

Bank:

Date of Exam:

Charter #:

Prepared By:

#3–AUDIT

ASSIGNMENT OVERVIEW:

The development and use of an effective audit program is an essential component of every bank’s internal control system. It assists the bank’s board of directors in ensuring adequate administrative and accounting controls are in place for the size and complexity of the bank. Ideally, a bank should have a continuous program of internal audit (to promote a controlled environment and accurate operations), coupled with a well-planned external auditing program (to test and evaluate the high-risk areas of the bank). These functions are performed by an independent auditor who may or may not be a public accountant. The objective of these procedures is to: (1) evaluate the competence and independence of those who provide the audit function, and (2) determine the reliance that can be placed on the audit procedures. For more information, refer to the section of the FDIC Examination Manual addressing “Internal Routines and Controls”.

INSTRUCTIONS:

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations.

All examiners performing these procedures must be listed above in the “Prepared By” section. All the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be indicated on the SCOPE FORM.

EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION’S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.

CORE ANALYSIS PHASE

#3 Audit

1. Prior Criticisms

1a. Determine whether deficiencies regarding the audit program were noted in the last examination and most recent internal/external audit. If so, determine if deficiencies have been addressed and/or corrected by management.

Detail how deficiencies were corrected.

Include a copy of audit exceptions and/or prior examination criticisms and management response in work papers or indicate the page number in the prior report of examination where the deficiencies are noted, or summarize exceptions/criticisms below, if applicable.

Comment:

2. General Procedures

2a. Review the Audit policy. Comment on any deficiencies or exceptions noted with the policy. Indicate the date the policy was approved by the Board. Refer to [Appendix](#) for policy guidelines.

Comment:

2b. Evaluate the Audit Committee. Consider the composition (percent of outside directors), frequency of meetings, adherence to audit plan, adequacy of reports received, approval of internal and external reports, timely response to audit findings, and follow-up procedures. Determine if Audit Committee reports are adequate based on the size and complexity of the institution. Comment on any weaknesses. *Include list of members in 3-C of work papers.*

Comment:

2c. Review the audit tracking matrix, if available, as well as prior audit and examination criticisms to determine if audit follow-up procedures are sufficient. For waived procedures, determine whether material weaknesses noted in internal/external audits or prior examinations have been addressed and/or corrected by management. *Include the audit tracking matrix, if available, in the workpapers.*

Comment:

3. Internal Audit (Internal or Outsourced)

3a. Address the effectiveness of the internal audit program and compliance with *Interagency Guidelines establishing Standards for Safety and Soundness* ([12 CFR 364](#) for state nonmembers; [12 CFR 208 Regulation H, Appendix D-1](#) for member banks).

Consider the following policy statements when evaluating the internal audit program:

- [Interagency Policy Statement on the Internal Audit Function and Its Outsourcing](#) (if applicable);

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and

- [Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing](#) (SR 13-01).

Refer to [Appendix](#) for additional guidance.

Comment:

3b. Evaluate the vacation/rotation of duties policy and/or bank's procedures to ensure that employees in key sensitive positions are absent from their duties for a minimum of two consecutive weeks annually. This would also include denying access to individuals who have electronic access to systems and records from remote locations. Determine if the bank's vacation/rotation of duties policy matches the Bond requirements for employees to be absent from duty.

Prepare a comment for the report of examination and give to the EIC if the two-consecutive week absence from duties is not met, or there are significant deficiencies in the bank's procedures to ensure an employees' absence from duties, or if the bank's policy conflicts with the Bond requirements.

For guidance, refer to the FRB's [SR 96-37](#) Supervisory Guidance on Required Absences from Sensitive Positions and [Section 4.2 FDIC Examination Manual - Internal Routines and Controls](#).

Comment:

4. External Audit

Section 36 of the FDI Act, as implemented by [Part 363 of the FDIC Rules and Regulations](#), establishes annual independent audit and reporting requirements for insured depository institutions with total assets of \$500 million or more. The 1999 [Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations](#) (1999 Policy Statement) encourages banks and savings associations that have less than \$500 million in total assets and that are not subject to other audit requirements to adopt an external auditing program as a part of their overall risk management process.

4a. External Audit Information

External Audit Firm (Name, City)	
Audit Manager	
Date of Last Audit	
Type of Audit*: 1 = Full Audit 2 = Director's Examination 3 = Other, please specify	

**Note: If Director's Examination, onsite review is not required. Answer questions 4d and 4h below.*

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Comment:

4b. If the external audit firm is different from last exam, has the bank filed a notice of termination of services with the FDIC (or Fed for state member banks), and Texas Department of Banking within 15 days of event? (Applicable to banks with total assets greater than \$500 million.)

Comment:

4c. Confer with EIC and Regional Director and determine whether an onsite work-paper review will be conducted or if an alternative method will be utilized. Provide reason(s) for decision in the Comment section. Refer to [Appendix](#) for guidelines.

If Applicable:

Date of Onsite Visit to Audit Firm:	
Examiners Attending:	

Comment:

4d. Review the Engagement Letter and compare to the audit scope of work performed. Note any discrepancies once review of work papers is completed.

Include copy of the engagement letter in 3-B of work papers. The letter should include a provision for the audit firm to share work papers and other information with regulators.

Comment:

4e. Review the Planning File and the work paper file to determine comprehensiveness of the audit and to assist in planning the examination. Refer to [Appendix](#) for more information on the documents to be reviewed.

Comment:

4f. Review Financial Statement Materiality Worksheet/Calculation to determine if amount is reasonable given the size and complexity of the institution. Determine if the Board or audit committee is informed of the materiality amount. *Include copy of worksheet in 3-D of work papers.*

Comment:

4g. Obtain and review summary of confirmation statistics. Determine reasonableness of confirmations and comment on exceptions and follow-up procedures utilized.

Comment:

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4h. Review management letter and audit reports to determine if specific areas need to be addressed during the exam. Note whether findings are considered significant / reportable, less significant/ non-reportable, material internal control weaknesses or verbal.

Comment:

5. Final Analysis

5. Complete the [Summary of Findings](#) documenting the scope of the exam based on this external review.

SUMMARY OF FINDINGS

#3-AUDIT

Describe all strengths evident from the evaluation.

Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/ noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.

Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.

SUMMARY RISK RATING ASSIGNED: Choose an item.

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM.

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INTERNAL AND EXTERNAL AUDIT

Audit Policy

An Audit Policy should address the following:

- Board approved
- Management's reporting responsibilities to the Board or Audit Committee.
- Mechanism for justification of exceptions and Board pre-approval.
- Scope and frequency of audits
- Objective performance criteria to evaluate the internal and external audit function

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Internal Audit Program

The internal audit program should:

- Be in written form.
- Be approved by the Board of Directors or Audit Committee.
- Identify the scope of the program, which is based on the recent control risk assessment of the bank's significant business activities.

The program should include audits of the following at least annually but no later than 18 months:

- Cash Accounts
- Due From Banks
- Investments
- Loans
- Allowance for Loan and Lease Losses
- Bank Premises and Equipment
- Other Assets
- Deposits
- Borrowed Funds
- Other Liabilities
- Capital Accounts and Dividends
- Consigned Items and Other Non-Ledger Control Accounts

- Income and Expense
- Wire Transfer and Electronic Funds Transfer Activities
- Electronic Banking Activities
- In-house IT processing
- Branches

There should be adequate work papers maintained that document work performance and support audit reports.

Personnel performing internal audit should:

- a. Have adequate expertise
- b. Be independent and objective
- c. Report directly to the board or committee
- d. Have complete control over reports submitted

Outsourcing Internal Audits

Outsourcing arrangements involve contracts between an institution and a vendor that provides internal audit services. The arrangements may involve vendors providing limited or extensive audit assistance. Regardless of the level of outsourced services, an institution's directors are responsible for establishing and maintaining effective internal controls and internal audit programs. Their responsibility *cannot* be delegated to others within the institution or to outside parties.

Management should exercise appropriate due diligence in selecting vendors and periodically review outsourcing arrangements and vendor performance thereafter.

If outsourced, the agreement should include the items detailed in the [Interagency Policy Statement on the Internal Audit Function and Its Outsourcing](#). This policy sets forth key characteristics of the internal audit function in Part I. Sound practices concerning the use of outsourcing vendors are discussed in Part II. Part III discusses the effect outsourcing arrangements have on the independence of an external auditor who also provides internal audit services to an institution. Part III also discusses the prohibition on internal audit outsourcing to a public company's external auditor under the Sarbanes-Oxley Act of 2002, the effect of this prohibition on insured depository institutions subject to the annual audit and reporting requirements of Section 36 of the FDI Act (12 U.S.C. 1831m), and the agencies' views on compliance with this provision of the Sarbanes-Oxley Act by institutions not subject to Section 36 (including smaller depository institutions) that are not publicly-held. Finally, Part IV of this statement provides guidance to examiners concerning their reviews of internal audit functions and related matters.

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External Audit – Work Paper Review Guidelines

Onsite Review

An onsite work-paper review should be conducted when any one of the following conditions exist:

- Institution has had a history of accounting errors;
- Institution is a composite “3” or worse, or Management is a “3”;
- This is a de novo bank and onsite reviews should be performed for the first 3 years;
- This is a conversion bank and an onsite review should be performed for at least the first state examination;
- There has been a change in auditors;
- This audit firm’s work-papers have never been reviewed by examination staff.

Off-site Review

If an alternate off-site work paper review will be utilized (correspondence between examiners and audit firm will still take place to document work-papers), all of the following conditions must exist:

- Institution is a composite “1” or “2” and has no history of accounting issues;
- The Department is in receipt of the audit with no outstanding “management letter” or “passed adjustments” when our materiality is being applied;
- There has been no change in auditors; and,
- We have a previous history with the audit firm and have a good understanding of what they do and the type of documentation they retain.

Note: If an alternative method is utilized, communication/correspondence between examiners and audit firms will still occur, however, the methods for receipt of pertinent information to document work-papers may be via mail, email, or fax. **Examiners should ensure that sensitive and confidential information sent by other methods is appropriately protected.**

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External Audit Documents

The audit firms may not have documentation titled exactly as those listed below but should have something comparable. Definitions are provided to give guidance in order to obtain the appropriate documentation from the audit firms. Additionally, some audit firms will not provide copies of documents at the onsite visit. Approval from the senior auditor may be required prior to copies being released. If a problem arises in obtaining copies of specific information, contact your RD.

The following documents should be reviewed:

1. **General Planning Questionnaire-** This document provides an overall summary of relevant information on the financial institution. (i.e. general bank information, previous examinations, changes in the industry effecting the institution, and identification of areas needing attention)
2. **Audit Planning Form/Audit Strategy Memorandum/ Audit Issue Control Document-** This form

is designed to assist the auditor in gathering information necessary to obtain an understanding of the client, its business and industry, and its internal controls. Also, provides guidance in evaluating the risk of material misstatement of the financial statements.

3. **Fraud Risk Assessment-** This procedure is designed to identify risks of material misstatement of the financial statements due to fraud (known as “identified fraud risks”), develop appropriate responses to those risks, and compliance with documentation requirements of SAS No. 99.
4. **Internal Control Questionnaire-**This questionnaire assists the auditor in obtaining a further understanding of control activities for the audit areas that have been determined to be reviewed based on the audit planning form. This questionnaire will include a matrix detailing the significant areas of risk for the bank.
5. **Inherent and Combined Risk Assessment-** Inherent risk is the risk that a material misstatement will occur in an account (or financial statement assertion) if the client has no internal controls related to that account (or assertion). Control risk is the risk that a material misstatement will not be prevented or detected on a timely basis by the client’s internal control. *Note: The risk will be categorized as Low, Moderate or High.*
6. **Test of Controls Form-** This form is completed for each area to be tested and describes each internal control to be tested, describes each test to be performed, and cross-references to the related work papers. Results are noted on the Test of Controls Sampling Planning and Evaluation Form.
7. **Audit Difference Evaluation (Also known as: Passed Adjustments, Summary of Unadjusted Differences, Summary of Audit Differences)-**This form is used to accumulate known audit differences detected by non-sampling substantive tests (including differences in accounting estimates) and projected audit differences from substantive tests that used sampling. The current year effect of prior years’ uncorrected audit differences should also be summarized. Did the auditor reasonably evaluate all uncorrected audit differences, individually and in the aggregate, in relation to individual amounts, subtotals, or totals in the financial statements and conclude on whether they materially misstate the financial statements? *Include copy of summary showing all adjustments.*
8. **Attorney Letter-**Describes any potential litigation, claims, and assessments against the financial institution. Were these satisfactorily considered in the Audit Opinion?
9. **Management Letter-**This letter is from the audit firm to the bank’s audit committee regarding the results of the audit. Did the bank receive a Management Letter that adequately summarized the results of the audit?
10. **Information Technology Questionnaire-**This questionnaire addresses internal control issues regarding IT. *Note: This should be updated annually.*
11. **Financial Statement Materiality Worksheet/Calculation-** This form determines and documents the materiality amount that will be considered suitable for audit planning purposes.
12. **Summary of Confirmation Statistics-**Details the amount of positive and negative confirmations.

Files should contain, at a minimum, the following:

1. Listing of Bank committees and members.
2. Minutes from committee meetings.
3. Previous examination reports.
4. Call Reports

5. Internal Audit Function work papers
6. Current bank policies
7. General Ledger
8. Income Statement
9. Internal spreadsheet of all accounts for balancing
10. Analytical Review of the balance sheet and income statements (i.e. yield curves)

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