Financial Conduct Authority

Internal Audit final report

A review of the Supervisory Oversight Function (SOF)

Findings identified	
Major	**1**
Moderate	**3**
Minor	**0**

24 April 2014

1 Executive Summary

1.1 Summary and opinion for Audit Committee

Audit Scope

The scope of this review included:

- the SOF's remit, governance and annual plan;
- the relationship with the executive management and the Supervision Division and the extent to which this enables the SOF to bring about continuous improvement in the FCA's supervisory approach;
- the relationship and interaction of the SOF with the FCA's three lines of defence; and
- the SOF's assurance review methodology (including reporting, action tracking and alignment with the FCA's supervisory strategy).

Background and context

The SOF reports to the Chief Executive and its main purpose as set out in its Terms of Reference is to "*provide FCA executive management with assurance over the effectiveness of regulation by assessing retrospectively the quality of regulatory judgements and outcomes*".

The SOF's assurance work is focused primarily on the Supervision Division although individual SOF reviews may touch upon other relevant divisions where appropriate. The department aims to deliver approximately four reviews per quarter including a set number of C1 and C2 reviews. The key outcomes the SOF is seeking to achieve include being viewed by the Executive and peers as a credible and insightful source of challenge and raising the quality of outcomes delivered through the supervision model.

We recognise that the period since legal cutover has been challenging for the SOF with a number of changes in its personnel, particularly in the Head of Department role. In our view, this has contributed to some of the issues we found. The SOF has also needed to invest time to align its activities with the new supervision model and build its staff capability to assess judgments made by supervisors in the context of this new model.

Findings and conclusions

We found that the purpose and remit of the SOF was not clear to the stakeholders we interviewed both within and outside of the SOF. The lack of clarity over the SOF's role and position in the FCA's three lines of defence model, and the conflict of interest presented by the appointment of a new Head of Department for the SOF, who is also Head of Client Assets Supervision (an area within the SOF's scope), add to this confusion. In our view, the lack of clarity over the SOF's purpose and remit across the organisation and the resulting perception that the SOF's work is not highly valued by the Executive had adversely impacted on the SOF's ability to deliver its desired outcomes. In particular, although we received positive feedback regarding the interaction between the SOF and stakeholders on some individual reviews, the SOF is not consistently engaging effectively with the Supervision Division. In addition, the SOF needs improved capability to drive continuous improvement in supervisory activity. Executive management needs to clarify and promote the purpose and remit of the SOF to enable the department to perform an effective assurance role (see Finding 1).

We recognised that the SOF's Interim Head of Department and management team in place at the time of our fieldwork have undertaken a number of changes to improve the way in which the SOF works. However, there remains a significant risk that the SOF will not be able to deliver the reviews committed to in its Terms of Reference and will not provide the level of assurance to management that it has committed to (see Finding 2). We also found that further improvements were required to the methodology the SOF follows for individual reviews (see Finding 3) and to the SOF's reporting processes (see Finding 4).

1.2 Overall management comments

We welcome the Internal Audit Review and findings, which come at a timely point for the Supervisory Oversight Function (SOF), particularly with the recent addition of a permanent Head of Department. It highlights some important issues, a number of which reflect the Management Team's own assessment of areas requiring further attention and greater clarity.

Like the rest of the organisation, the period since legal cutover has been challenging for the SOF, both from a resourcing perspective and as we worked to adapt our approach to the new supervisory framework. As referenced in the report, we have already started work in key areas highlighted in the report such as review planning and budgeting, our wider communication and resourcing strategy. We are already starting to see the fruits of this work with a number of former supervisors joining the SOF, a secondment to Supervision to alleviate a resourcing issue and a number of external hires. Stakeholders will also be aware of an increased level of engagement and requests for feedback on our role and reviews, together with changes to our process, report format and assurance opinions.

The report provides a good platform to review the remit and purpose of the Supervisory Oversight Function, reinforce its role as part of the second line of defence and that value it can add to Supervision across the FCA. It will also provide an opportunity to clarify the SOF's Terms of Reference and Review Plan for the forthcoming year. We welcome Executive management's support in promoting and clarifying the SOF's role to improve the effectiveness of its assurance function.

1.3 Schedule of findings

Ref	Findings	Rating
1	**The SOF's purpose, value and remit** We found that the purpose and remit of the SOF was not clear to the stakeholders we interviewed both within and outside of the SOF. The lack of clarity over the SOF's role and position in the FCA's three lines of defence model, and the conflict of interest presented by the appointment of a new Head of Department for the SOF, who is also Head of Client Assets Supervision (an area within the SOF's scope), add to this confusion. In our view, the lack of clarity over the SOF's purpose and remit across the organisation and the resulting perception that the SOF's work is not highly valued by the Executive had adversely impacted on the SOF's ability to deliver its desired outcomes. In particular, the SOF is not consistently engaging effectively with the Supervision Division, and the SOF needs improved capability to drive continuous improvement in supervisory activity. Executive management needs to clarify and promote the purpose and remit of the SOF to enable the department to perform an effective assurance role.	**Major**
2	**Delivery of the SOF's assurance commitments** The number of reviews in the SOF's approved annual plan for 2014/15 represents a planned shortfall against the number of reviews it has committed to in its Terms of Reference. This suggests that the SOF will be unable to provide the level of assurance to management that it has committed to. We also found that the SOF's annual review plan is not risk based and may not therefore focus on the highest risk areas in supervision.	**Moderate**
3	**The SOF's methodology for identifying and escalating key risks** The SOF has a high-level methodology in place for its firm-specific quality assurance reviews. We concluded that there is an increased risk that the SOF's current methodology does not drive the SOF to identify and escalate the key risks to the Supervision Division in achieving its objectives. While we are aware that the methodology had recently been updated, we concluded that further updates are required in a number of key areas to address this risk.	**Moderate**
4	**Impact of the SOF's reports on the Supervision Division and continuous improvement** Feedback we received from stakeholders indicated that the SOF's reports were not having the desired impact of adding significant value to the quality of supervision and driving continuous improvement in the Supervision Division.	**Moderate**