

INTERNAL AND EXTERNAL AUDIT EVALUATION

Core Analysis Decision Factors

Examiners should evaluate the Core Analysis in this section to determine whether an Expanded Analysis is necessary. This module should incorporate and summarize audit findings from all of the completed ED Modules for a given examination. Click on the hyperlinks found within each of the Core Analysis Decision Factors to reference the applicable Core Analysis Procedures.

Do Core Analysis and Decision Factors indicate that risks are appropriately identified, measured, monitored, and controlled?

Note: If, after completing this module, examiners answer this question no, continue to the Management and Internal Control Evaluation (MICE) Expanded Analysis module.

- C.1. Has the board of directors established an audit committee that monitors and provides effective oversight of audit activities? Refer to Core Analysis [Procedures #1-8](#) & [Procedure #12](#).**
- C.2. Has management established audit policies and procedures that are adequate for the size, complexity, activities, and risk profile? Refer to Core Analysis [Procedure #11](#).**
- C.3. Is the internal audit function independent from all functional areas? Refer to Core Analysis [Procedure #10](#).**
- C.4. Is the internal audit program sufficient for the risk profile? Refer to Core Analysis [Procedures #11-13](#).**
- C.5. Are internal audit record keeping and reporting processes sufficient? Refer to Core Analysis [Procedures #14-15](#).**
- C.6. Is the internal audit function adequately staffed with auditors who possess an appropriate level of experience and expertise? Refer to Core Analysis [Procedure #12](#).**
- C.7. Do the internal auditors adequately identify, document, and report key risks in the organization? Refer to Core Analysis [Procedures #15-16](#).**
- C.8. If the internal audit function is outsourced, do the board and senior management provide sufficient oversight of the relationship? Refer to Core Analysis [Procedure #9](#).**
- C.9. Is the organization's external audit program effective and in compliance with applicable laws and regulations? Refer to Core Analysis [Procedure #17](#).**

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Core Analysis Procedures

Examiners are to consider the following procedures but are not expected to perform every procedure at every institution. Examiners should complete only the procedures relevant for the institution’s activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

Resources: *FDIC: 12 CFR Parts 363 and 364, and the Interagency Policy Statement on Internal Audit Function and its Outsourcing FIL 21-2003; FRB: 12 CFR Part 208 - Appendix D, SR 03-5 Amended Interagency Guidance on the Internal Audit Function and its Outsourcing, SR 13-1 Supplemental Policy Statement on the Internal Audit Function and its Outsourcing, and AD 13-2 Examiner Guidance Relating to the Internal Audit Function at Supervised Institutions.*

Preliminary Review

1. Identify previous concerns by reviewing prior examination reports, file correspondence, audits and audit or board committee minutes.

2. Determine the general structure and primary responsibilities of the board of directors, board committees, and executive management relating to audit activities.

3. Determine whether any material changes occurred or are expected that may affect this area. Discuss the changes and implications with management.

Audit and Other Independent Reviews

4. Determine whether an audit committee has been established, and evaluate the composition of the committee. Consider the following:

- Number of members,
- Number of outside directors,
- Independence from management, and
- Presence of financial experts, if required.

5. Determine whether the audit committee operates under an appropriate charter. Satisfactory charters generally address topics such as:

- Requirements for audit committee membership;
- Frequency of committee meetings;

- **Responsibility for engaging independent accountants and appointing the internal auditor;**
- **Responsibility for reviewing internal audits, the annual external audit, and the quarterly and annual financial statements;**
- **Requirements and responsibilities for supervision of the internal audit program;**
- **Guidelines for establishing open communication among the audit committee, the internal auditor, the independent accountant and the board of directors; and**
- **Authorization for the audit committee to obtain outside legal counsel and conduct investigations.**

6. Determine whether the board or audit committee reviews the effectiveness of the institution’s internal audit systems. Appropriate reviews¹ generally consider items such as:

- **The internal audit charter, budget and staffing levels, and overall risk-assessment methodology;**
- **The audit organizational structure, including the selection, termination, and compensation of external auditors and outsourced internal auditors, and placement of the internal audit function and the internal audit manager within the institution’s organizational and management structure, as applicable;**
- **Annual audit plans and updates;**
- **The internal auditor’s progress in completing the audit schedule;**
- **Internal audit reports and management’s response;**
- **Status reports on management’s actions to correct control weaknesses and violations of laws and regulations identified in internal and external audit reports as well as examination reports;**
- **The integrity of internal and external financial-reporting processes (reviews may involve discussions with independent accountants and internal auditors);**
- **The organization’s annual financial statements and reports or other financial information submitted to any governmental body, or made public (including certifications, reports, opinions, or reviews rendered by the independent accountants); and**
- **Significant disagreements between management and the independent accountants or the internal auditing department in the preparation of the financial statements.**

7. Determine whether audit committee responsibilities are commensurate with the size, complexity, activities, and risk profile. Responsibilities generally include:

- **Establishing an internal audit function that operates adequately, independently, and has sufficient resources to effectively oversee the audit function;**
- **Evaluating all significant vendor arrangements, including the independence of internal and external auditors, and the effectiveness of the internal audit program;**
- **Retaining auditors who are qualified to audit the organization’s activities. (Note: The committee typically hires the senior auditor, sets his or her compensation, and evaluates his or her performance.);**
- **Establishing schedules and agendas for regular meetings with internal and external auditors;**
- **Interacting with the auditor, separate from formally scheduled meetings, to remain current on**

¹ Generally, institutions perform reviews at least annually, with reviews correlated to the risks in activities reviewed.

internal audit department, organizational, or industry concerns;

- Considering the independent accountants' judgments about the quality and appropriateness of the organization's accounting policies as applied in its financial reporting; and
- Considering and approving, if appropriate, all major changes to the institution's auditing and accounting principles and practices as suggested by the independent accountants, management, or the internal auditing department; and
- Fostering forthright communication and maintaining processes in which employees or other stakeholders can submit confidential and anonymous concerns to the committee about questionable accounting, internal accounting controls, and other auditing matters.

8. Determine whether committee minutes note significant actions, such as:

- Reviewing and approving the code of ethics and audit charter;
- Recommending selection and approval of the certified public accountant (CPA) firm to serve as external auditor;
- Discussing and validating the CPA firm's independence;
- Approving the internal auditor's salary and the audit department's budget;
- Reviewing the annual internal audit plan and conformity with the plan;
- Discussing internal audit staffing levels and training needs;
- Discussing with the CPA firm the quality of the application of accounting principles;
- Reviewing and approving the annual and quarterly financial statements prior to issuance; and
- Reviewing and approving, if applicable, attestation letters for internal control reports and compliance with Section 36 of the FDI Act, 12 U.S.C. 1831m, and 12 CFR Part 363.

9. If portions of the internal audit function are conducted by outside vendors, consider whether:

- An internal audit conducted by the same vendor that conducts the financial statement audit meets independence considerations;
- Due diligence is adequate, performed prior to entering the outsourcing arrangement, and considers vendor competence, independence, and objectivity;
- The outsourcing contract and engagement letter between the organization and the vendor appropriately detail each party's responsibilities;
- The scope of outsourced audit work² is adequate, documented, and revised when the institution's environment, activities, risk exposures, or systems change significantly;
- Findings are appropriately and effectively communicated; and
- Contingency planning is adequate to mitigate audit coverage discontinuity if the outsourcing arrangement is terminated.

² For institutions with formal internal audit departments, refer to the Interagency Policy Statement on the Internal Audit Function and Its Outsourcing for additional information.

10. Determine whether the internal audit function is sufficiently segregated from operations. Appropriate segregation is generally evidenced by the following items:

- The audit department does not report to an operational function in the organizational structure.
- The audit staff is prohibited from performing operational duties such as preparing general ledger tickets and daily reconcilements, or performing a procedure under dual control.
- Reporting procedures are independent of the influence of operating personnel.
- The auditor reports directly to the board of directors or the audit committee and meets with them to review reports.

Policies

11. Determine whether internal audit policies and procedures are adequate for the institution’s size, complexity, activities, and risk profile. Items to consider include, but are not limited to:

- Risk analysis and assessments,
- Internal control questionnaires or narratives,
- Audit frequency commensurate with risk,
- Audit schedule,
- Audit work programs,
- Account confirmations,
- Workpapers,
- Reporting standards,
- Corrective-action tracking standards, and
- A comprehensive quality assurance program that:
 - Includes both internal and external quality assessments,
 - Ensures internal audit activities consider The Institute of Internal Auditors (IIA) professional standards, and
 - Ensures audit practices conform with internal audit policies and procedures.

12. Determine whether the size and qualifications of the audit staff are appropriate based on the institution’s activities, assets, and complexity. Consider the audit staff’s academic backgrounds, experience, competency, and ongoing training initiatives.

13. Consider whether the internal audit schedule is based on a risk assessment. General considerations include the following items:

- All institution functions and services are reflected.
- The audit schedule is reviewed and approved by the audit committee at least annually.
- The auditor periodically reports progress in completing the schedule to the audit committee.
- The audit committee approves changes to the schedule.
- Audit plans and frequencies are reasonable and completed as scheduled.
- Audit schedules use varied starting dates and time intervals between audits to avoid anticipation by

<p>those subject to audit.</p>
<p>14. Assess the adequacy of audit workprograms and the maintenance of corresponding audit workpapers. Items to consider include:</p> <ul style="list-style-type: none"> • A reasonable record retention schedule is maintained for audit records. • Audit workprograms are sufficiently detailed to allow for effective audits. • Workprograms are updated to keep pace with changes (such as new products, accounting guidelines, and regulations). • Workpapers document approval of all deviations from established audit procedures. • Workpapers contain evidence that audit managers reviewed the workpapers for conclusions and recommendations. • All significant and unresolved exceptions are noted in workpapers and included in audit reports. • Workpapers are well organized and support conclusions and recommendations. • Workpapers are cross-referenced to procedures and institution reports.
<p>15. Determine whether the internal audit department’s reporting procedures are adequate. Consider if:</p> <ul style="list-style-type: none"> • The auditor submits formal reports directly to the board of directors or audit committee. • Audit reports include an overall opinion and an assessment of the effectiveness of internal controls and compliance with established procedures. • The board or audit committee supports the audit staff in resolving audit matters. • Audit reports record departmental managers’ commitment to resolve reported matters. • Audit reports include a summary of the effectiveness of all controls reviewed. • The auditor maintains a formal record of all unresolved audit or regulatory exceptions and recommendations. • Changes to the audit schedule are approved.
<p>16. Assess the adequacy of work performed by the internal auditors. Items to consider include:</p> <ul style="list-style-type: none"> • Examination findings, • Time elapsed since the previous audit, • Scope and relevance of internal auditors’ work, and • Testing performed by internal auditors.
<p>17. Review the institution’s external audit program. Refer to the <i>Review of External Auditor Workpapers</i> ED Module as needed.</p> <ul style="list-style-type: none"> • If the institution is covered by Part 363 of the FDIC Rules and Regulations, or Part 208, Appendix D-1 of FRB Regulation H and has \$1 billion or more in total assets, determine whether management, at least annually, assesses the effectiveness of its internal control structure and

procedures for financial reporting and compliance with designated laws. Review the documentation maintained to determine whether management adequately assesses the institution's internal control structure and compliance with laws.

- **Determine whether publicly-owned institutions or those covered by Part 363 that have \$1 billion or more in total assets have an external auditor attest to management's assessment of its internal control structure and procedures for financial reporting.**
- **If the institution chose not to obtain an external audit, review the board of director's documentation of its reasons, including whether the auditing program provides sufficient coverage of areas of potential concern or unique risk. Review the minutes describing the board's consideration of this audit issue at each examination.**
- **Determine whether the audit program conforms with FR Appendix D of Regulation H or FDIC Part 363.**
- **Determine whether the external audit engagement letter contains any limitation of liability provisions. Refer to the Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, February 9, 2006. (FDIC: FIL 13-2006, FRB: SR 06-4.)**
- **Determine whether issues presented in the CPA management letter have been addressed.**
- **Review any additional CPA reports and follow up on issues presented.**

End of Core Analysis. If needed, Continue to the MICE Expanded and Impact Analyses.