FOCUS

Quarterly Newsletter
Volume 97 Autumn 2020

Crossing the Threshold: 5 Things Banks Should Do as They Approach a specific milestone in Assets

Share

With stable economic conditions, many community and local banks are experiencing a period of steady growth. As they approach a milestoe in total assets, these growing banks encounter additional opportunities – but they also face new risks and regulatory expectations.

In some instances, boards and executive teams might find the added pressures and increased supervisory efforts and may choose to restrain growth when they see the milestone approaching. Regardless of whether they choose such a strategy, management should begin surveying the wide variety of new requirements/compliances well in advance so that they can make an informed strategic decision and equip themselves to manage the increased compliance and risk management challenges they will face if they choose to continue their growth. Such growth invariably give rise to individual borrowers beyond risk. Within the bank high quality internal control system to avoid slippage which may allow borrowing beyond acceptable limit.

Here are five important steps banks should take as they approach such milestone in total assets.

1. Document internal controls for financial reporting

Such Banks will already be familiar with some of the requirements of the UAE central bank. Among other provisions is to have an audit committee made up mostly of outside directors. In some countries, they must submit an annual report that includes an independent auditor's report to the audit committee and management reports that clearly state management's responsibility for establishing and maintaining adequate internal controls over financial reporting.

The management reporting requirements are expanded as well. When a bank exceeds milestone total assets, the CEO and CFO are required to submit a formal assertion regarding the effectiveness of the bank's internal controls over financial reporting based on a recognized internal control framework. In addition to developing and implementing a qualified framework, this assertion also involves extensive documentation and testing of the controls. Moreover, the independent auditor's report must include an attestation regarding the effectiveness of such controls.

Clearly, looking ahead and anticipating the threshold a few years in advance is important. Starting early gives everyone time to document the relevant business processes, identify critical financial reporting controls, implement the necessary framework, and test the controls to confirm their operating effectiveness. What's more, the associated costs of these activities can be spread out over two years.

2. Develop a robust, enterprise wide risk management (ERM) function

A formal, structured ERM function is an almost universal feature among large financial institutions, as it is among most large organizations. In smaller banks, however, risk management typically is a more locally focused activity, with each functional unit's management team focusing on its own specific risk. These responsibilities can range from simple and obvious roles such as protecting cash in teller drawers to more complex ones such as verifying regulatory compliance, assessing and managing credit risk, and developing and implementing long-term strategies.

In such situation, banks that do not yet have dedicated ERM functions can expect to encounter growing regulatory pressure to establish such a unit. Banks that already have established ERM functions should be prepared to devote additional time, personnel, and other resources to advance their risk management programs to the next level of maturity.

In addition to implementing consistent, structured processes for assessing and mitigating risks across all departments, effective ERM programs also can help banks do a better job of identifying and seizing opportunities. After all, a prudent amount of risk is inherent to banking. Without risk, a bank ultimately ceases to function.

The ERM function identifies, assesses, reports, and mitigates those risks appropriately so that management can correctly balance the risk against the potential reward. In this way, ERM becomes much more than a defensive measure for managing immediate risk. Instead, it can live up to its full potential as a strategic tool that supports the bank's long-term growth.

Obviously, ERM cannot succeed without complete support from the board and executive team. The board must actively ask strategic questions to validate management's focus on risk management, identify gaps in the system, and establish and support a formal structure for identifying, assessing, and addressing risks and opportunities.

Clear ownership of the effort is important, and banks should appoint a chief risk officer or comparable high-level executive who will be responsible for the ERM process and program. He or she is charged with bringing together the various risk-related activities within the bank to make sure see that they align with the bank's overall risk tolerance profile.

3. Invest in data

For many years, the largest banks have been working aggressively to capitalize on fast-changing technological advances. Regional and community banks, on the other hand, often find they must allocate their more limited resources carefully to achieve the greatest possible benefit for their technology investments. As a result, the rate at which banks adopt various advanced data science tools varies widely among individual institutions.

One of the fundamental requirements for taking advantage of today's digital technologies is having access to the necessary data, particularly customer data. The process of building out a bank's databases, verifying their accuracy, synchronizing them, and making them secure can require a major commitment of time and resources – not to mention a very large financial investment.

The migration to the current expected credit losses (CECL) methodology for estimating credit loss allowances offers a good example of the type of data challenges faced by growing financial institutions. The expanding loan-level analytics and reporting requirements associated with CECL have put severe strains on some banks' data management capabilities, especially when data is siloed and not easily integrated across the enterprise. In such instances, the costs of data acquisition, monitoring, and governance can be substantial.

As data volumes grow, and as the loan and deposit data that banks capture becomes increasingly granular and detailed, the issue of data governance takes on added importance. Cybersecurity, data privacy, data integrity, and regulatory compliance also become increasingly challenging. Growing banks should reassess and, if necessary, enhance their data governance programs now, in anticipation of the increased reliance on data-driven decision-making in the future.

4. Re-evaluate critical infrastructure

In addition to upgrading their data management processes and governance policies, banks can expect to make additional investments in new data technology systems and solutions, starting with the bank's core technology system. A core system designed to meet the needs of a smaller bank in a cost-effective manner generally will not have the level of sophistication that a bank needs at higher volume and will become even more inadequate as growth continues. In almost every instance, the infrastructure and systems either begin to fail or, at the very least, cannot deliver the solutions the growing bank is seeking.

The new infrastructure should be designed and implemented in a way that can be scaled up in the future as demand grows. In addition to growing volumes of customer and transaction data, the new system must also be flexible and adaptable to new types of digital banking products and services, some of which have probably not been invented yet. For a community bank with extensive paper files and manual processes, the upgrade can be much less costly and stressful today than it could be several years from now. In addition, delaying needed technological upgrades can deprive the bank of several years' worth of productivity and efficiency improvements.

In most instances, upgrading a bank's core system can help centralize many functions. Properly managed, this centralization can help produce improved quality and greater consistency in the way transactions are handled. At the same time, though, centralizing various functions can have a significant impact on bank staff, so the infrastructure upgrade should include plans for reallocating resources and retraining employees as needed.

While most of the focus in infrastructure is on technology systems, it is also prudent for growing banks to revisit their physical infrastructure as well. Branch strategies, reconfigurations, and consolidation will continue to grow in importance as the bank's asset size increases.

5. Benchmark and manage vendor expenses

As the costs associated with crossing the $1 billion threshold rise, bank executive teams might reasonably wonder how they will maintain reasonable cost structures and maintain shareholder value in the coming years. Fortunately, bank growth also presents an opportunity to reduce some incremental costs by taking advantage of economies of scale and other efficiencies.

Reducing costs can be most readily accomplished by engaging strategic sourcing and procurement specialists to perform a comprehensive vendor benchmarking project. The first step involves gathering accounts payable and vendor contract data across the entire organization and then comparing those expenditures against expense levels reported by comparable peers.

The bank executive team also reviews additional opportunities for centralizing the procurement of various operational services, which might still be handled at the branch or operational unit level. Armed with up-to-date expense benchmarks, procurement teams can then prioritize the various disparities and develop a renegotiation strategy, beginning with those contracts that offer the greatest savings opportunity.

Start early for a successful transition

As banks cross the milestone threshold, they can expect to encounter more robust regulatory requirements as well as the need to implement new programs, processes, and procedures across all business lines and administrative departments. At the same time, however, boards and management teams should remember what got them to this point – a focus on corporate cultures and underlying values.

Maintaining a consistent commitment to customer service will become even more crucial as banks expand into more competitive arenas. In the same way, reiterating cultural values can help maintain the right tone from the top – an important tool in offsetting fraud risks that also are likely to increase as banks grow.

Above all, banks approaching the milestone should begin early – well over a year in advance – to engage in a thorough, thoughtful, and comprehensive evaluation of the changes they will encounter and to develop the strategies they will employ for a successful transition.

Reference: Crossing the Threshold: 5 Things Banks Should Do as They Approach $1 Billion in Assets, https://www.crowe.com/insights/5-things-banks-should-do-approach-billion-assets by By Jaideep S. Chadha and Richard C. Kloch, Jr., CPA, Crowe USA

Dr. Khalid Maniar
Founder & Managing Partner
khalid.maniar@crowe.ae

How to survive small business in hard times

The pandemic is globally impacting all forms and sizes of businesses. It has resulted in difficult business environment, recession and economic downturn which has put businesses to the test. Surviving in these hard times requires unwavering determination and never-say-quit attitude. But in today's fast and merciless marketplace, more is needed than a winner's attitude. Following are small business hard time strategies to help steer these small businesses in these difficult times: -

Cost cutting with precision

It is typical cost-cutting approach by big corporations in hard times to employ a wide sweeping cost reduction policy. But for small business, cost-cutting ought to be implemented with the precision of a surgeon's scalpel. If you cut too deep your business will never recover. If you cut too shallow, then cash flow problems could force you to the back of the unemployment line. One should exercise care and judgment in determining what and where to cut and by how much. It is very crucial to retain best talent and hence proper evaluation is needed from cost cutting perceptive.

Out of box approach

The difficult times demand out of box approach. Normally, majority of small businesses are local not only in location but in marketing focus. Looking beyond the regular boundaries of your business is good business. These small businesses should look for prospective markets out of the boundaries of their locations. The other idea could be to work out on diversification and innovation. Adoption of e-commerce and online businesses has significantly accelerated and hence digitalization could be a viable option.

Don't stop marketing

The marketing function of a business is the first to get the cut. Due to the reduction, the funnel of incoming prospects is reduced resulting to lower revenues leading to a vicious cycle. The key to salvage any business is not to reduce your marketing activities but to replace them with low-budget marketing tactics such as online marketing.

Connect with peers

Another useful approach to handle downturns is by applying 'the wisdom of crowds'. A term coined by James Surowiecki in his bestselling book The Wisdom of Crowds, asserts that group wisdom is greater than the individual. By using the crowd wisdom philosophy small businesses can connect with industry trade or professional peer groups to extract the knowledge and best practices to navigate through a business slump.

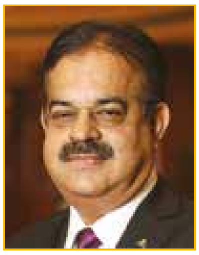
Focus on the fundamentals

Carry out regular financial checks, providing training to employees, specially to the marketing people. This is the right time to manage your customer relationship, be in regular touch with your customers and suppliers. We need to try to understand the issues and requirements of our customers in difficult times. This is the time to focus on the fundamentals to keep your house in order.

Learn from mistakes

We all commit mistakes, but we should not repeat the mistakes. Such mistakes could be relating to business decisions like pricing, buy or manufacture and outsourcing etc. Research published in the *Journal of Personality and Social Psychology* by Lyubomirsky, Sousa, reveals analysis occurring during talking or writing is beneficial in difficult times while replaying negative events is detrimental.

It certainly looks difficult to survive during this pandemic, it will require a resilient leadership with positive outlook and a good strategy. We should remember that hard times will pass too as nothing lasts forever.



Khalid Mehmood
Senior Partner
khalid.mehmood@crowe.ae

ISA 600 (Revised) – A timely IAASB initiative for Financial Reporting in the Tourism Industry

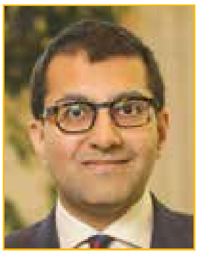
There is no doubt that the pandemic has created unprecedented challenges for the Travel, Tourism and Hospitality industry. However, with challenges come opportunities. Several regional airlines and hotel chains are backed by Sovereign Wealth Funds. It's no surprise that they are keen to acquire trophy assets globally, whilst valuations are low.

What this means for those of us dealing with the Financial Reporting aspects is that there will be a greater number of entities to consolidate, as more global assets come under the umbrella of these burgeoning Investment Funds.

The IAASB has been working diligently with global professional bodies such as the ICAEW. The aim is to update the International Standards on Audit to help deal with recent and upcoming changes to the International Financial Reporting Standards, which are moving away from a Rules based and more towards a Principles based approach.

Whilst still at an Exposure Draft stage, the revised standard aims to make growing between the Group and Component Auditors fair more cohesive. Hence, financial controllers may expect the teams to work closely on areas such as performance materiality, a refreshed approach to aggregation risk and a consistent approach to documentation.

This does make for quicker reporting at a group level, which will be welcome by stakeholders and investors who are keen to deal with the aftereffects of the pandemic. Earlier this week, the International Air Transport Association said global air passenger traffic is unlikely to recover to pre-Covid-19 levels before 2024, a year later than previously expected. We can hence expect to continue dealing with Audit issues pertinent to valuations, going concern as well as business combinations.



Zayd Maniar
International Liaison Partner
zayd.maniar@crowe.ae

Getting the Real Value of Internal Audit for business

It will be nice to hear two top executives in a casual talk about internal audit and how they stress on the importance and added value of internal auditors, but the reality is not as beautiful.

In real life, internal auditors, mainly those working in the industries face major challenges; the most prominent one is their reporting line/s. As you know Internal Auditors report functionally to the Audit Committee and administratively to the CEO, but is this actually as good as it sounds? The simple answer is NO.

Internal Auditors at the industries deal and report on daily basis to their ultimate auditee; yes, right the CEO, why? Because Audit Committee members, in most cases, are unavailable, they are not part of the executive team. Can you imagine the level of stress, discomfort, and lack of objectivity this creates? Correct, huge lack of objectivity, why? Could you, as an employee, whether Internal Auditor or not work under the most powerful executive who is sensitive about your mission?

Now, why the above described situation is allowed at the companies?

Scenario one: lack of knowledge about what actually going on.

Scenario two: which is quite common: Conflict of interest.

You might read a lot about major scandals worldwide, embezzlement of billions by top executives, or providing financial uncapable clients with major facilities in billions. Do you really think that it is difficult to internal auditors to uncover and avoid those situations? No, it is not. It is so easy to prevent those; via strong corporate governance, where internal auditors don't report administratively or in any other manner to the CEO, they should not report at all to the CEO.

I believe, worldwide, we had enough of those stories of funds embezzlement and abuse of power. Internal Auditors need to be left alone to do their job by being completely independent of the management they audit.

Fahem Almusa
Director- Internal Audit
fahem.almusa@crowe.ae

Rise in protecting the brand

Although there have been many negative impacts of the lockdown due to the global pandemic, UAE has seen a spike in renewals in the past month. This could possibly be due to the reduced official fees.

The Trademark Office of United Arab Emirates has reduced the official fees for trademark registration and renewal and will be applied on new applications and retroactively on the pending applications. The reduced official fees have immediate effect from 5 April 2020 and are understood to be permanent.

While trade in counterfeit goods has risen steadily in recent times, governments are tightening regulations to curb the issue. UAE has been the most proactive in the region when it comes to seizing counterfeit products. Many companies have now understood the importance to secure their brand. Thus, if registration of IP rights is taken as an indicator of business activity, it is quite possible that business activity may indeed return to pre-pandemic levels faster than expected.

Whilst the fees will certainly be welcomed, brand owners should keep in mind that the UAE trademark Office still requires a notarised and legalised Power of Attorney to file any applications, carry out any register maintenance or file an opposition. This requirement has not changed at the present time and was re-confirmed by the trademark office ahead of their fee reduction announcement.

Ilhaam Maniar
Practice Manager
ilhaam.maniar@crowe.ae

Moving towards "the new norm"-Transformation

The global economy is limping back to life but the road to a full recovery is hard and bumpy. Are you prepared for the any unprecedented changes in the foreseeable future?

- Re-introduced lock-down measures
- Falling demand and resources
- Effects of repatriation
- Effects of the crisis within the value and supply chain
- Logistic and transportation impacts for import & export business.
- Infections at the workplace
- Surge in fraud and corporate espionage
- The new want vs need perception

Companies have been impacted differently so far due to COVID, some more severely than others. Where does your business stand amid these crises; more importantly how resilient are your processes and what needs to be done to tackle the new challenges in the ever-changing scenario. Those who recognize and transform stand a better chance of not only survival but excelling under the upcoming and uncertain situations

BUSINESS TRANSFORMATION - STICH THE CLOTH TO THE SIZE

Update the SWOT and realign the Objectives and Strategy

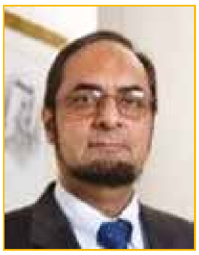
Review the product/units/market protfolio-cash generating ability

Convert fixed costs into variable

Recalibrate/realign the cost base

Review the capital structure-Equity vs Debt

Leverage the learning



Arif Choksy
Director-Corporate Transformation Division
arif.choksy@crowe.ae

Challenges for the construction sector

Change brought about due to technology, products, human behavior, competitive environment, new marketing strategies, global economic changes, political strategies, climatic changes has enlarged the various dimensions of risk for the construction industry. An adaptive approach to risk assessments, synergic management, and development of new controls is required to meet the challenges put forward to the industry by these changes. Some of the biggest risks are from frauds and the worst of it are seen from bribes and thefts.

Bribes

Bribes may be internal or external. Internal bribe is offered by employees to other employees to form collusion of teams for committing fraud without involving external parties. External Fraud are instances where external parties collude with employees to commit fraud.

Bribes exist in both aspects in various forms

1 Monetary values – as a fixed value or as a share in the booty.

2 Non-monetary values – Promotion, employment for self of other related personnel, in kind.

3 Areas where bribes thrive in construction

- Sub-Contract awards including bid rigging
- Procurements
- Increase in variation works for Sub-contractors
- Facility support to sub-contractors without back-charge
- Selection of personnel for Internal Sub-contract
- Facilitate extra time for hired equipment.

Prevention model for bribes

You may consider taking the following multipronged approach for detecting and preventing bribery schemes.

1 Implement an employee hotline.

2 Continuous monitoring of the bidding process. Review the reasons for failure and estimations made for such bids. Question the management on not correcting bids based on negotiation rounds. Have independent persons follow up on potential subcontractor cost.

3 Prohibit excessive gifts.

4 Monitor vendors that win far too often.

5 Ensure that the productivity is established at a standard level for achievement.

Thefts

Thefts occur where the oversight process does not provide for preventive measures at site, stores, and offices. Thefts happen at all these places and even while goods are in transit. For a proper oversight to be established it is better to understand the various areas where thefts potentially exist.

Prevention model for Thefts

Preventive plans for theft can be installed by following the below mentioned measures.

1 Reduce the materials stored at the work-site warehouse for long durations.

2 Establish oversight policies and systems for specific strategic materials.

3 Internal auditors should conduct surprise visits to warehouses and sites. Escalate issues which are found to be in variation.

4 For monitoring movement, ensure that the warehouses have surveillance cameras and lighting covering all crucial areas.

5 Implement robust inventory management and asset management systems. In case of theft documentation/records prepared due to these systems are useful for claims with insurance providers.

6 Ensure that all procurements to site are controlled and reviewed by the cost controller on issue of material requisition from the site. A work breakdown structure-based review for material resource planning would enable the cost control and quantity surveyors to execute the necessary security required in this area of concern.

Conclusion

Risk Consultants play a vital role in establishing the infrastructure for Fraud/Loss deterrents in the Construction Industry. They have made remarkable achievements in cost cutting, detecting of revenue identification failures, fraud detection, prevention, and supporting corrective measures. The approach required to meet with the infrastructural applications has been duly explored to provide value adding services to the organizations in this industry.

Sujith Kumar Velayudhan
Director – Internal Audit & Risk
sujith.pillai@crowe.ae

About Us

Your global partner

Crowe is ranked as the 8th largest accountancy network with globally more than 41,000 partners and people in over 130 countries.

We share a common purpose of building value for clients through international business. Still placing great emphasis on establishing long-term relations with each of our clients. This enables to work together in an atmosphere of openness and trust. Simply stated, it is how we live our core values – care, share, invest and grow.

The firm continually demonstrates a commitment to quality while serving clients through our international expertise and talent. Our commitment to the highest technical standards and integrity, ensures that our clients receive the most accurate and relevant advice.

We provide professional services by leveraging through extensive local experience and high level of partner involvement. Our aim to provide due diligence with care has enabled us to serve a diverse range of clients ranging from small family owned businesses to large multinational conglomerates.