

Outsourcing Co-Sourcing and Maintaining an Independent Department

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WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Create Opportunities

Session Objectives

- Provide a definition of co-sourcing and outsourcing of the internal audit function
- Review successful internal audit co-sourcing arrangements
- Discuss internal audit department structure success stories
- Provide ways to enhance internal audit visibility

Acronyms

- CAE – chief audit executive
- IRS – Internal Revenue Service
- DOL – Department of Labor
- FFIEC – Federal Financial Institutions Examinations Council
- FDIC – Federal Deposit Insurance Corporation
- IA – internal audit
- IIA – The Institute of Internal Auditors

Outsourcing vs Co-sourcing

- Outsourcing – the hiring of a third party to complete a majority of the credit union’s internal audit program.
- Co-sourcing – the hiring of a third party to assist an internal audit department in completing a portion of the credit union’s internal audit program.
 - Ideal for audits of that require a specialized level of expertise such as:
 - ◇ Information technology
 - ◇ Specialized lending
 - ◇ Specialized operational
 - ◇ Sensitive areas



Why Discuss Outsourcing

- Allow CAE to guide supervisory committee in designing the internal audit program
- Examples where this was not the situation
 - Case Study 1 – Exam issues
 - Case Study 2 – Conflict with management
 - Case Study 3 – Maintaining adequate staffing
 - Case Study 4 – Issuing audit reports



Current Landscape

- Credit Unions continue to get more complex
 - New products and services
 - Increase reliance on technology
 - Increasing complexity with regulations
 - ◇ Consumer compliance
 - ◇ IRS and DOL regulations
- Continued pressure to manage operating expenses
- Continued need to hire and retain qualified people
- Need to do more with less resources

Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:

“Effective internal control is a foundation for the safe and sound operations of a financial institution (institution). The board of directors and senior management of an institution are responsible for ensuring that the system of internal control operates effectively. Their responsibility *cannot* be delegated to others within the institution or to outside parties. An important element in assessing the effectiveness of the internal control system is an internal audit function.”



Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
 - Outsourcing may be beneficial if properly structured, carefully conducted, and prudently managed
 - Agencies have concerns the structure, scope, and management of some IA outsourcing arrangements do not contribute to safety and soundness
 - Agencies want to ensure outsourcing arrangements do not leave directors and senior management with the erroneous impression they have been relieved of responsibility for maintaining effective system of internal controls



Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
 - Part 1 – The internal audit function
 - ◇ Addresses board (supervisory committee for credit unions) and senior management responsibilities
 - Part 2 – Internal audit outsourcing arrangements
 - ◇ Includes both outsourcing and co-sourcing
 - ◇ Addresses items to include in contracts with vendors

Regulatory Requirements for Internal Audit

- Interagency Policy Statement on the Internal Audit Function and Its Outsourcing:
 - Part 3 – Independence of the independent public accountant
 - ◇ Addresses independence and using the same firm for both financial statement audit and internal audit services
 - Part 4 – Examination guidance
 - ◇ Indicates examiners should have access to workpapers
 - ◇ Addresses what examiners will look for related to the internal audit function

Regulatory Requirements for Internal Audit

- NCUA Examiner Guide Chapter 5
 - Provides general guidance for assessing the adequacy of internal audit based on NCUA Regulation 715
 - Emphasizes success of internal audit based on:
 - ◇ Independence
 - ◇ Adequacy and effectiveness of the audit program

Regulatory Requirements for Internal Audit

- Washington Department of Financial Institutions (DFI) Division of Credit Unions Bulletin B-18-08
 - Provides guidance for credit unions that may outsource their internal audit function
 - Addresses how examiners will evaluate the outsourcing function
 - Based on policy statements from FDIC and FFIEC



Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
 - Examiners will exercise judgement on quality and scope of internal audit program regardless of whether it is performed internally or externally. The following may be considered in the evaluation:
 - ◇ IA function's risk assessment, audit plan, and audit programs
 - ◇ IA activities that have been adjusted for significant changes at the CU
 - ◇ IA activities consistent with long range goals and strategic direction of the CU

Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
 - IA Evaluation (continued)
 - ◇ Supervisory committee promotes IA independence
 - ◇ CAE is placed in management structure that does not impair independence
 - ◇ CU is promptly responding to significant internal control weaknesses
 - ◇ IA program is carried out timely including communication of results



Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
 - IA Evaluation (continued)
 - ◇ Workpapers adequately document IA work performed and support audit reports
 - ◇ Reasonable standards are used in performance of work, such as IIA Standards
 - ◇ IA provides high quality advice and counsel to management and board of directors related to risk management, internal control, and regulatory compliance
 - ◇ Competence of IA staff



Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
 - In addition the following will be assessed related to an outsourcing relationship:
 - ◇ Arrangement maintains or improve quality of IA function
 - ◇ Key employees of CU understand lines of communication with outsourcing function
 - ◇ Scope is revised with changes in CU operations and risk
 - ◇ Directors have ensured CU is managing outsourcing activities



Regulatory Requirements for Internal Audit

- Washington (DFI) Bulletin B-18-08 (continued)
 - In addition the following will be assessed related to an outsourcing relationship (continued):
 - ◇ IA workpapers are property of the CU
 - ◇ Regulators will have access to workpapers
 - ◇ Independence standard is satisfied
 - ◇ Adequate due diligence on the vendor

IIA Position Paper - Staffing/Resourcing Considerations for Internal Audit Activity

- IIA believes the following
 - Internal audit is most effective when the following are aligned with organizational strategy:
 - ◇ Resource level
 - ◇ Competence
 - ◇ Structure
 - Function is fully internal resources with supplemental external experts in specialty knowledge areas

IIA Position Paper - Staffing/Resourcing Considerations for Internal Audit Activity

- IIA Perspective
 - “As an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations, internal audit helps an organization accomplish its objectives in bringing a systemic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”

IIA Position Paper - Staffing/Resourcing Considerations for Internal Audit Activity

- IIA Perspective
 - When the internal audit activity is fully outsourced oversight and responsibility for the internal audit activity cannot be outsourced
 - ◇ Needs to be someone designated internally for responsibility over IA (liaison)
 - ◇ Need to evaluate independence of liaison
 - Change in strategy of outsourcing or co-sourcing should be approved by supervisory committee

IIA Position Paper - Staffing/Resourcing Considerations for Internal Audit Activity

- Considerations for evaluating outsourcing options
 - Available resources
 - Size of organization
 - Types of outsourcing alternatives
 - Regulations and laws
 - Advantages and disadvantages

CU Internal Audit Success Stories

- Case Study 1 – Using IA as a consultant
- Case Study 2 – Hiring internal specialists
- Case Study 3 – Leveraging interns



Enhancing IA Visibility and Credibility

- Build relationships
 - Understand you are a consultant to your credit union
 - Get to know your co-workers

- Promote internal audit
 - Identify IA awareness month (May 2019)
 - Introductions at new employee trainings



Enhancing IA Visibility and Credibility

- Perform audits as a consultant
 - Enhance communication
 - Discuss audit scope with management
 - Identify what departments are doing well
 - Hold exit meetings
- Write impactful reports
 - Report only significant findings
 - Report minimal risk items verbally at exit meetings

Enhancing IA Visibility and Credibility

- Obtain professional certifications
 - CCUIA – certified credit union internal auditor
 - CIA - certified Internal auditor
- Perform work in accordance with professional standards
- Implement required training programs



Questions?

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