

Internal Audit 102

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Agenda

- Defining Your Audit Universe
- Audit vs. Risk
- Risk Defined
- Internal Controls
- Audit Risk Assessment Process
- Internal Audit Plan Creation
- Internal Audit Plan Tools and Documents

Audit Universe Defined

- ▶ An **audit universe** represents the potential range of all **audit** activities and is comprised of a number of auditable entities. These entities generally include a range of programs, activities, functions, and initiatives which collectively contribute to the achievement of the department's objectives.

...it is a list of all the possible audits that could be performed

Audit Universe Defined

► Interestingly...

...the actual IIA Standards do not mention the term “audit universe.”

However, there are references in various auditing books which state “...the **audit universe** can be influenced by the results of the risk management process.”

Audit Universe

- ▶ The number of audit entities in any given audit universe varies greatly and there is no useful metric for universe size.
- ▶ Audit universes differ by organizational size, complexity, and/or factors driven by audit efficiency considerations (e.g., aggregating multiple risk areas into single audit unit or vice versa).
- ▶ An audit universe should be somewhat dynamic to reflect organizational structure and risk changes.
- ▶ An audit universe is best updated as organizational structure and risk changes occur.
- ▶ An audit universe is not an audit plan, but audit plans are derived from the audit universe.

Audit Universe - Benefits

- ▶ Provides an inventory of Auditable Units or Entities
- ▶ Improves Organizational Understanding
- ▶ Provides for Risk Coverage Assurance
- ▶ Supports Board/Manage Risk Coverage Considerations
- ▶ Supports Audit Plan Development & Maintenance
- ▶ Assesses Extent of Organization Audited
- ▶ Provides Audit History Tracking
- ▶ Can Serve as Auditor Training and Development Tool

Audit vs Risk Universe

- ▶ The audit universe and risk universe are closely related, intertwined and occasionally merged, serving as a single source for audit plan determination purposes.

“...the audit universe can be influenced by the results of the risk management process.”

Audit vs Risk Universe

Audit Universe

- ▶ List of potential *audits*
- ▶ Focus on controls, processes, etc. designed to mitigate risks to objectives
- ▶ Easier to define and develop than a risk universe
- ▶ Audit Universe changes over time as the organization changes

Risk Universe

- ▶ List of potential *risks*
- ▶ Focus on risks to corporate objectives and strategy
- ▶ More complex than audit universe due to the changing nature of risk, risk appetite, etc.
- ▶ Not all risks can necessarily be audited
- ▶ Risk Universe can change regularly as the “environment” changes

Three Lines of Defense

1. Senior Management/Board

- Management Internal Controls
- Internal Control Measures

2. Internal Monitoring & Oversight Functions (Operational Management)

- Financial Control
- Security
- Risk Management
- Quality
- Inspection
- Compliance

3. Internal Audit

Management's Responsibility for Risk

- There are some basic steps that credit union management must perform for a system of risk assessment:
 - Identify the risk
 - Measure and assess the risk
 - Control the risk
 - Monitor the risk

NCUA Defined Risk

7 Categories:

Credit

Interest Rate/Market

Operational/Transaction

Compliance/Legal

Liquidity

Reputation

Strategic

Emerging Risk categories: Security and Information Technology

Risk Process

3 Key Tasks

- Identify Risks
- Measure and Assess the Risk
- Control Risks

Risk Definitions

- **Inherent Risk** - assessment of the likelihood that there are material misstatements due to error or fraud in a segment before considering the effectiveness of the internal controls established
- **Risk Mitigation** - A systematic reduction to the extent of exposure to a risk and / or likelihood of its occurrence. (Risk reduction)
- **Residual Risk** - the risk or danger of an action or an event, a method or process is still risky, even if all theoretically possible safety measures would be applied

Internal Control Defined

...is the process, effected by the credit union's Board of Directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories; *reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets and compliance with laws and regulations.*

Internal Control Types

- **Directive**
...designed to establish desired outcomes
- **Preventive**
...designed to keep (“prevent”) errors or irregularities from occurring in the first place
- **Detective**
...designed to discover errors or irregularities that may have occurred
- **Corrective**
...designed to react to fix the errors or irregularities that have been detected

Questions to Ponder

- ▶ Has the risk focus eliminated the usefulness of an audit universe?
- ▶ Is a risk universe sufficient?
- ▶ Can the audit and risk universe be combined?
- ▶ Should the audit/risk universe be combined?
- ▶ Do we audit risk?
- ▶ Can meaningful audits be applied to all areas of risk?
- ▶ How do we know if all risks are being addressed?

Audit Universe Risk Assessment Benefits

- ▶ Provides a basis for organization-wide risk analysis
- ▶ Provides basis for audit plan development
- ▶ Can be sorted by risk, or any other attribute/ criteria maintained to support specific audit needs
- ▶ Provides a basis for cyclical, periodic and emerging risk audit plan components
- ▶ Provides a reference for discussions regarding what can be, should be, and will be audited

Risk Assessment Methodology for Audit Planning

- Risk Assessment Methodology
- Components of a Risk Assessment
- Determining and Calculating Risk
- Creating a Risked-Based Internal Audit Plan

Standard 2010 - Planning

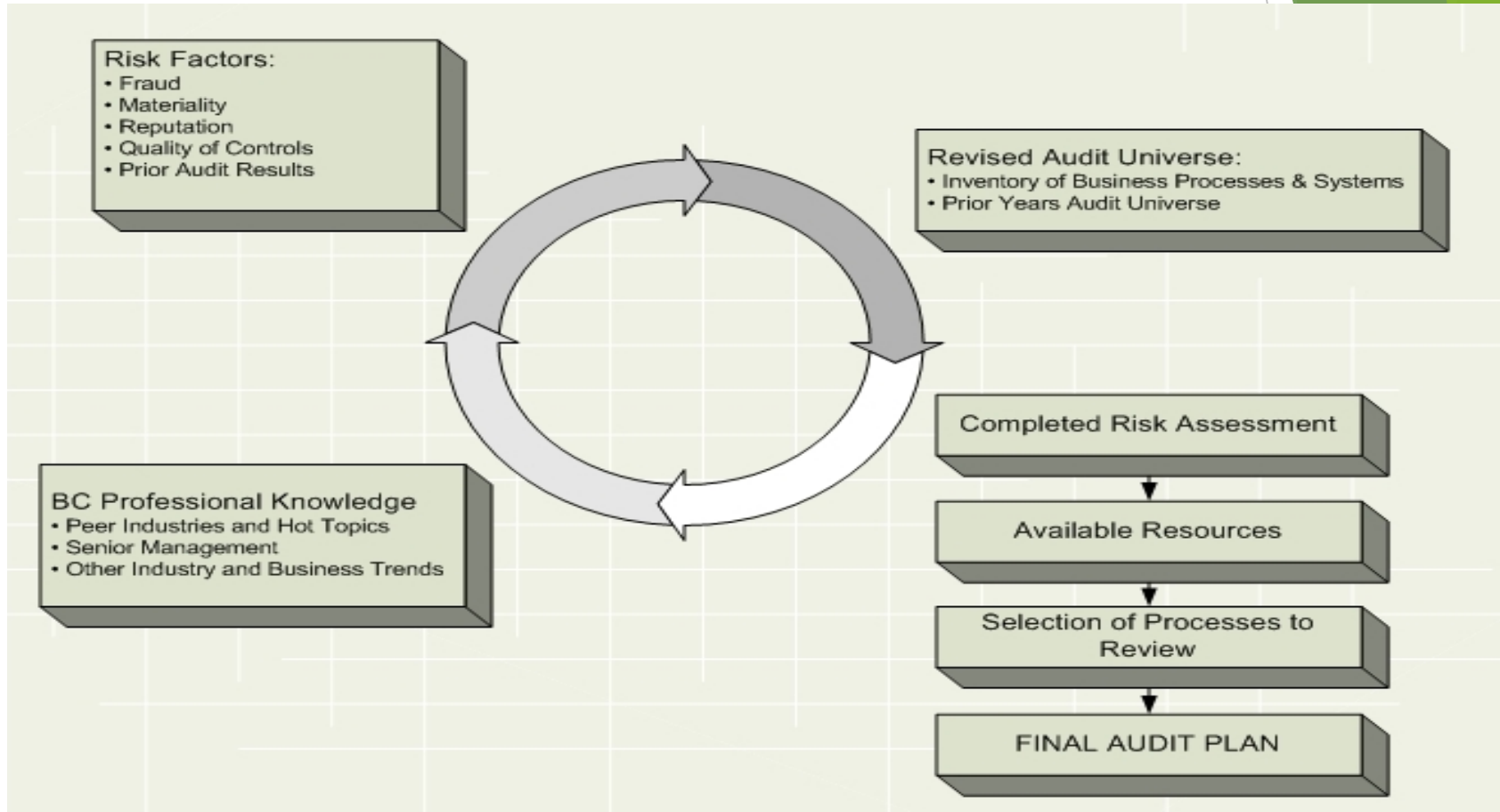
- **2010** - The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals.
- **2010.A1** - The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process

Audit Risk Assessment Process

Format

- Fit individual credit union structure & culture
- Be size and complexity appropriate
- Does not have to be overly complicated, expensive, or time consuming

Audit Risk Assessment



Audit Risk Assessment

- Identification and Measurement

- Auditable Entity

- Department/Function (Branch Network, Collections, Lending, Accounting, Investments, Human Resources, etc.)
 - **Product** (Shares, Loans, Term Shares, etc.)
 - **Process** (i.e. new account opening, loan origination, reconciliations, etc.)
 - **Service** (Online Banking, ACH, RDC, Wire Transfers, Mobile, etc.)

NOTE: The auditable entities can, and most likely will, be further broken down into sub-categories.

(Ex. Accounting = Accounts Payable/ Expenses, Fixed Assets, Financial Reporting, etc.)

Audit Risk Assessment

- Identification and Measurement

- Risk Measurement Factors

- **Portfolio** (credit, interest rate, liquidity risk)
 - Volume (ex. # of transactions processed, # of wire transfers in and out, etc.)
 - Size (dollars outstanding, # of debit/credit cards issued, unused lines of credit, concentrations)
 - Liquidity (Fixed vs. variable, long vs. short term maturity)
 - **Business Exposure** (reputation risk)
 - Potential for financial loss (Fraud)
 - Impact on reputation

Audit Risk Assessment

- Risk Measurement Factors Cont.
 - Organizational Change (strategic risk)
 - Staff turnover
 - Change in reporting structure
 - Change in processing methods
 - Degree of staff competence and knowledge required
 - IT Environment (IT security risk)
 - Level of software and hardware usage
 - Information timeliness, accuracy, integrity and dependability
 - Technology knowledge and administration
 - Reliance on third party vendors

Audit Risk Assessment

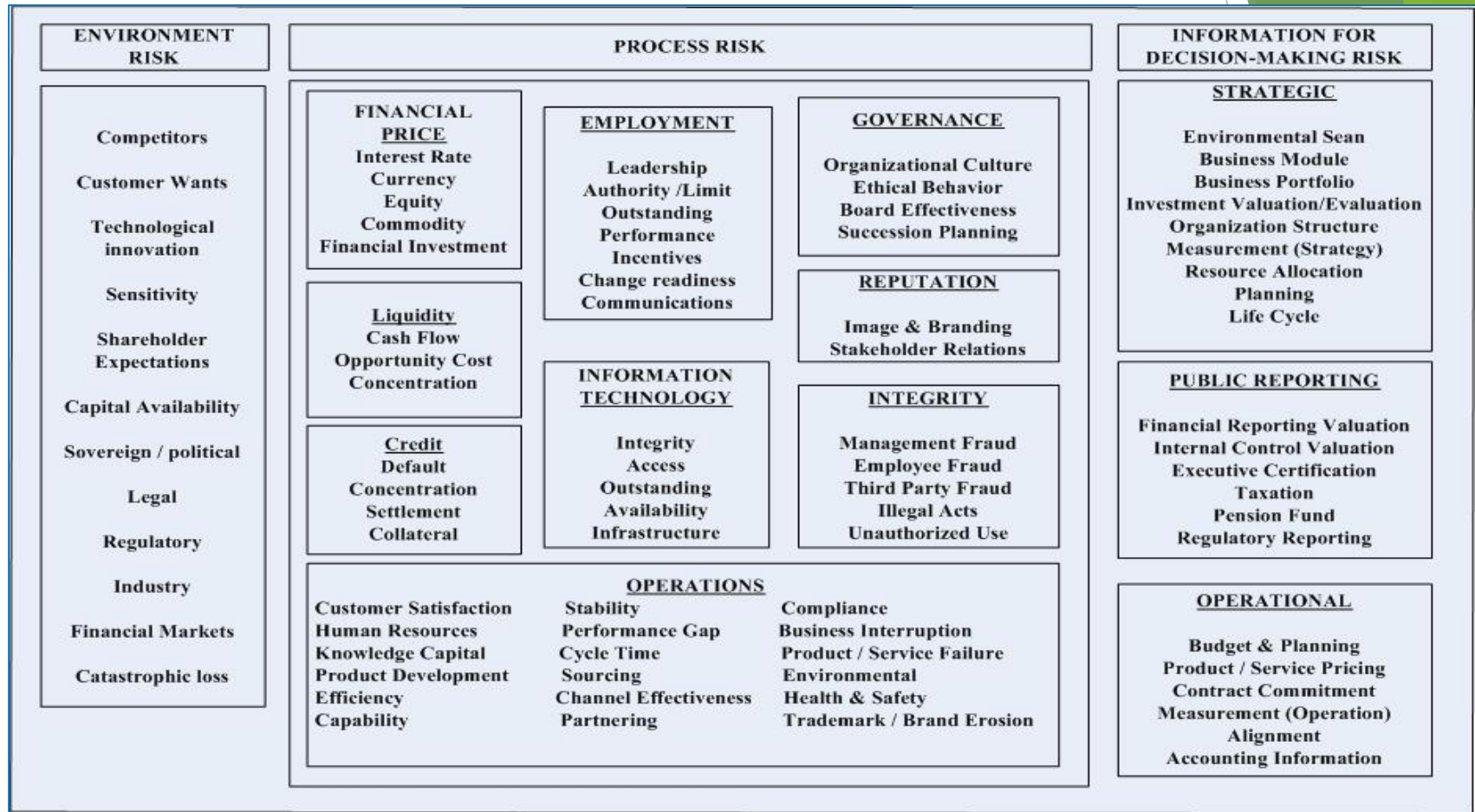
- Risk Measurement Factors Cont.
 - Regulatory Environment (compliance risk)
 - Amount and complexity of regulatory and statutory compliance matters affecting operations
 - Management Control Environment (operational/transaction risk)
 - Complexity of operations
 - Efficiency of operations
 - Management knowledge and expertise
 - Internal control structure (use of dual control, management oversight/monitoring, self-assessment practices, risk mitigation practices)

Audit Risk Assessment

▶ Example - Member Business Lending

<u>Risk Factor</u>	<u>Risk Rating</u>	<u>Weight</u>	
Business Exposure	3	10%	
Organization Change	4	15%	
IT Environment	3	25%	
Regulatory Environment	3	20%	
Control Environment	<u>4</u>	<u>30%</u>	
Total Weighted Risk Score		100%	3.45

Audit Risk Assessment



Audit Risk Assessment

Risk Based internal Audit Plan

A Risk Based Plan will look like this

Sr	Criticality	Criticality Score	Process Name	Frequency
1	High	25-30	<ul style="list-style-type: none">• Revenue• Human Resource	Quarterly to Half Yearly
2	Medium	20-25	<ul style="list-style-type: none">• Accounts Payable• Fixed Assets• Compliances	Half Yearly to Once in a year
3	Low	Below 25	<ul style="list-style-type: none">• Admin Functions	Annual to Once in Two Year

Risk Mitigation

- **Definition**

- A systematic reduction in the extent of exposure to a risk and/or the likelihood of its occurrence. Also called risk reduction.

i.e. internal controls

Risk Mitigation

Four Strategies

- Risk Acceptance
- Risk Avoidance
- Risk Limitation
- Risk Transference

Break

Internal Audit Planning

- What to consider
 - Risk & control environment
 - Past audit results/findings
 - Risk score (identify frequency)
 - High (score of 3.5 or higher) - annual
 - Moderate (2 to 3.4) - 18 to 24 months
 - Low (below 2) - 24 to 48 months
 - Surveys/Input of Management, Supervisory/Audit Committee, Board, etc.

Internal Audit Planning

- Other factors to consider
 - Previous audit date (internal and external)
 - Number of audit hours available/scheduled
 - Size of audit staff
 - Audit staff knowledge and expertise
 - Regulatory environment
 - Organizational/strategic changes
 - Required vs. Elective Audits
 - Input from SC and senior management

Internal Audit Planning

- Internal Audit Plan Documents
 - Audit Universe
 - Audit Schedule/Calendar
 - Audit Plan Progress Report
 - Hours Tracking
 - Audit Finding Tracking Report

Internal Audit Universe

- ▶ [Internal Audit Universe and Plan Template.xls](#)

Internal Audit Calendar

- [Internal Audit Plan Calendar Template.xls](#)

Internal Audit Progress Report

- [Plan Results February 2017.xls](#)

Internal Audit Hours

- [IA Hours Tracking Sheet Template.xls](#)

Questions?

Questions?

Questions?

Risk Assessment/IA Plan Exercise

Step 1

- ▶ Identify top 10 entities that you would believe you would include in your audit plan.

Step 2

- ▶ Identify the criteria you would use to calculate the risk rating for each entity

Step 3

- ▶ Perform a risk assessment and calculate the level of risk for each entity

Step 4

- ▶ Identify and arrange top 5 entities based on level of risk...highest to lowest

Step 5

- ▶ Discuss your list and assessment with other attendees seated near you.
 - ▶ Are they similar...different?
 - ▶ Does the order differ between you?
 - ▶ Would you be likely to change your entities or order based on these discussions?

Step 6

▶ Open Discussion

Discussion of Considerations

Branch Audits

Branch Audits

Considerations:

- ▶ Number of Internal Audit Staff
- ▶ Number of Branches
- ▶ Geographic Location of Branches
- ▶ Complexity of Branch Operations
- ▶ Branch Operations/Administration Function

Branch Audits

▶ Example

- ▶ 3 Internal Audit Staff Members
- ▶ 45 Branches, plus 2 Mobile Branches
- ▶ 4 Geographical Areas Across NYS
- ▶ Full Service Centers (Deposits, Loans, ATMs, Negotiable Instruments, Safe Deposit Box Operations, Signature Guarantee, etc.)
- ▶ Branch Administration Department provides monthly oversight and monitoring activities
- ▶ Network Based Approach
- ▶ 200 - 300 Audit Hours Allocated

Branch Audits

- ▶ 1) Cash
 - a) Teller
 - b) Vault
 - c) Bait
 - d) ATM
 - e) TCD/TCR
 - f) Over/Short

Branch Audits

- ▶ 2) Negotiable Instruments
 - a) Money Orders
 - b) Checks (Starter, Teller, Counter)
 - c) Gift Cards
 - d) Other (stamps, movie passes, amusement park tickets, etc.)

Branch Audits

3) Bank Secrecy Act Compliance

- a) CTR and SAR Testing
- b) Who prepares reports?
- c) BSA Quiz?

Branch Audits

- 4) Branch Security Assessment
 - a) Surveillance Equipment
 - b) Alarms
 - c) Manuals

Branch Audits

5) Teller Work Review

- a) Policy and procedure adherence
- b) Fraud
- c) Member Signature/Initials
- d) Identification Presented

Branch Audits

6) Confidentiality of Member Data

a) Work area review (Clean Desk Policy)

Branch Audits

7) ATM

- a) Onsite versus Offsite
- b) Maintenance
- c) Replenishment

Branch Audits

8) Loans

a) Centralized versus Decentralized

Branch Audits

9) New Account Activity

a) In-person versus Online

b) Account Type (member, Trust, POA, IRA, etc.)

Branch Audits

12) Other Activity

- a) Night and Express Deposits
- b) Safe Deposit Boxes
- c) Human Resources - Staffing and Turnover
- d) Image/Brand
- e) Service Standards

Lending Audits

Lending Audits

- a) Direct / Indirect Lending
- b) Real Estate Lending
- c) Credit Card Lending
- d) Commercial Lending
- e) Student Lending
- f) Employee Lending
- g) Loan Servicing
- h) Credit Risk/Risk Pricing / Concentration
- i) Quality Control/Assurance/Loan Review

AML/BSA Audits

AML/BSA Audits

BSA AUDIT

OFAC AUDIT

CIP AUDIT

AML/BSA Audits

BSA AUDIT

- Compliance Program
- CDD/membership eligibility
- SARS
- CTRs

AML/BSA Audits

BSA AUDIT

- Exemptions
- Products and Services
- High Risk Persons and Entities

Questions?

Questions?

Questions?