit work is conducted.
- **Closing meeting/Findings Discussion**: Meeting held to communicate and discuss the audit results.
- **Report and Management Review and Answers**: The final audit report is prepared and reviewed by the management.

Central to this process is the pivotal role of risk analysis, which defines the audit strategy. The risk analysis is completed by the auditor and encompasses all regulatory domains earmarked for the audit cycle (typically several years). **This is not the risk analysis produced by the organization!**

A risk-based approach is advocated to conduct the regulatory audit, although the concept of materiality, so central to financial audits, does not readily apply in the regulatory context. Consequently, for a firt-time audit, all areas are conventionally designated as high-risk by default (as a combination of area per se and risk of control), with refinements possible only after the initial audit and its outcomes/findings. The results of the risk analysis dictate the sequencing and prioritization of the audit strategy and the audit cycle.

The considerations in this regard are multifaceted, and the risk analysis is customarily tailored to the specific attributes of each organization. Both the risk analysis and the audit strategy necessitate submission for management review and approval to initiate the audit process.

It goes without saying that all meetings and interactions between the organization and the auditors in the course of the audit should be documented. However, key meetings such as the **opening meeting** (when auditors meet the people in charge to coordinate the audit within the organization) and the **closing meeting** (when results and findings are communicated) **must be minuted**.

As per FINMA definition, audits' results are reported in a standardized fashion. The reports are digital, (on the FINMA platform: **FINMA_ Regulatory audits templates**) follow a pre-determined structure, including: *"general information about the audit procedure, a statement of the auditors' independence and other information about the development of the respective institution's business activity and its organization. The report also contains a commentary on any irregularities discovered or on recommendations for improvements."*

Findings

The results of audits are materialized in the auditors' workpapers (usually not shared with the auditee). These papers must describe the steps taken to audit a specific area as well as the outcome and findings where applicable.

What are "findings"? Audit findings are the result from the evaluation of the collected audit evidence with regard to the audit criteria. Findings are then classified into two sections: "recommendations" and "irregularities", both quantified thereafter in terms of "gravity": **low, medium and high**. Here as well, each degree has a definition (which can be found in the RA70) and it is of the utmost importance that auditees understand them, in order to be able to discuss them in a constructive way with the auditors.

Notably, Article 27, "Reporting and Measures," of FINMASA assumes significance in the context of findings. Failure to comply within the stipulated timeframe necessitates the immediate notification of FINMA.

[1] The audit company provides FINMA with a report on its audits. The audit company provides the supreme management body of the audited supervised person or entity with a copy of the report.

[2] If it identifies violations of supervisory provisions or other irregularities, it shall give the audited supervised person or entity an appropriate period to restore compliance with the law. If the period is not complied with, it informs FINMA.

[3] In the case of serious violations of supervisory provisions or serious irregularities, the audit company notifies FINMA immediately.

In certain instances, severe violations or irregularities may precipitate the loss of authorization, thereby jeopardizing the entity's license to operate.

Management's response to findings

Indeed, the closing meeting during which findings are discussed is always a bit "feared" from both sides who want to avoid any blood bath (we have witnessed some!). A compromise must be reached but it should not end up in some haggling session.

We will never stress enough the importance of understanding the content and the implications of findings. Quite often, Management or business owners are quite happy to see auditors leave and would agree to anything. This cannot be a positive strategy since auditors would be back in one year's time and check on the resolution of findings!

Conclusion

To summarize, the regulatory audit, akin to its financial audit counterpart, adheres to a rigorous and structured framework, impervious to arbitrary decisions by auditors. **The regulatory audit merits equitable consideration alongside financial audits, given that findings may exert a pronounced influence on an entity's "license to operate."** Comprehensive preparation represents the linchpin of audit efficacy, with the initial investment of time yielding substantial dividends in the long term. Audit preparations are designed to span years, affording a learning curve.

Recommendations for a successful preparation

1. **Involvement of Management from Day 1**
2. Appointment of a coordination team (usually the Compliance team) but define Roles and responsibilities of each business owners audited!
3. Communication and transparency with auditors: **Don't make promises you cannot keep!**
4. **Don't produce documentation for the auditors!**
5. Ensure all business owners understand the findings identified: **Don't' commit to anything to get rid of the auditors. It will backfire!**
6. Ensure that findings are followed up and closed. If they are still open, ensure that the rationale behind is well documented.

About the author

Audrey Milesi, ACCA, ACFE, ACAMS and President of the ACAMS Switzerland Chapter (audrey.milesi@amc-advisory.com)

Founded AMC Advisory (www.amc-advisory.com), a consultancy specialized in Compliance Advisory and Outsourcing, AML, internal and regulatory audits as well as AML and Data Protection trainings.

More to come!

Part 2: Regulatory audits in Switzerland: «How is AML audited?"

Part 3: Regulatory audits in Switzerland: «How is Governance audited?"

Part 4: Regulatory audits in Switzerland: «How is Investment compliance audited?"