



# Internal Audit.. Looking Ahead and Forward

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Association of Credit Union Audit and Risk Professionals

**Presented By**

**Eileen Iles, CPA, CGMA, CIA, CFSA, CCSA, CRMA, MsAcc – Shareholder Financial Institutions Group**



*Success is a Journey. Not a Destination.*

# Trusted Business Advisor

- Internal Audit is an **independent, objective** assurance and consulting activity designed to add value and improve an organization's operations.
- Internal Audit is the eyes and ears of the Supervisory Committee.
- Internal Audit reports to the Supervisory Committee. **Executive session should be held with the Internal Auditors after each Supervisory Committee meeting.**
- Internal Audit's role is to independently monitor and evaluate whether **management has implemented processes and controls to mitigate risks and identify opportunities.**
- Internal Audit evaluates whether **processes and controls are designed and operating effectively.**

# What's In The News

- Rising Inflation
- Consumer Prices
- Possible Recession
- Labor Shortage
- Rising Interest Rates
- Stock Market Fluctuations
- Mortgage Rates Climbing
- Investment Valuation
- Housing Sales, Production, Valuation
- Regulation
- Increasing Internal and External Fraud
- Retail Shortage
- Supply Chain
- Cybersecurity
- Weather, Natural Disasters – Fire, Flooding, Heat
- Climate Change
- War in Ukraine Impact
- And more...

# Risk...What could go wrong? What's the opportunity?

Operations

Regulation Compliance

Procedure Compliance

Policy Compliance

Tax Compliance

Legal

Member Service

Competition

Market

Valuation

Pricing

Interest Rate

Liquidity

Fiduciary

Financial reporting

Accounting

Financial

Human Resources

Fraud

Ethics

Information Privacy

Data Security

Member Satisfaction

Strategic

Leadership

Governance

Succession Planning

Communication

External

Weather

Performance Measurement

Geographic

Concentration

Third Party

Planning

Budgeting

Projecting

Political

Project Management

Technology

Cybersecurity

Sustainability

Reputation

Inflation

Business (model)

Economic

Risk Management

Business Continuity

Business Disruption

Natural Disaster

Contract Management

Foreign Exchange

Environmental

Cultural

Labor shortage

Producer or Supplier

Physical security

Supply Chain

# Polling Question #1

- What is your credit union's asset size ?
- Less than \$500 million
- \$500 million - \$1 billion
- \$1 billion - \$5 billion
- > \$5 billion

# NCUA General Expectations of Credit Unions

**Strategic Plan:** Develop and maintain a comprehensive strategic plan that outlines their goals, objectives, and strategies for achieving their mission. This plan could cover areas such as growth, risk management, and member services.

**Internal Controls and Risk Management:** Credit unions are expected to have robust internal controls and risk management practices in place to identify, assess, and manage various risks, including operational, credit, liquidity, and compliance risks.

**Data Security and Cybersecurity:** Credit unions are required to have measures in place to safeguard member information and sensitive data, including cybersecurity controls to protect against data breaches and cyberattacks.

**Regulatory Reporting:** Credit unions have reporting requirements to the NCUA, including financial reports and other relevant information.

**Compliance with Applicable Regulations:** Credit unions must ensure compliance with various federal regulations that apply to financial institutions, including anti-money laundering (AML) regulations, consumer protection rules, and fair lending laws.

**Corporate Governance and Board Oversight:** Credit unions are expected to have effective corporate governance structures in place, including boards of directors that provide oversight and strategic guidance to the credit union's management.

**Safeguarding Member Interests:** Credit unions must prioritize the interests of their members and ensure that their financial products and services are aligned with members' needs and financial well-being.

# NCUA Supervisory Priorities 2023

- Interest Rate Risk
- Liquidity and Contingency Funding
- Credit
  - Concentration risk
  - Charge-offs
  - Home equity lines of credit
  - Commercial real estate
  - Residential mortgage
  - Loan workouts
- Fraud Prevention and Detection
- Internal Controls
- Cyber and Information Security
- Payment Solutions
- Consumer Financial Protection
  - Overdraft Programs
  - Fair Lending
  - Residential Real Estate Appraisals (Bias)
  - Truth in Lending
  - Fair Credit Reporting
- Credit Union Service Organizations (CUSOs)
- Succession Planning
- Current Expected Credit Losses (CECL)
  - Calculation
  - Policy and Procedures
  - Documentation
  - Internal Controls

# Examiner Rating

## New category added to CAMEL score effective April 1, 2022 (S)

- **C** – Capital (also known as members' equity, net worth)
- **A** – Asset quality (includes delinquencies, charge-offs)
- **M** – Management (subjective rating)
- **E** – Earnings (net income or ROA)
- **L** – Liquidity risk
- **S** – **Sensitivity to interest rate risk**
  - Used by regulators to rate credit unions on overall soundness
  - Rating system is 1 to 5 with **1 being the most sound**





# Examiner Focus of Internal Audit

- \* Identification of areas subject to fraud risk
- \* Controls implemented to prevent fraud
- \* New technology, third parties, processes
- \* Loan review – credit quality assessment
- Areas of growth and significant change
- Status of completion of audit plan
- Reporting of audit status and results to Supervisory Committee and Board
- Sufficiency of internal audit resources
- Audit coverage of significant current risks
- Existing effectiveness of internal controls including separation of duties
- Areas with changed/reduced controls

# Polling Question #2

Have you had your NCUA exam this year?

- Yes
- No

# Supervisory Committee Responsibilities of Internal Audit

- Review and approve internal audit charter.
- Review and approve risk assessment and internal audit plan.
- Monitor progress of completion of internal audits.
- Approve any changes to the internal audit plan.
  - Understand whether changes involve deferring audits that should be performed based on risk, whether internal audit has the expertise to perform audits planned or needs to seek assistance from other professionals.
- Review and approve internal audit reports.
  - Understand whether issues/findings reported are systemic or isolated human errors.
- Monitor progress of resolution of internal audit findings.
  - Understand whether resolution provided by management is reasonable and attainable.

# Internal Audit – Process, Risk, and Controls

- Internal audit testing performed the same each year or isolated testing of ‘compliance with documented procedures’ may no longer be applicable or effective in identifying, assessing, and mitigating current risks impacting the credit union.
- Historical testing may not address current structure:
  - System(s) and technology utilized
  - Processes, individual(s)/department(s) assigned, limits, authorities
  - Degree of automation
  - Outsourcing to Third and Fourth Parties
  - CUSO
  - Changes in centralization or decentralization, Tone at the Top, etc.

# Internal Audit – Process, Risk, and Controls

- **Beyond testing** – evaluating design of internal controls. Evaluating the design of current processes and risks allows the internal auditor to determine whether current controls are designed effective for the current environment. Effective controls can process 100 or 1,000 transactions effectively, achieving the same results.
- **“Trust But Verify”**
  - System user access, review of system user access, transfer of employees, and separation of duties
  - Review of SOC reports and implementing user control considerations
  - Automation of processes and design of application controls

# Internal Audit – Process, Risk, and Controls

- The risk-based internal audit approach of process, risk, and controls helps the credit union to understand the design of its processes, audit to the specific processes, and establish controls that are effective in mitigating risk.
- The risk-based internal audit approach also allows the auditor to identify pertinent controls that may be absent and need to be added.
- Effectively designed and operating internal controls assist in preventing errors, irregularities, and fraud. Doeren Mayhew's approach to internal audit encompasses identifying preventive controls. The risk-based internal audit approach is also aligned with NCUA's 2023 Supervisory Priorities.

# Process, Risk, and Controls – Credit Unions \$1B

Credit unions over \$1B are increasingly focusing on **formalizing controls**, **educating** employees, management, Supervisory Committee, Board on COSO methodology and **state of controls** of their credit union.

**Risk and control matrices** – evaluate, document, and test internal controls including financial reporting and other risks including operations, compliance, interest rate, liquidity, market, fraud, technology.

**Reasons** – Seeing the need for stronger control structure, have experienced fraud, changing technology, greater automation, need for greater monitoring, adopting riskier products, need to understand and implement internal controls better.

# NCUA and Credit Unions Expectations Approaching \$10 Billion – Compliance Management System (required by NCUA and CFPB)

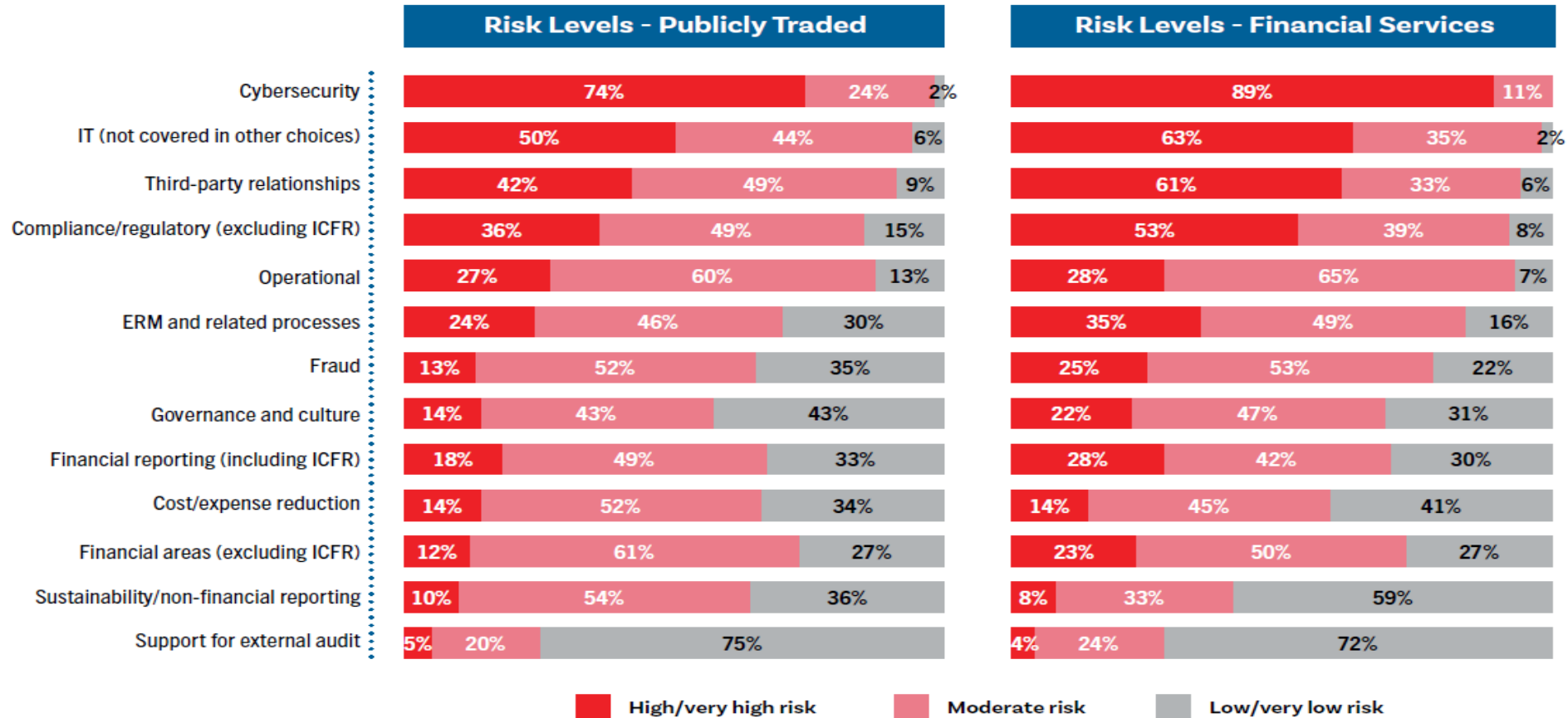
- Board and Management Oversight
- Compliance Program
  - Risk and control identification and assessment
  - Reporting and Technology (cybersecurity)
  - Monitoring and Testing (including three lines of defense)
  - Issue Management
  - Change Management
  - Skills, Staffing, Training
  - Complaint Management
  - Third Party Risk Management
  - Governance and Culture
  - Regulatory Relations and Exam Management
  - Policies and Procedures
- Consumer Complaint Management
- Compliance Audit – compliance internal audit, independent of Compliance and business functions and performs audit of regulations and controls



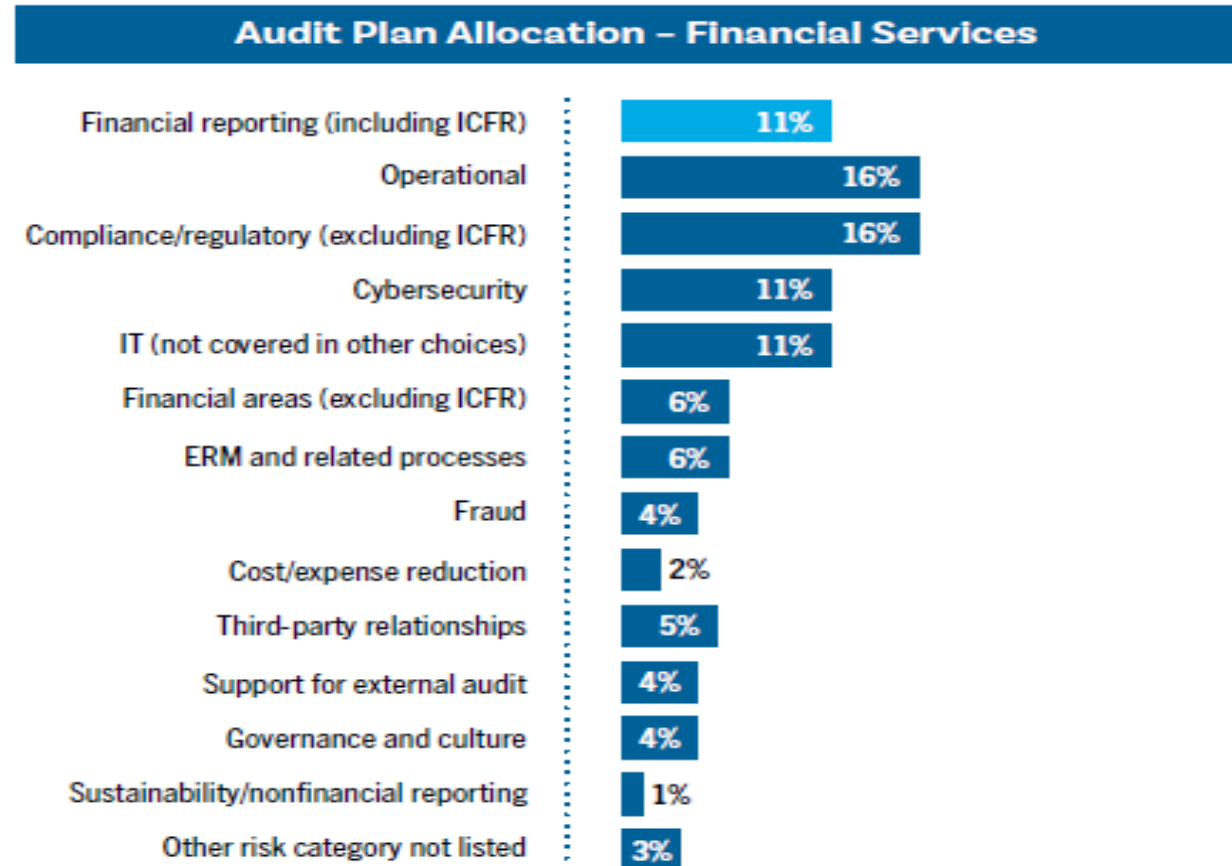
# NCUA and Credit Unions Expectations Approaching \$10 Billion - Readiness Timeline

- Durbin interchange fee income – reasonable and proportional to the cost incurred by the issuer
- **Gain an understanding of the current state of Credit Union's Compliance Management System (CMS)** and inventory of applicable regulations, functions, processes, and controls
- **Identify gaps** of current CMS state based on interviews, review of documentation, and possibly limited sample testing
- **Report results** to Compliance Committee/Board/Supervisory Committee
- **Update** policy, processes, documented procedures, controls, risk assessment, as identified
- **Develop and implement** new policy, processes, controls, documented procedures, as identified
- **Test** compliance with regulation and controls
- Based on results, **additional testing** if more remediation is needed
- **Report results** to Compliance Committee/Board/Supervisory Committee

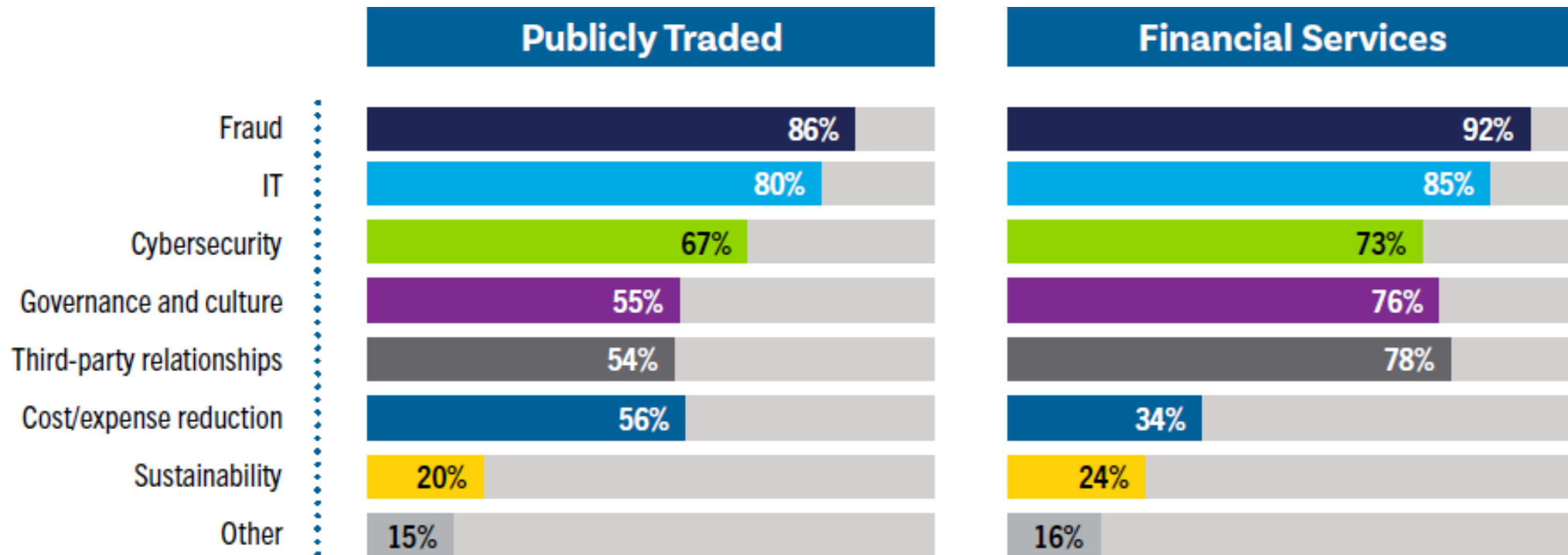
# Institute of Internal Auditors 2023 North American Pulse of Internal Audit – Risk Ratings



# Institute of Internal Auditors 2023 North American Pulse of Internal Audit – Allocation of Internal Audit Plan



# Institute of Internal Auditors 2023 North American Pulse of Internal Audit – Considerations Integrated Into Internal Audits

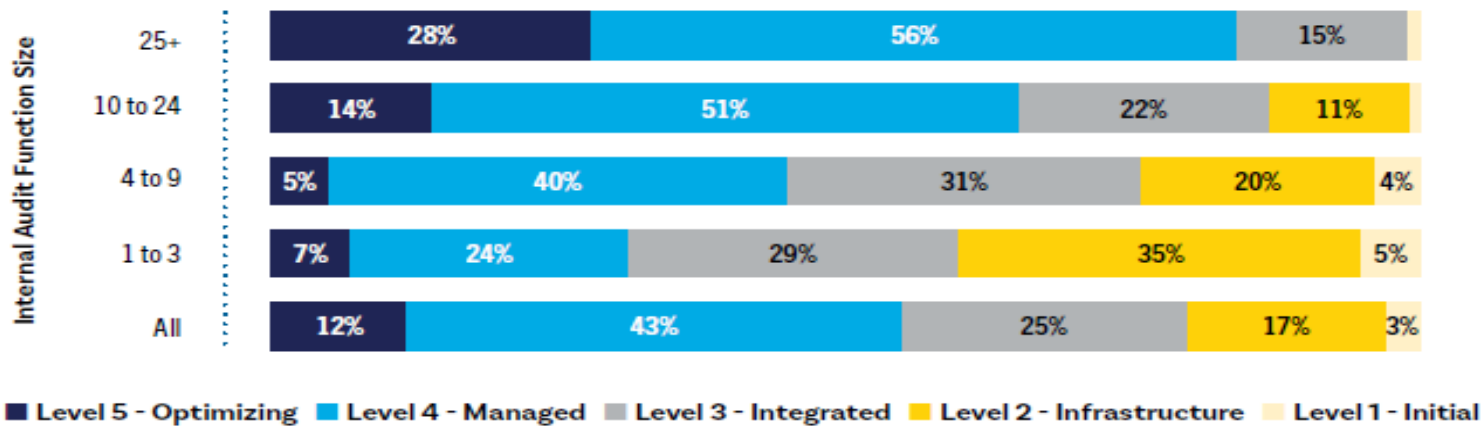


# Institute of Internal Auditors 2023 North American Pulse of Internal Audit – Maturity of Internal Audit Function

The survey asked internal audit leaders to rate their functions' maturity using the levels from the Internal Audit Ambition Model, developed by IIA-Netherlands and LKO/NBA.

As function size increased, the percentage at the top 2 levels increased as well. At the largest size, 28% rated themselves at the top level, compared with 7% at the smallest size. Overall, 55% of respondents reported maturity at the top 2 levels.

**Ambition Model Levels Compared to Function Size**



## Internal Audit Ambition Model Levels

### Level 1 – Initial

Functioning at an initial stage of development, with ad hoc or unstructured activity.

### Level 2 – Infrastructure

Developing administrative infrastructure, along with policies, processes, and procedures.

### Level 3 – Integrated

Integrated into the organization and conforming to IIA Standards.

### Level 4 – Managed

Well-managed, with a visible role in the organization and a long-term vision and plan.

### Level 5 – Optimizing

Optimizing value with continuous improvement for both internal audit and the organization.

Learn more about the Internal Audit Ambition Model, developed by IIA-Netherlands and LKO/NBA at <https://www.iaa.nl/kwaliteit/ambition-model>.

# Polling Question #3

How large is your internal audit department?

- What department?
- 1 individual
- 2 – 4 individuals
- 5 + individuals

# Institute of Internal Auditors - Internal Audit Maturity Components

**Scope and Coverage:** A mature internal audit function has a well-defined scope that covers all critical areas of the organization, ensuring that risks are adequately addressed.

**Governance and Oversight:** The function operates with a clear reporting line to the board or an audit committee, which helps ensure independence and objectivity.

**Risk Assessment:** The function has a systematic process for identifying and assessing risks, allowing it to prioritize audits based on the organization's most significant areas of risk exposure.

**Methodology and Processes:** Mature internal audit functions follow a standardized methodology for conducting audits. This includes planning, fieldwork, reporting, and follow-up processes.

**Talent and Skills:** The function has skilled and qualified professionals with expertise in various areas relevant to the organization's operations.

# Institute of Internal Auditors - Internal Audit Maturity Components

**Technology and Tools:** A mature internal audit function embraces technology to enhance its efficiency, effectiveness, and ability to analyze data.

**Communication and Reporting:** The function communicates its findings and recommendations clearly and effectively to management and the board, providing actionable insights.

**Continuous Improvement:** A mature function actively seeks opportunities to improve its processes, methodologies, and overall performance based on feedback and lessons learned.

**Stakeholder Engagement:** The function collaborates with various stakeholders, including management and external auditors, to ensure a comprehensive understanding of the organization's operations and risks.

**Value Addition:** A mature internal audit function goes beyond compliance and adds value by providing strategic insights, process improvements, and recommendations for enhancing governance and risk management.

**Best Practices:** The function benchmarks itself against best practices, adopting relevant standards and frameworks to enhance its practices.



# Institute of Internal Auditors - Internal Audit Current Challenges

- Internal audit expertise and experience
- Professional development
- Specialized expertise and experience
- Budget
- Technology and training

# Opportunity for Journey with Data, Analytics, Storytelling, Technology

- \* We need to remain relevant. So **THINK BIG**
- \* Stay close to management

## Data Opportunity.

- \* Internal audit lifecycle
  - Continuous monitoring of KPIs, KRIs, etc help us plan and scope more efficiently and effectively
  - In the audit, focusing on riskier attributes and population testing, soon manual sampling will no longer be deemed adequate
  - Reporting to include data-led findings and recommendations
- \* Challenge the data and don't assume that the data is 100% correct and meets the criteria that you seek
- \* Share your data stories internally and with internal audit and risk professionals data community

# Data, Analytics, Storytelling

- Assemble group of individuals to brainstorm and experiment. What are our strategic objectives, performance goals. What is important to us? What would we like to know?
- Start small, with one or two areas/functions/products.
- Identify and understand what data exists and data would like to have.
- Look at data quality, missing data fields, unused data fields.
- Objectives, goals need to be SMART – specific, measurable, attainable, relevant, time-bound
- Develop data quality action plan.
- Develop data governance framework.

# Data, Analytics, Storytelling

- Understand data, trends, anomalies, relationships, story in data for risk identification, assessment, quantification.
- Incorporate data into internal audit planning/scoping/testing. Identify procedures that utilize the data.
  - Analyze data, population(s), trends.
  - Audit population(s).
  - Incorporate risk thresholds.
  - Set targeted scopes and tests.
  - Review data for concentrations, anomalies, patterns.
- Quantify audit results of functions, products and services.
- Incorporate audit results to support control effectiveness in risk assessments.

# Data, Analytics, Storytelling

## Risk Assessment, Data Monitoring, Audit Results Reporting

- Should speak to and about your organization.
- Should allow the reader to visualize the message, audit results, types of risks, risks assessed, effectiveness of controls, etc.
- Reports should be concise, factual, timely.
- Easy to see, understand, and digest issues and recommendations. Possibly include summary, comparison of current audit results with last time audit was performed.
- Address risk(s) of what could happen as a result of the issue(s).
- Substantiate recommendations with regulation, requirements, industry practice, “how to” address the risk(s).

There are a number of professionals focused on “storytelling with data”.

# Technology and Methodology

- Empower people to innovate.
- Improve efficiency of internal audits.
- Continuous monitoring.
- Auditing the population.
- Process mining.
- Embrace dynamic management risk assessments.
- Explore greater use of technology, such as Artificial Intelligence.

Open AI CHatGPT, Microsoft Bing, Google Bard AI, Amazon Codewhisperer are examples of AI technologies.

Be involved and participate in *journey for new technology* for internal audit and organization-wide, new ways of evaluating and doing things, design your *data journey*, and advise on controls of new technology.



# Questions or Comments?

 **DoerenMayhew**  
CPAs AND ADVISORS





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Thank you!



**Eileen Iles**  
Shareholder  
eiles@doeren.com  
630.301.0558