

Internal Audit 101

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AGENDA

- “Rules” for the Morning Session
- Speaker Introductions
- Acronyms and Audit Terms
- Who and What is Internal Audit?
- Monitoring vs. Auditing
- Governance
- Internal Audit Structure
- Audit Processes



Rules for the Day

- #1 - There are no rules (well, not really!!)
- #2 - Participation is key, ask away
- #3 - Let's converse, do not make us lecture
- #4 - There are no "irrelevant" questions
- #5 - It's not just about you!
- #6 - Take advantage of the knowledge
- #7 - Make new friends and network

Meet and Greet

ice
BREAKER

So now that the formalities are out of the way...





THINGS TO KNOW

Acronyms

- ▶ ACH - Automated Clearing House
- ▶ ACUIA - Association of Credit Union Internal Auditors
- ▶ AD&D - Accidental Death and Disability (insurance coverage)
- ▶ AFG - Auto Financial Group
- ▶ ALCO - Asset and Liability Committee
- ▶ ALLL - Allowance for Loan & Lease Loss
- ▶ ALM - Asset Liability Management
- ▶ AML - Anti-Money Laundering
- ▶ ATM - Automated Teller Machine
- ▶ BCP - Business Continuity Plan
- ▶ BIA - Business Impact Analysis
- ▶ BPO - Broker Price Opinion
- ▶ BSA - Bank Secrecy Act
- ▶ CDD - Customer Due Diligence
- ▶ CFPB - Consumer Protection Financial Bureau
- ▶ CIP - Customer Identification Program
- ▶ CLA - CliftonLarson Allen (external audit firm)
- ▶ COBIT - Control Objectives for Information and Related Technology
- ▶ COSO - Committee of Sponsoring Organizations
- ▶ CRA - Community Reinvestment Act
- ▶ CRM - Customer Relationship Management
- ▶ CTR - Currency Transaction Report
- ▶ CUMAA - Credit Union Membership Access Act
- ▶ CUNA - Credit Union National Association
- ▶ CUNEB - Credit Union National Extension Bureau
- ▶ CUSO - Credit Union Service Organization (CU subsidiary)

Acronyms

- ▶ DDFP - Direct Dealer Financing Program
- ▶ DFI - Direct Financial Institution
- ▶ DIG - Data & Information Group
- ▶ EFT - Electronic Funds Transfer
- ▶ EPN - Electronic Payments Network
- ▶ ERM - Enterprise Risk Management
- ▶ FFIEC - Federal Financial Institutions Examination Council
- ▶ FRB - Federal Reserve Board
- ▶ FSP - Financial Services Platform (core system processor)
- ▶ GAAP - Generally Accepted Accounting Principles
- ▶ GAAS - Generally Accepted Auditing Standards
- ▶ GAP - Guaranteed Asset Protection
- ▶ GRC - Governance, Risk & Compliance
- ▶ HELOC - Home Equity Lines of Credit
- ▶ HMDA - Home Mortgage Disclosure Act
- ▶ ICQ - Internal Control Questionnaire
- ▶ IDFP - Indirect Dealer Financing Program
- ▶ ISO - International Organization for Standardizations
- ▶ LTV - Loan to Value
- ▶ MBL - Member Business Loans
- ▶ MFA - Multi-Factor Authentication
- ▶ MIS - Management Information Systems
- ▶ MSA - Member Service Advisor
- ▶ MSC - Member Solutions Center
- ▶ MSL - Member Service Leader

Acronyms

- ▶ NACHA - National Automatic Clearing House Association
- ▶ NAFCU - National Association of Federal Credit Unions
- ▶ NCUA - National Credit Union Association
- ▶ NCUSIF - National Credit Union Insurance Fund
- ▶ NOC - Notification of Change
- ▶ NW - Net Worth
- ▶ ODFI - Originating Depository Financial Institution
- ▶ OFAC - Office of Foreign Asset Control
- ▶ OPM - Organizational Performance Management
- ▶ PCA - Prompt Corrective Action
- ▶ QA - Quality Assurance
- ▶ RBNW - Risk Based Net Worth
- ▶ RDC - Remote Deposit Capture
- ▶ RDFI - Receiving Depository Financial Institution
- ▶ RESPA - Real Estate Settlement Procedures Act
- ▶ RFP - Request for Proposal
- ▶ SAFE Act - Secure and Fair Enforcement for Mortgage Licensing Act
- ▶ SAR - Suspicious Activity Report
- ▶ SIA - SEFCU Insurance Agency
- ▶ SMS - SEFCU Mortgage Services
- ▶ TCD - Teller Cash Dispenser
- ▶ TCR - Teller Cash Recycler
- ▶ TDR - Troubled Debt Restructuring (loan classification)
- ▶ TILA - Truth in Lending Act

Glossary of Audit Terms

- ▶ **Audit evidence:** Facts gathered during the audit procedures that provide a reasonable basis for forming an opinion.
- ▶ **Audit risk:** The risk of forming an inappropriate opinion within the audit.
- ▶ **Control risk:** The risk that a credit union's internal controls won't detect or prevent mistakes.
- ▶ **Due professional care:** Taking the time to gather reasonable audit evidence to support your audit conclusions.

Glossary of Terms

- ▶ **Generally accepted accounting principles (GAAP):** Standard U.S. accounting guidelines for reporting financial statement transactions.
- ▶ **Generally accepted auditing standards (GAAS):** Standard U.S. auditing guidelines for planning, conducting, and reporting on audits.
- ▶ **Independence:** Having an arm's-length relationship – meaning no special or close relationship – with the area or individuals being audit.
- ▶ **Inherent risk:** The likelihood of arriving at an inaccurate audit conclusion based on the nature of the credit union's business.

Glossary of Terms

- ▶ **Internal controls:** The operating standards a credit union uses to prevent or uncover mistakes.
- ▶ **Materiality:** The importance placed on an area of reporting or control based on its overall significance.
- ▶ **Objectivity:** The ability to evaluate records with no preconceived notions or prejudices.
- ▶ **Professional skepticism:** Approaching an audit with a questioning mind-set.
- ▶ **Sampling:** Selecting a small but pertinent and representative number of records to represent the entire population of records.



Internal Audit Purpose

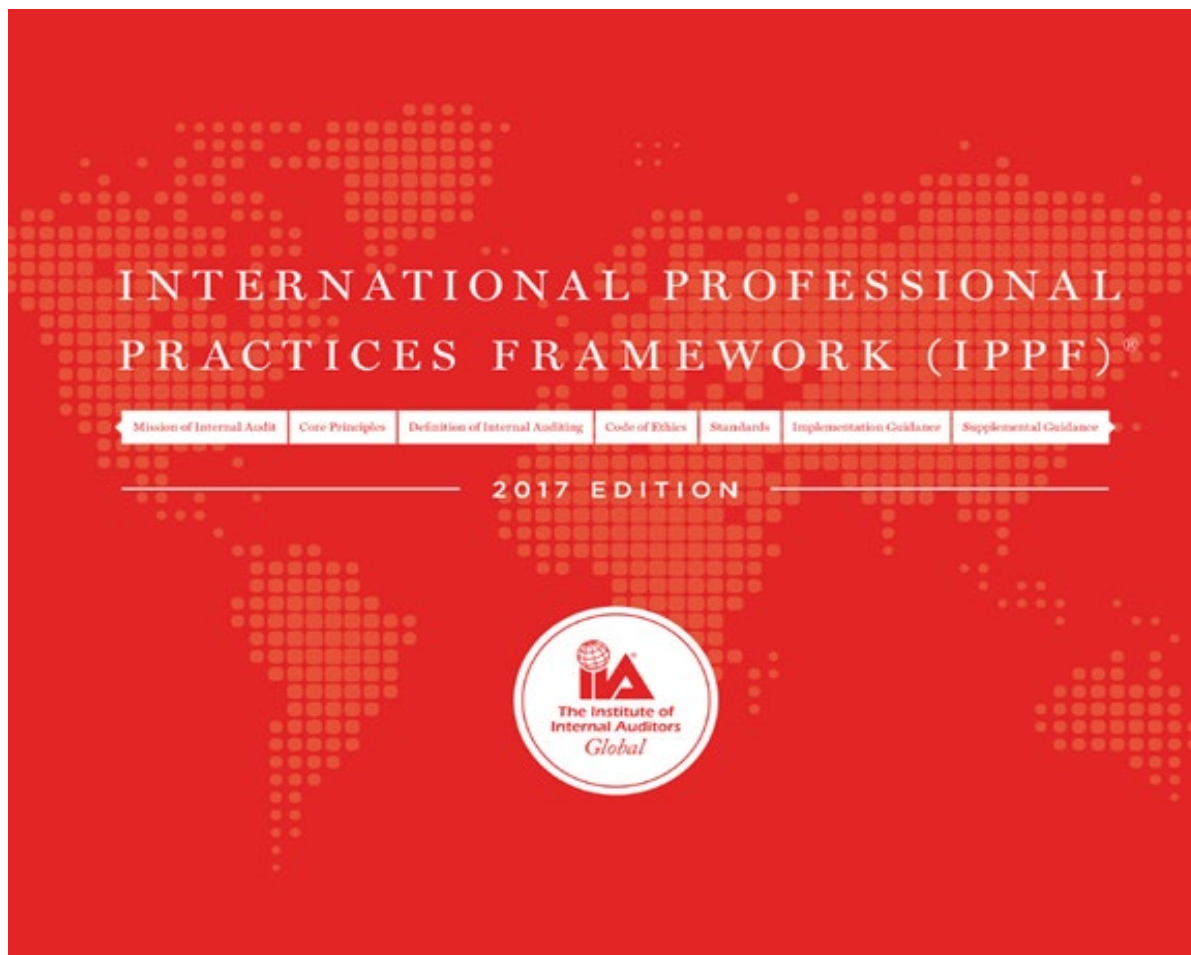
- Safety and Soundness
- Assist Supervisory/Audit Committee
- Consultant
- Catalyst

Definition-Internal Audit

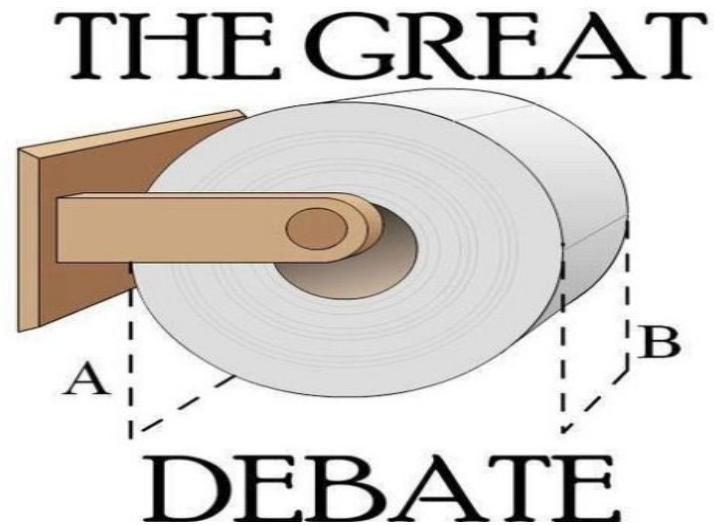
...is an independent, objective assurance and consulting activity designed to add value and improve operations.

Internal Audit helps the Credit Union accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Standards

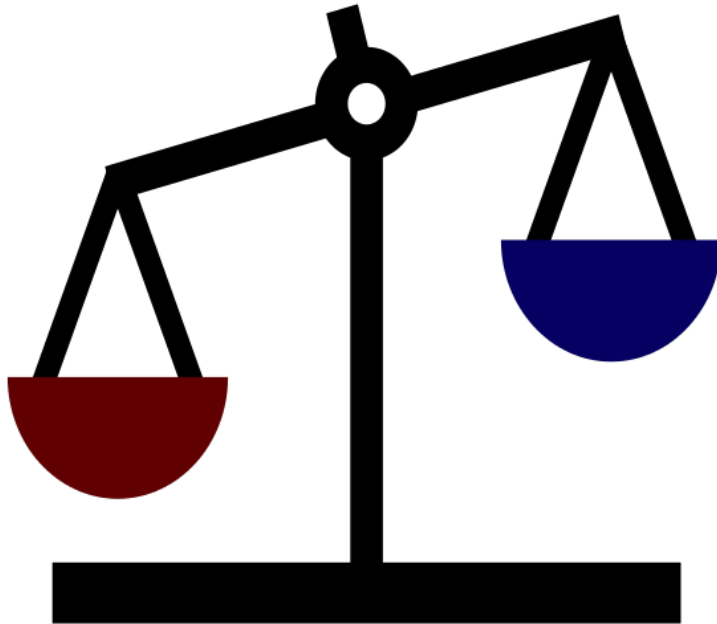


Monitoring vs. Auditing



Monitoring vs. Auditing

- ▶ Which category best describes you?



Monitoring vs. Auditing

Auditing

... is a quality assurance function; is an independent, top-down, systematic evaluation of operational processes and quality control.

Monitoring vs. Auditing

Monitoring

... is a quality control function where conduct is routinely assessed on an on-going basis

... is to observe and check the progress or quality of (something) over a period of time; keep under systematic review.

Monitoring vs. Auditing

Auditing + Monitoring

While monitoring and auditing are distinct functions, together, they can compliment each other to create an additive impact on the overall quality and integrity of credit union operations.

Monitoring vs. Auditing

Audit Characteristics

- ▶ Formal review governed by professional standards
- ▶ Completed by professionals independent of the operation
- ▶ Formal, systematic and structured approach
- ▶ Involves planning, sampling, testing, and validating
- ▶ Formal communication with recommendations and corrective action measures
- ▶ Documented follow-up of corrective actions
- ▶ Audit accountability is typically to the Chief Audit Executive and the Supervisory/Audit Committee

Monitoring vs. Auditing

Monitoring Characteristics

- Often less structured than auditing, though audit techniques may be employed
- Usually completed by operations or compliance personnel
- Involves on-going checking and measuring
- Can be periodic spot checks, daily/weekly/monthly tests
- May identify the need for an audit
- Accountability for monitoring is typically to operations leadership
- If completed in relation to a compliance work plan, formal communication to Chief Compliance Officer and Compliance Committee

- May involve internal audit or compliance

Monitoring vs. Auditing

Independence

While consisting of similar tasks, auditing and monitoring are separate concepts and activities.

- ▶ Typically used in tandem throughout the credit union industry, “auditing” and “monitoring” **do not** represent a single concept. The primary defining characteristics distinguishing auditing and monitoring are **independence, objectivity and frequency**.
- ▶ Auditing represents evaluation activities completed by individuals **independent** of the process on a periodic basis and monitoring represents evaluation activities completed by individuals who **may not be** independent of the process on a routine or continuous basis.

Monitoring vs. Auditing



Do you have your answer yet?

Which category best describes your current function?

Which category should you be performing?

Internal Audit Governance

Governance

► Independence

...is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

The chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship.

Governance

- **Objective/Objectivity**

...is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made.

Governance

Independence and Objectivity

Examples:

- ▶ Personal conflicts of interest
- ▶ Scope limitations
- ▶ Restrictions on access to information or personnel
- ▶ Limited funding for departmental activities

Governance

Question...

How long should an internal auditor abstain from performing any audit work within an operational area for which they previously worked in to ensure objectivity is not perceived as being compromised?

Governance

Tone at the TOP

- ▶ Principles
- ▶ Strategy
- ▶ Policy
- ▶ Expectations/Behaviors
- ▶ Control
- ▶ Fiduciary Duty
- ▶ Accountability
- ▶ Risk
- ▶ Compliance
- ▶ Reputation

Governance

Where was Internal Audit?



Example #1

*Former Municipal Credit Union **CEO** Kam Wong got away with his \$10 million fraud for years by managing New York's oldest financial cooperative by forewarning employees to follow his demands without question or risk termination and to address him as Mr. Wong or risk public reprimand.*

Example #2

A little more than two years after receiving that Community Hero Award from the Fenton Regional Chamber of Commerce, the businessman and accountant walked into the Oakland County Sheriff's Office and told detectives that he embezzled about \$20 million over a dozen years from Clarkston Brandon Community Credit Union, while he was the chief financial officer.

Example #3

*Authorities say a **former president** of 1st Kansas Credit Union in Topeka has pleaded guilty to embezzlement. The U.S. attorney's office said in a news release that 52 year-old Connie Marie Kent of Topeka pleaded guilty to one count of theft from a credit union and has agreed to repay nearly \$40,000.*

Example #4

*After more than three years since a Kansas credit union was merged following a suspected embezzlement scheme, federal authorities indicted a **former president/CEO** who is allegedly responsible for stealing more than \$5 million. Nita Rae Nirschl, 64, was charged with an 81-count indictment including 22 counts of embezzlement, 37 counts of money laundering, 18 counts of interstate transportation of stolen property and four counts of attempting to evade taxes.*

Example #5

The former **chief operating officer** of a federal credit union pleaded guilty Wednesday at the federal courthouse in Central Islip to embezzling \$465,172 during her tenure there, authorities said. Suzanne Silva of Carle Place had served as COO of the Winthrop University Hospital Employees Federal Credit Union. Silva had admitted that she abused her authority as chief operating officer by stealing funds from the credit union for personal travel and shopping sprees.

Example #6

A former **CEO** of Valley State Credit Union was sentenced to up to 20 years in prison after stealing \$710,000 from the credit union. Stanley Hayes, 45, was sentenced on 13 felony counts in the Saginaw County Circuit Court.

“As CEO of the credit union Hayes had the trust of his employees and members of the credit union and he took advantage of that for personal gain, breaking the law in the process.”

Example #7

*Calling the thefts “mind boggling,” a federal judge sentenced the former **CEO** of Valor Credit Union on Wednesday to five years, 10 months in prison for embezzling about \$718,000 from the financial institution. Jelen, 35, pleaded guilty in July 2016 to bank fraud and attempted bank fraud.*

Prosecutors say he used several different schemes to steal funds from July 2014 to August 2015. He used the money to fund a lavish lifestyle, including a \$20,000 grandfather clock, a \$30,000 birthday party for his wife and a \$25,000 golf sponsorship at his alma mater, St. Francis College in New York City.

Example #8

*A former Little Falls credit union **CEO** pleaded guilty to stealing at least \$2.5 million following a five-year fraud investigation by the FBI. Margurite Mary Cofell, former president/manager/CEO of the St. Francis Campus Credit Union pleaded guilty to to a criminal charge of felony credit union fraud.*

Example #9

*She gambled, bought a Mercedes and big motor home and took luxury vacations. Now, a Westland, Mich., woman convicted of stealing millions from a veterans' credit union she ran will have up to 20 years to ponder her actions in prison. Michigan Attorney General Bill Schuette, who called the crime "despicable," announced Fuataina Afutiti had been sentenced to 2½ to 20 years for stealing nearly \$2 million from the Veterans Health Administration Credit Union. Afutiti not only took advantage of her position as **president and chief executive of the credit union**, she "took advantage of military veterans, many of whom were disabled or on a fixed income," Schuette said.*

Example #10

*The former **CEO** of a credit union that collapsed will be arraigned later this month on felony fraud charges. Prosecutors allege that Marguerite Mary Cofell, the former CEO of St. Francis Campus Credit Union, stole at least \$2.5 million while leading the institution.*



Core Audit Principles

Integrity

- honest, diligent, responsible, ethical, etc.

Competence

- Follows standards, continuing education

Objective

- Unbiased, truthful and open about material facts, no conflict of interest

Independent

- No restrictions, unimpeded access

Organizationally aligned

- strategically, risk perspective, etc.

Audit Principles Con't

Appropriately positioned
Adequately resourced
Effective communicator
Continuous improvement
Risk-based
Proactive
Insightful
Future-focused!

Ethics

Internal Auditors, like many other professionals, should adhere to a strict code of ethics and professional values to include both principles and rules of conduct.

Ethics

- **Rules of Conduct**
 - Same of first 4 Core Audit Principles

Standards

Attribute and Performance

Attribute Standards

- ▶ Address the characteristics of organizations and individuals performing internal audit activities

Attribute Standards

- ▶ **Examples:**
 - ▶ independence
 - ▶ objectivity
 - ▶ due profession care
 - ▶ proficiency
 - ▶ continuing education
 - ▶ quality assurance

Performance Standards

- ▶ Describe the nature of internal audit activities and provide criteria against which the performance of these services can be evaluated.

Performance Standards

- ▶ **Examples:**
 - ▶ Managing audit activities
 - ▶ Planning
 - ▶ Communications
 - ▶ Reporting
 - ▶ Nature/scope of work
 - ▶ Audit engagement practices
 - ▶ Monitoring (i.e. follow-up)



Internal Audit Department

- ▶ Reporting Structure
 - ▶ Supervisory/Audit Committee
 - ▶ Executive Management
 - ▶ Dual
 - ▶ Administrative versus Functional

Internal Audit Department

- ▶ Department Structure/Hierarchy
- ▶ Size (Number of Staff)

Internal Audit Department

- ▶ Roles and Responsibilities
 - ▶ What functions can Internal Audit perform?
 - ▶ Wearing multiple hats
 - ▶ Why and How without impacting independence?
 - ▶ Area Responsibilities

Internal Audit Department

▶ Roles and Responsibilities

- ▶ Audit (Assurance Services)? ✓
- ▶ Regulatory Compliance? ✓
- ▶ Fraud/Investigations? ✓
- ▶ Enterprise Risk Management? ✓
- ▶ Consulting? ✓
- ▶ Physical and IT Security? ✓
- ▶ Others?

Staff Development/Training

- ▶ Where?
- ▶ How?
- ▶ How Much?
- ▶ On What?
- ▶ Does it vary by position?

Internal Audit Components



Audit Program

Internal Audit must develop and document a an audit program the achieves the audit objectives, and includes procedures for analyzing, evaluating and documenting information. [STD 2240; 2240.A1]

Audit Workpapers

Internal Audit must document information to support the conclusions and audit results. [STD 2330]

Audit Workpapers

▶ Include:

- ▶ **A descriptive heading:** It should include the auditee name, the workpaper's purpose, and the date.
- ▶ **Indexing:** Like a book, every workpaper has a unique page number showing its place in the audit file.
- ▶ **Cross-referencing:** To improve your efficiency, you want to cross-reference your workpaper to related and supporting workpapers. Doing so eliminates the duplication of work.

Audit Workpapers

- ▶ **Tick marks:** For the sake of brevity, you use tick marks as abbreviations for standard auditing tasks. For example, *V* means that the item you're reviewing *vouched* to the source document. Another tick mark is *F*, which stands for *foot* and means that you confirmed the arithmetic calculations on the workpaper or schedule.
- ▶ **The source of the information:** Be sure to include what documents you examined or who you interviewed to gain evidence about the auditing matter at hand.
- ▶ **A conclusion:** Write a summary of the results of your analysis and your opinion of the validity of the assertion.

Audit Fieldwork

Internal Audit must identify, analyze, evaluate and document information to achieve the audit objectives. [STD 2300]

Audit Reports

Internal Auditors must communicate the results of the audit. [STD 2400]

Audit Reports

- ▶ Format
- ▶ Distribution
- ▶ Rating System
 - ▶ Overall, Findings, etc.
- ▶ Content
- ▶ Management Response
- ▶ Follow-up

Audit Meetings

- ▶ Entrance Meetings
- ▶ Status Update Meetings
- ▶ Exit Meetings

Who attends?

What is discussed?

What information is provided?

Tracking Audit Hours

- ▶ Method
- ▶ Categories
- ▶ Increments
- ▶ Reports
- ▶ Metrics

Morning Break



Supervisory / Audit Committee Charter

- ▶ **Main responsibilities:**
 - ▶ Perform or obtain a financial statement audit, as prescribed in §715.4
 - ▶ Verify or cause the verification of members' passbooks and accounts against the records of the credit union, as prescribed in §715.8

Committee Charter

- ▶ Ensure that the credit union adheres to the measurement and filing requirements for reports filed with the NCUA Board under §741.6

Supervisory / Audit Committee Structure

- ▶ How many members?
- ▶ Who?
- ▶ How appointed or elected?
- ▶ Compensated or Not Compensated?
- ▶ Qualifications?

Supervisory / Audit Committee Meetings

- ▶ Frequency
- ▶ Method
- ▶ Participants
- ▶ Invited Guests
- ▶ Format / Agenda
- ▶ Closed Sessions

Charters

- ▶ Internal Audit's purpose, authority and responsibility must be *formally defined in an internal audit charter*, consistent with the Definition of Internal Auditing, the Code of Ethics and the Standards (STD 1000)

Internal Audit Charter

- ▶ Defines Internal Audit's authority
- ▶ Should include the definition of internal auditing, the code of ethics and the standards, and be discussed with management
- ▶ Periodically reviewed with senior management and the Board of Directors / Supervisory Committee for approval

Sample Charters

- ▶ [Sample Supervisory Committee Charter.docx](#)
- ▶ [Sample Audit Charter.docx](#)
- ▶ [SEFCU AUDIT CHARTER.doc](#)

IA Relationships

- With management and employees
- With Board & Supervisory/Audit Committee
- With External Auditors and State/Federal Regulators

Internal Audit versus Risk Management

Internal Audit versus Risk Management

- ▶ 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.”

Internal Audit versus Risk Management

Risk management	Internal audit
Develop the risk management framework	Audit the adequacy and effectiveness of the risk management framework
Implement the risk management framework	Audit implementation of the risk management framework
Advise management on integration of risk management into business operations and their roles in making it work	Audit management's commitment to risk management and the take up of their roles
Advise on the allocation of accountability for risks, controls and tasks	Audit whether accountable managers fulfil those roles and are capable
Advise management and the Board on the interpretation of risk management information	Provide independent assurance of the risk management information submitted to the Board
Provide appropriate risk management status and performance information to the Board Audit and Risk Committee	Provide an independent view on the credibility and reliability of the risk management information submitted to the Board Audit and Risk Committee
Act as an advisor and mentor to management on risk management matters	Act as an independent reviewer to provide assurance on management's capability and performance in risk management

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

Business Owners/Management/Board

Risk Management and Other Support
Areas

Internal Audit

Questions and Answers

THE END