

# Internal Audit 202

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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



# 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, and include both internal and external audit engagements

# 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 - 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 Universe

So let's talk about the audit universe at your credit union!!

# Audit Universe

- ▶ Who creates and maintains the audit universe?
- ▶ How often is it updated?
- ▶ Who provides input?
- ▶ How many audit entities are included?
- ▶ What types of audit entities are included?
- ▶ What other information is included?





# NCUA Risk Categories

7 Categories:

Credit

Interest Rate/Market

Operational/Transaction

Compliance/Legal

Liquidity

Reputation

Strategic

Emerging Risk categories: Security and Information Technology

# 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

# Risk Process

# 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

# Risk Mitigation

## Four Strategies:

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

# Internal Controls



# 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

# Risk Assessment Methodology

# 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

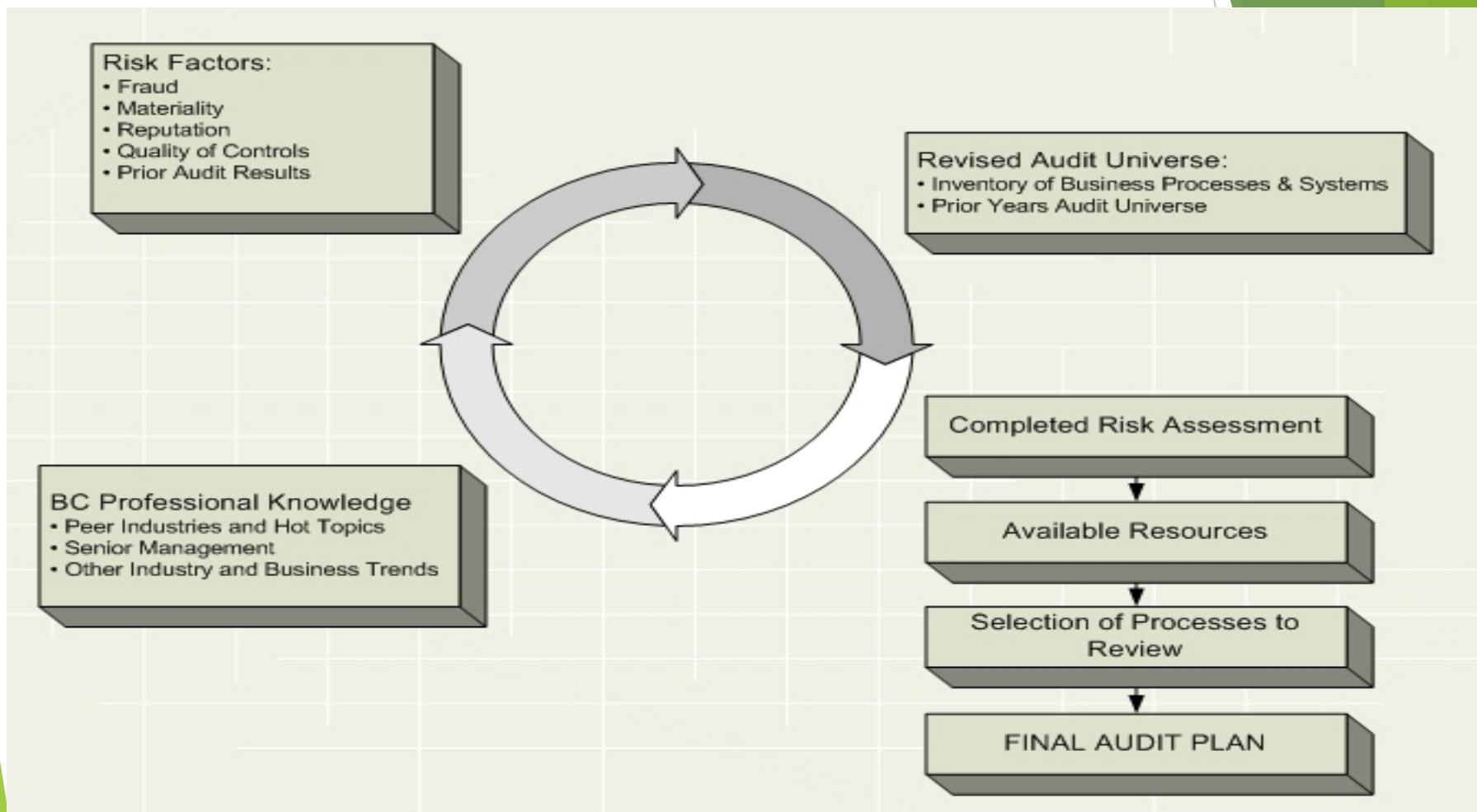
# Audit Risk Assessment Process

## 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 & Plan



# Audit Risk Assessment

- **Identification**
  - **The what**

# Audit Risk Assessment

- **Risk Measurements**
  - Portfolio Size
  - Potential for Loss (Fraud)
  - Degree of Organizational Change
  - Reliance on Technology/IT Security
  - Regulatory Environment
  - Level of Operational Complexity
  - Significance of Internal Controls
  - Risk Strategy

# Audit Risk Assessment

- ▶ **Risk Rating Systems**

- ▶ **Numerical scale**

- 1-3, 1-5, 1-10...

- ▶ **Severity/Criticality scale**

- High, Moderate, Low

- ▶ **Heat Mapping**

- Likelihood and Impact Chart

# Audit Risk Assessment

## ▶ Example - Member Business Lending

<u>Risk Factor</u>	<u>Risk Rating</u>	<u>Weight</u>
Portfolio	2	10%
Business Exposure	3	10%
Organization Change	4	15%
IT Environment	3	25%
Regulatory Environment	3	20%
Control Environment	<u>4</u>	<u>20%</u>
<b>Total Weighted Risk Score</b>	<b>3.25</b>	<b>100%</b>

# Audit Risk Assessment

► Example - Member Business Lending

Risk Factor

Portfolio

Business Exposure

Organization Change

IT Environment

Regulatory Environment

Control Environment

**Overall**

Criticality

Low

Moderate

High

Moderate

Moderate

Moderate

**Moderate/High**

# Audit Risk Assessment

RISK RATING KEY		LOW	MODERATE	HIGH
		0 - Acceptable Ok to Proceed	1 - Reasonable Take Mitigation Efforts	2 - Unacceptable Seek Support
		SEVERITY		
		ACCEPTABLE	TOLERABLE	UNDESIRABLE
		Little to Effect	Some Effects, Not Critical	Serious Impact
L I K E L I H O O D	IMPROBABLE Risk Unlikely to Occur	- 1 -	- 2 -	- 3 -
	POSSIBLE Risk Likely to Occur	- 2 -	- 3 -	- 4 -
	PROBABLE Risk Will Occur	- 3 -	- 4 -	- 5 -

# Internal Audit Planning



# Internal Audit Planning

## ■ What to consider

- Risk & control environment
- Past audit results/findings
- Risk Rating (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
  - Organizational/strategic changes
  - Required vs. Elective Audits

# Internal Audit Plan Documents

# Internal Audit Documents

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

# Afternoon Break

# How to Get Audits Done

- ▶ Internal Audits
- ▶ Co-Sourced Audits
- ▶ External Audits (Outsourced)

# Common Audits

- ▶ Branches
- ▶ Lending
- ▶ Payroll/Human Resources
- ▶ ACH
- ▶ AML/BSA
- ▶ Others

# Audit Risk Assessment and Plan Exercise



# Step 1

- ▶ Identify top 10 auditable 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

- ▶ How does the Plan you created compare to the one that exists today in your credit union?
- ▶ Open Discussion

# Step 7

Based on what you learned here today, what would or are you going to change when you get back?

Questions?

Questions?

Questions?



# Audit Tool and Template Samples and Resources

# Internal Audit Universe

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

# Internal Audit Risk Assessment

- ▶ [Risk Assessment Template-CU 2019.xlsx](#)
- ▶ [Risk Category Definitions-CU 2019.docx](#)

# Internal Audit Calendar

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

# Internal Audit Progress Report

- [Plan Status Report Sample.xls](#)

# Internal Audit Hours

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

[Audit Hours Distribution Sample 2.xlsx](#)

# Additional Resources

- ▶ [IA Plan review areas-Master List.docx](#)
- ▶ [IA Plan review areas-Master List.docx](#)
- ▶ [IA Report Sample.doc](#)
- ▶ [Internal Audit Report Format Example.docx](#)

***THE END***