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## How Internal Audit and External Audit Should Work Together

Presented by Dean Rohne and Ana Foret

## Session Objectives

- Review roles internal audit and external audit play at a credit union
- Discuss ability and requirements for internal audit to provide assistance to the financial statement audit
- Discuss co-sourcing/outsourcing
- Identify best practices for internal and external audit working together



Key Differences Between Internal and External Audit		
	Internal Audit	External Audit
<b>Purpose</b>	Analyze and improve controls and performance	Express an opinion on the financial condition
<b>Scope</b>	Organizational operations	Fiscal financial records
<b>Skills</b>	Interdisciplinary	Accounting, finance, tax
<b>Timing</b>	Present/future, ongoing	Past, point in time
<b>Primary Audience</b>	Board, executive management	Investors, public interests
<b>Standards</b>	The IIA's <i>International Standards for the Professional Practice of Internal Auditing</i>	Generally Accepted Auditing Principles, Generally Accepted Auditing Standards
<b>Focus</b>	Enhance and protect organizational value	Fair representation of financial statements
<b>Employment Relationship</b>	An organization's employee	A contracted third party

Source: IIA Issue 8 – Global Perspectives and Insights – Internal Audit and External Audit



# External Audit Relying on Internal Audit

- AU-C Section 610.06
  - External auditors may use the work of internal auditors depending on the following:
    - ◇ Level of competency of the internal audit function
    - ◇ Internal audit function's organizational status and policies and procedures support objectivity
    - ◇ Function applies a systematic and disciplined approach, including quality control

# External Audit Relying on Internal Audit

- AU-C Section 610.09
  - External auditor's responsibility is not reduced in expressing an opinion on the financial statements is not reduced based on relying on internal audit
    - ◇ By definition internal audit function and internal auditors not considered independent, even though they may do work similar to external auditors

# External Audit Relying on Internal Audit

- AU-C Section 610.11
  - If placing reliance on internal audit function external audit must perform the following:
    - ◇ Identify the extent and areas where placing reliance
    - ◇ Assess the adequacy of the work
    - ◇ Appropriately direct, supervise and review their work

# External Audit Relying on Internal Audit

- AU-C Section 610.16
  - External auditor should make significant judgments in the audit engagements including when using the work of the internal audit function
- AU-C Section 610.17
  - External audit should use work of internal audit less when there is more judgement involved and higher risk of material misstatement

# External Audit Relying on Internal Audit

- AU-C Section 610.19
  - External auditor is required to communicate with governance how external auditor will rely on internal audit
    - ◇ Communication should be prior to start of engagement
    - ◇ Include anticipated scope and timing
    - ◇ Most times done through audit engagement letter



# External Audit Relying on Internal Audit

- Areas that would be beneficial for internal to assist with external audit
  - Internal control walk documentation
  - Surprise cash counts
  - Testing of correspondent accounts
  - Loan reviews
  - Testing of clearing and suspense accounts



# External Audit Relying on Internal Audit

- Areas that would be beneficial for internal to assist with external audit (continued)
  - Reconciling loans and deposits
  - Member account verification
  - Yield and cost of fund testing

# External Audit Relying on Internal Audit

- Areas that would not be beneficial for internal to assist with external audit (continued)
  - Testing areas with significant estimates
    - ◇ Allowance for loan losses
    - ◇ Fair values of investments
    - ◇ Mortgage servicing rights
    - ◇ Defined benefit plan estimates
  - Inquiries with key staff (fraud inquiries)
  - Consideration of subsequent events



# External Audit Relying on Internal Audit

- Best Practices
  - Internal audit should consider cost savings when determining whether to design their audit plan to assist external audit
  - Discuss with external audit in advance to determine where reliance can be placed

## External Audit Relying on Internal Audit

- Issues where reliance cannot be placed
  - Internal audit is not independent
  - Scope of internal audit work not sufficient
    - ◇ Not enough of period tested (three or six months of year)
    - ◇ For loan review – not all loan types included
    - ◇ Testing scope set too high



# Internal Audit Requirements for External Audit

- Institute of Internal Auditors (IIA) Professional Standards
  - 2050 – Coordination and Reliance
    - ◇ The chief audit executive should share information, coordinate activities, and consider relying on the work of other internal and external assurance and consulting service providers to ensure proper coverage and minimize duplication of efforts
    - ◇ Interpretation – CAE must have clear understanding of scope, objectives, and results. CAE is still accountable and responsible for ensuring adequate support for conclusions and opinions reached by the internal audit activity



# Internal Audit Requirements for External Audit

- Best practices
  - Reliance of external audit by internal audit for items such as:
    - ◇ Investment testing
    - ◇ Testing of general ledger processes
    - ◇ Significant estimates
    - ◇ Member account verification
    - ◇ Utilization of external audit's internal control documentation



# Co-Sourcing

- Allows internal audit department to utilize outside specialists for areas where internal audit department does not have adequate resources, expertise, or independence
  - Information security
  - Bank Secrecy Act
  - Commercial loan review
  - ACH audit requirements
  - Employee account review
  - Mortgage quality control





# Pressures Facing Internal Audit

- Maintaining relationships with management and/or supervisory committee
- Continued evolving of audit landscape
  - Use of data analytics
  - Automated auditing
- View by management as a cost center
  - Provide support for cost savings through external audit relationship



## Best Practices

- Communicate periodically and prior to developing of external audit and internal audit plans:
  - Avoid duplication
  - Identify cost savings (less internal audit staffing and/or audit fees)
  - Allow for collaboration to discuss changes in operations for risk based plans
    - ◇ Both external and internal audit plans





## Questions?

Dean Rohne, CPA, CIA

[Dean.rohne@claconnect.com](mailto:Dean.rohne@claconnect.com)

507-434-7046

Ana Foret, CPA

[Ana.foret@claconnect.com](mailto:Ana.foret@claconnect.com)

781-402-6300 Ext. 36427



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