

Credit Union Internal Auditors Association  
Southern Regional Training Meeting  
Tuesday, October 18, 2011

## Auditing Fundamentals & Insight

Presented by: Mike Richards, CPA  
Richards & Associates, CPAs

### Topics of Discussion

---

- ▶ Current audit concerns and recommendations
- ▶ Auditing for regulatory compliance
- ▶ Creating an audit plan

## Audit Concerns

---

- ▶ New disclosure requirements for allowance for loan losses
- ▶ Cloud computing
- ▶ Mobile banking
- ▶ Targeted cyber attacks
- ▶ Internal and external fraud is on the increase

---

▶ 3

## Tips for Avoiding Fraud

---

- ▶ The most common method of fraud detection is a tip or complaint from an employee, vendor, customer or anonymous informant.
- ▶ Although small business frauds have a relatively low detection rate of fraud by audits, it does not accurately reflect the effectiveness of audits as deterrents to fraud by putting personnel on notice that a theft is likely to be detected.

---

▶ 4

## Tips for Avoiding Fraud *-continued*

---

### ▶ Internal Controls

- ▶ Separate the duties of receiving funds, disbursing funds, writing checks, signing checks, and reconciling bank accounts. Having one employee responsible for all cash-related functions makes small businesses vulnerable to fraud.
- ▶ Have the monthly bank statement delivered unopened to the owner, who should review it for unusual transactions such as declining deposits and unfamiliar payees.
- ▶ Owners should look for signatures or endorsements that look forged, missing checks, check numbers that are out of order, and checks where the payee listed does not match the name in the check register.
- ▶ Consider an independent review of the cash accounts and bank statements by an anti-fraud specialist.

---

▶ 5

## Tips for Avoiding Fraud *-continued*

---

### ▶ Employment Conditions

- ▶ Institute background checks on new employees, and notify job applicants that their backgrounds will be checked.
- ▶ Employees who receive regular and recurring training about the detrimental aspects of fraud are more likely to aid in controlling it.
- ▶ Employees who feel well-treated and adequately compensated are less likely to commit occupational fraud than those who don't.
- ▶ Employees who hold grudges against their employers, whether or not justified, are more likely turn to occupational fraud and abuse.

---

▶ 6

## Tips for Avoiding Fraud *-continued*

---

### ▶ Workplace Conditions

- ▶ Insist that employees take a vacation for at least one week every year and use that time to have the books reviewed for discrepancies.
- ▶ Adopt a tip hotline or complaint-reporting mechanism that will enable employees, vendors, customers, or outside sources to report suspected fraud anonymously or without fear of reprisal.
- ▶ Employers can gain valuable information by simply asking questions in a non-threatening, non-accusatory manner.
- ▶ Conduct internal and external audits, especially a "fraud audit" instead of a "general audit" if you suspect fraud.

---

▶ 7

## Tips for Avoiding Fraud *-continued*

---

### ▶ Automation

- ▶ Have an accounting software program expert, preferably a CPA, do the initial set-up of the program to make sure that helpful features are turned on and unhelpful features are turned off.
- ▶ Access to personnel and vendor master file records should be password protected and restricted by job function.
- ▶ Computer systems should create an audit trail of all changes made to the vendor master file records, including an identification of those who made the changes.
- ▶ Changes to vendor master file records should require supporting documentation, supervisory approval, and independent review.

---

▶ 8

## Regulatory Compliance

---

- ▶ FCU Director Duties Rule
  - ▶ NCUA letter 11-FCU-02
- ▶ Evaluating Payment Systems Providers
  - ▶ NCUA letter 10-CU-26
- ▶ Best Practices in Real Estate Appraisals
  - ▶ NCUA letter 10-CU-23
- ▶ Investment Due Diligence
  - ▶ NCUA letter 10-CU-18

---

▶ 9

## Regulatory Compliance *-continued*

---

- ▶ Indirect Lending and Due Diligence
  - ▶ NCUA letter 10-CU-15
- ▶ SAFE Act
- ▶ Dodd-Frank Legislation
- ▶ ACH Rules Changes
- ▶ New Federal Garnishment Rules
- ▶ Overdraft Payment Supervisory Guidance

---

▶ 10

## Regulatory Compliance *-continued*

---

- ▶ BSA Reorganization of Regulations
- ▶ Residential Mortgage Foreclosures Concerns

---

▶ 11

## Internal Audit Plan

---

- ▶ Should be submitted to Supervisory Committee and Management for Approval
- ▶ Should contain an explanation for scope of audit activities and planned frequency of the audits
- ▶ Should include a budget of audit hours for each specific area

---

▶ 12

## Risk Assessment

---

- ▶ Used to identify the risk potential in various departments
- ▶ Based on information obtained from
  - ▶ Discussion with members of management
  - ▶ Considerations of applicable laws and regulations
  - ▶ Analysis of financial and operating data
  - ▶ Internal auditor's knowledge and experience

---

▶ 13

## Sample Audit Schedule

---

- ▶ **January**
  - ▶ *Outside Auditors* The internal audit department will assist the outside auditors in whichever programs they deem necessary to expeditiously help in completing their examination.

---

▶ 14

## Sample Audit Schedule *-continued*

---

### ▶ **February**

- ▶ *Investments* The purpose of this examination is to verify that adequate controls exist and that there is compliance with GAAP. A confirmation of all investments will be made during this examination. This examination includes the program previously approved regarding investment settlement procedures.
- ▶ *Home Mortgage Disclosure Act* The purpose of this examination is to validate that ABC FCU is complying with the act by making copies available to the general public and to test the document for accuracy in its completed form prior to its being mailed to the FFIEC.

---

▶ 15

## Sample Audit Schedule *-continued*

---

### ▶ **March**

- ▶ *Loan Department (Real Estate)* The purpose of this examination is to verify that loans are approved by the credit committee, correct documents are secured before funding, all compliance issues are met, and disbursements are not made without evidence that the first or best lien position is verified. It includes those programs previously approved for loan review, loan file maintenance, real estate compliance, and denied applications and funded loans, which will be audited on a monthly basis. Loans granted to credit union officers, committee persons, or employees will be reviewed when funded.
- ▶ *NCUA Examination* The purpose of this examination is to assist and review the results of the audit, to ascertain what responses are necessary, and to submit the NCUA's final result to the supervisory committee and the board of directors.

---

▶ 16



## Sample Audit Schedule *-continued*

---

### ▶ **April**

- ▶ *Loan Department (Consumer)* The audit will confirm that loans are properly approved, recorded, and supported by notes or other necessary documents; that ABC FCU is listed as the lien holder on any collateral that is required; and that existing compliance regulations are being followed.

---

▶ 17

## Sample Audit Schedule *-continued*

---

### ▶ **May**

- ▶ *Special Services* The purpose of this examination is to validate that servicing procedures protect ABC FCU's interest and integrity on all loans secured by liens or collateral and that collection procedures are timely and thorough. This audit will test the allowance for loan losses report for accuracy and will include previously approved programs for delinquent loans, charge-offs, and OREO (other real estate owned).
- ▶ *Accounting Department* This examination will confirm and identify accounting controls (physical and information system) in order to authenticate that all transactions are real, properly valued, recorded in a timely manner, correctly classified, summarized, and posted. Includes previously approved monthly programs.

---

▶ 18

## Sample Audit Schedule *-continued*

---

### ▶ **June**

- ▶ *Branches:* The purpose of these examinations is to perform verification of cash in office, consignables, and other asset and liability accounts as deemed necessary. Additionally, internal controls will be reviewed and evaluated. This program includes those programs previously approved, such as change fund and traveler's checks. Currency transactions, as well as other back-office items, will be reviewed.
- ▶ *Branch Analysis:* This examination compiles the audit reports concerning retail branches into a detailed summary of their operations. A review of the shared exceptions will be detailed in this report along with any comments or recommendations.

---

▶ 19

## Sample Audit Schedule *-continued*

---

### ▶ **July**

- ▶ *Marketing:* The purpose of this examination is to appraise the entire cost of each project in relation to budget restraints, review invoices for each product, and ascertain that the department receives approval prior to expenditures.

### ▶ **August**

- ▶ *Human Resources:* The examination is to determine the department's operational efficiency and to verify compliance with state and federal employment regulations. Additionally, this examination will test the validity of ABC FCU's benefit program and examine records in order to verify the gross and net pay to employees.
- ▶ *Administrative Services:* The purpose of this examination is to review the various aspects of this department's responsibilities, including mail, facilities, inventory control, and record retention.

---

▶ 20

## Sample Audit Schedule *-continued*

---

### ▶ **September**

- ▶ *Compliance (Regulatory)*: The purpose of this examination is to evaluate ABC FCU's systems for monitoring and ensuring regulatory compliance. The evaluation includes the commitment of the board of directors, supervisory committee, and senior management to compliance. Also included are the scope, structure, and effectiveness of the program.
- ▶ *Internal Controls*: The purpose of this examination is to ascertain that the assets of ABC FCU are properly safeguarded, policies are followed, and accounting and operational data are accurate.

---

▶ 21

## Sample Audit Schedule *-continued*

---

### ▶ **October**

- ▶ *Support Services*: This examination will be rated in two parts — member services and electronics. The examination will include verification of previously approved programs regarding VISA, ATM card issuance, ATM PIN security, and compliance with laws, including check processing (systems and controls), closed accounts of members, deceased member accounts, and IRAs and the required withholding taxes.
- ▶ *Outside Auditors*: The internal audit department will assist the outside auditors in whichever programs they deem necessary to complete their examination.

---

▶ 22

## Sample Audit Schedule *-continued*

---

### ▶ **November**

- ▶ *Information Technology:* The purpose of this examination is to determine whether transactions are recorded and processed using acceptable accounting methods. The examination will furnish management with an analysis and recommendations concerning data processing activity. This analysis will include a review of the monthly reports prepared for the use of ABC FCU personnel.
- ▶ *Establish Audit Schedule:* The purpose of this examination is to review prior audit reports and examinations in order to facilitate the preparations of an internal audit program. The audit schedule of examinations will use this information in its priorities for scheduling audits.

---

▶ 23

## Sample Audit Schedule *-continued*

---

### ▶ **December**

- ▶ *Year-End Review:* The purpose of this examination is to review the past year's performance and to assure senior management and the board of directors that all departments had received a yearly audit. In addition, the examination will ensure that those departments with less than a Level 5 grade have been reviewed at a later date (to confirm that corrective measures have been started). The year-end review will also allow the completion of any special audits and assure that all questionable activity reports are up-to-date and will be completed within a reasonable length of time.

---

▶ 24