

# Managing the Internal Audit Function

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# Managing the Internal Audit Function

[Mark P. Colombo, CPA](#)

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Mark is a Principal with Firley Moran, Freer & Eassa, CPA, P.C. and is a Certified Public Accountant with over 20 years of public accounting experience providing auditing, accounting, general business consulting, forensic and tax services to the firm's clients. Mark's client service experience primarily includes credit unions and credit union service organizations. Mark has an extensive background in providing auditing, accounting, tax and regulatory compliance services, and internal control evaluations to credit unions. Mark manages various projects for the firm's credit union clients ranging in asset size from \$10 million to over a billion dollars. Mark also heads the firm's internal audit co-sourcing and regulatory compliance engagements. He has designed internal audit programs, assisted in creating internal audit departments and oversees the internal audit and compliance work.

Mark holds a position as Treasurer on the Board of Directors of the Central New York March of Dimes. Mark received his Bachelor of Science degree from LeMoyne College and is currently a member of the ACUIA, AICPA and the NYSSCPAs.

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Jim is a Senior Manager with Firley, Moran, Freer & Eassa, CPA, P.C. and is a Certified Public Accountant with over 20 years of public accounting experience providing auditing, accounting, consulting, tax and forensic services to clients. Four of his 20 years of public accounting experience were with PricewaterhouseCoopers where he had a concentration in financial institutions and insurance. He currently serves clients in the credit union, group self-insurance and construction industries, including a specialization in auditing employee benefit plans. Jim has been involved with the credit union movement since college when he worked as a teller at a local credit union. He currently performs services for eight of our credit union clients ranging in size from \$90 million to over \$1 billion in assets.

Jim is a member of the ACUIA, AICPA and the NYSSCPAs, holds a Bachelor of Science degree, with distinction, from Clarkson University and serves his community as a member and past fire chief of a local volunteer fire company and is the treasurer of Gigi's Playhouse of Syracuse Down Syndrome Awareness Center.



# Managing the Internal Audit Function

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## Education

**BS- Accounting, Providence College  
Certified Bank Auditor (CBA)  
Certified Risk Professional (CRP)  
Certified Loan Review Officer (CRP)**

## Experience

**Started audit function at Sunmark FCU in 2002. Prior to that, 17 years' experience auditing in banks.  
Frequent speaker at ACUIA events, along with serving 6 years on the ACUIA Board of Directors, last 3 years as Chair.**

# Mission of the Internal Audit Function



- Evaluate the internal control structure
- Opportunities are identified and recommendations are made to improve operational and non-operational processes and controls
- Protect assets of the credit union



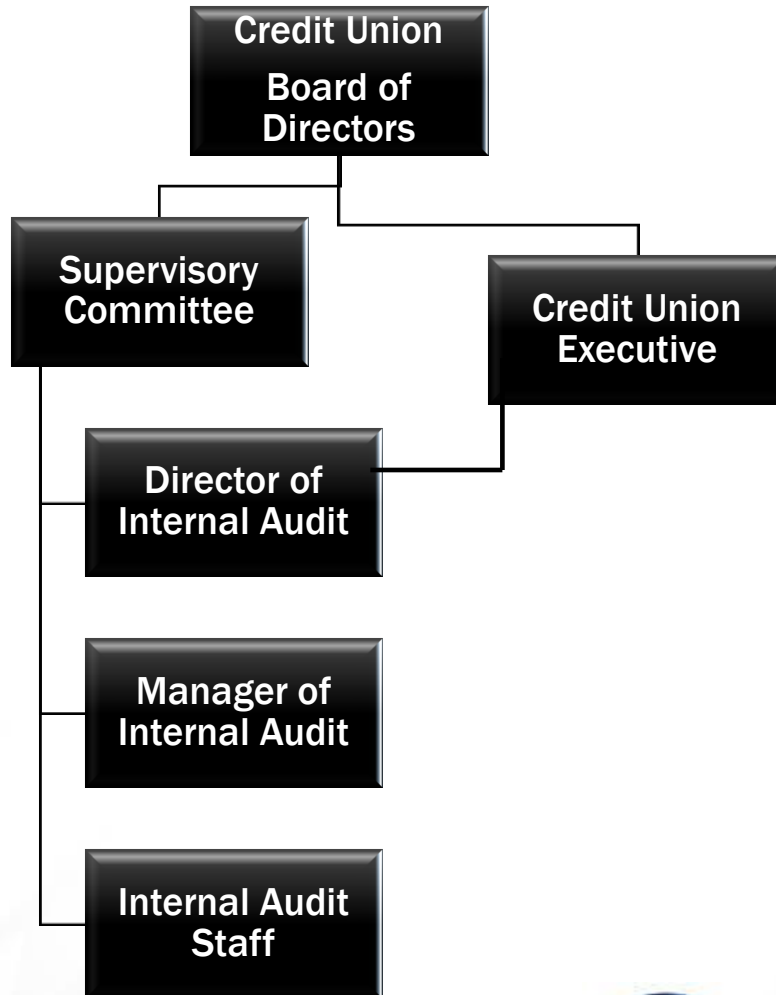


# Mission Statement / Audit Charter

- Document developed to outline the purpose, objectives, organization, authorities, and responsibilities of the internal audit department, internal audit management, internal audit staff, Supervisory Committee
- Grants the internal audit department the initiative and authorization to access ALL data, records and employees needed to effectively and efficiently evaluate Credit Union activities
- Excellent example in ACUIA Internal Audit Shop Tools
- Should be an evolving document as the Credit Union changes
- Should be approved by the Supervisory Committee and the Board of Directors



# Organizational Structure



# Responsibilities of the Supervisory Committee

- Approve the organizational structure of the internal audit department
- Approve Annual Internal Audit Plan
- Establish schedules and agendas for regular meetings with internal and external audit (recommend monthly)
- Supervise the internal and external audit process to ensure independence is maintained and findings made are objective
- Continually review and challenge the internal audit risk assessment to ensure that audit coverage is comprehensive in nature to meet the operational and financial risks that present themselves
- Select external audit firm





# Responsibilities of the Supervisory Committee Cont.

- Participate in hiring and termination within the internal audit department as well as participation in establishing compensation, schedules and performance reviews
- Verifying that the internal or external auditors are qualified to perform each audit area assigned (establish when to outsource)
- Meet with NCUA or State Regulator to discuss exam findings and corrective actions required
- Have representation at Board of Directors meeting - can be very beneficial and can assist with risk assessment



# Responsibilities of the Internal Audit Department



- Risk assessment
- Develop annual audit plan
- Complete the audit plan and issue reports on audits performed
- Follow-up with management on previously audited areas to discuss corrective action or actions taken to consider best practices
- Monitoring and tracking of responses from management regarding audit findings
- Special investigations
- Evaluate control environment surrounding new products and services and give advice as to potential control issues



# Responsibility of Internal Audit Management

- Audit management is responsible for implementing supervisory committee and Board of Directors directives
- Monitor audit operations and establish lines of authority and communication
- Provide leadership and direction to audit staff members and the organization as a whole
- Verify and maintain independence
- Qualifications of staff
- Establish meeting with CEO or senior executives to stay informed on Credit Union initiatives - establishes open lines of communication with management
- Assist external audit team with the coordination of the annual financial statement audit and / or internal audit work performed by external auditors



# Authority

- No restrictions of access - personnel or information
- Allocation of resources - personnel and money to accomplish the audit plan is subject to approval by committee
- Coordination with Credit Union personnel - Keep disruptions of Credit Union operations to a minimum
- Coordination of outside services - IT / BSA audit
- Unrestricted access to the Supervisory Committee: Weekly calls / email blasts to the Chair or entire committee



# No Authority



- To perform operational duties
- To develop and/or write policies & procedures
- Initiate or approve accounting transactions
- Manage employees outside of the internal audit department
- Accept responsibility or authority over areas that are under examination or audit
- Engage in activities in areas that would fall under audit



# Internal Audit Program Design

- Risked based programs allow for audit efficiency and effectiveness
- Memo's, ICQ's and flowcharts
- Must identify all of the Credit Union's lines of business (including CUSO's), product lines and services, and be continually updated at each audit date as applicable
- Identify compliance issues that impact the lines of business, product lines and services
- Create profiles of each line of business, product lines and services
- Document control structure
- Identify business and control risks





# Risk Assessment and Guidelines

- Objective (Independent) and subjective approach
- A risk assessment considers the risk for error or fraud associated with a Credit Union operating unit/area
- Analyze unit/area policies and procedures, observe operational flow (walkthrough) and make inquiries of management within the unit/area
- Inquire as to
  - Business lines - new and existing
  - Number of employees and years of relevant experience
  - Significance of regulatory impact
  - Prior audit rating
  - Any outside service providers involved in the process
  - Do other auditors perform audit procedures over components of the unit/area
  - Extent and depth of policies and procedures
  - Management confidence over control structure



# Risk Assessment and Guidelines Cont.

- Provide for a risk score/rating (e.g., high, moderately-high, moderate, low) for each operating unit/area and document support for rating
- Some risks are more likely than others to occur, and some will have a greater impact than others if they occur. The probability and significance must be assessed
- Rank areas according to their overall risk score. Ranking audit priorities can be established and the audit plan developed
- Remember that the risk assessment process is an ongoing one. Internal and external threats constantly develop, presenting new hazards to the Credit Union



# Internal Audit Plan

- The audit plan should include the results of the audit departments budgeting process, planning process, and should define audit goals, schedules, staffing and reporting timeframes
- Develop a plan that addresses those areas deemed to have the most risk more frequently (Annually) and those with less risk less frequently
- All identifiable units/areas in the Credit Union should be examined by internal audit at least once every 2 to 3 years depending on levels of risk
- Allocate resources based on risk ratings and time available of staff. (Consider-Part-time/Full time, vacations, sick time, special projects, assistance with external audits, CPE, etc.)
- Don't cut yourself short - Be conservative in your time estimates - Don't set yourself up to fail



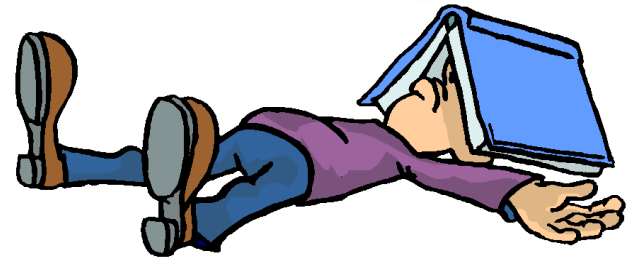
# Internal Audit Plan Cont.

- Approval of Supervisory Committee at a minimum on an annual basis (include approval in minutes.) Give status updates to the Supervisory Committee. Comparisons should be completed to show completed jobs - actual to budget and variances should be explained. Also jobs in process should be compared and insight given as to status
- Keep audit plan as simple as possible
- **ALWAYS** communicate if you are ahead of or behind schedule: Communication is key as it will establish or reestablish expectations of the Supervisory Committee and if alternate courses of action need to be taken, it allows time to proceed.
- The audit plan is a moving target; as circumstances arise the audit plan needs to be adjusted to reflect a true picture as to what can be accomplished and what needs to be accomplished.



# Audit Types

- Financial / Financial Attributes
- Operational or Performance
- Regulatory Compliance
- Information Systems



# Audit Types – Financial / Financial Attributes

- This audit traditionally is done by an external audit firm. The audit is a review of the Credit Union's financial statements to verify that they fairly present the financial position, results of operations, and cash flows at a point in time. The independent public accountant will render an opinion in conjunction with the audit.
- Not to say that internal audit cannot do financial audits, in fact they are encouraged
- Internal audit with the Supervisory Committee should review the Allowance for Loan Loss calculation on a quarterly basis
- Internal audit can review accounts that may pose a higher level of risk such as those that have a significant volume of manual journal entries, are related party expense accounts, or are employee accounts





# Audit Types – Financial / Financial Attributes Cont.

- Internal audit should also review all deferred compensation agreements and verify that the Credit Union is in compliance with the agreement and that contractual assets and liabilities are properly reflected
- Note that internal audit will also assist the external firm during the audit
- Coordination of gathering data requested, loan file reviews, member loan and share confirmation tracking, and alternate procedures
- Note that internal audit cannot take the place of an external auditor
  - External audit will need to re-perform a sample of the internal auditors work to draw a consistent conclusion



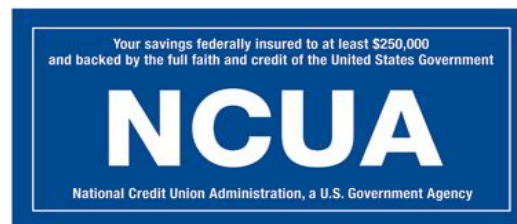
# Audit Types – Operational or Performance

- Include procedures to test the integrity of accounts, regulatory reports, informational system reports and other aspects of operations of a particular branch or line of business within the Credit Union.
- The audit verifies that the Board of Director approved policies and departmental procedures are being consistently adhered to and that informational reports used by management to make business decisions are accurate.



# Audit Types – Regulatory Compliance Audits

- Include procedures to determine if the Credit Union is complying with all federal and state regulations to which it applies.
- Very time consuming - Sections are often completed within the operational audit - (i.e. Reg. Z could be examined in the Loan area)
- This is often a means to validate how effective the Credit Union's compliance program is operating



# Audit Types – Information Systems

- Many times outsourced to external party due to complexity
- Assess the controls, integrity, accuracy, and security of a Credit Union's core data processing system and any other ancillary systems that may capture Credit Union transactions.
- Audits should cover at a minimum:
  - Policies and procedures
  - Support and delivery
  - Networks - local or wide area
  - Telecommunications
  - Security
  - Data interchange
  - Development and purchasing
  - Continuity and contingency planning (Disaster Recovery)
  - Data integrity
  - Confidentiality and safeguarding member data
  - Management



# Audit Area Work Programs

- Establishes scope and timing of audit procedures
- Documents extent of and criteria for testing
- May at times be the platform for documenting evidential matter
- Guide to obtaining information, evaluating information and summarizing information
- Issuing reports timely after fieldwork



# Audit Area Work Programs Cont.

- Audit area work programs should include at a minimum:
  - Area risk assessment review and conclusions drawn on risk
  - Coordination with area being audited - **Unless Surprise**
  - Review policies (some of which are NCUA-required) and procedures of area
  - Review of compliance or regulations that apply and abstract relevant information to assist in testing/evaluation
  - Documents requested for review - DRL (Document Request List) - Need to be specific as to information needed and **WHEN** it is needed
  - Document sampling methodology and results
  - Workpaper preparation and testing results
    - Documentary evidence - Source documents
    - Direct confirmation results
    - Inspection
  - Effort should be made not to disrupt area/department operations
- **REMEMBER:** Timeliness is important as findings and corrective actions need to be communicated so that the area/department personnel can make corrective actions quickly to eliminate potential for risk of fraud or error





# Audit Reports

- Written by internal audit staff or whoever performs the testing
- Reviewed with internal audit management
- Meet with management in the area/department to validate accuracy of findings and reasonableness of corrective action prior to release of final audit report
- Meeting will build confidence and respect for the internal audit function within the organization
- Reports should be in a summary format and to the point  
- eliminate FLUFF



# Audit Reports Cont.

- Communicates to the Supervisory Committee and the Board if area/department is complying with approved policies, procedures and regulations and if not, what is deficient?
- Communicates if the operating and financial controls are effective and mitigates to risk of error/fraud to a minimum. **YOU WILL NEVER ELIMINATE ALL RISK.**
- Communicates corrective actions or best practices
- Sets timeline for management response



# Follow-Up Evaluation

## Make sure it happens

- As time passes the findings lose their punch if corrective actions are not followed through with
- Report to the Supervisory Committee status
- Evaluate internal audit staff by area audited
- Evaluate budgeted hours to actual hours
- Will dictate the need for resources (more or less)
- Validates effective budgeting process
- Validates effective management of process
- Should explain in memo format why budget to actual is not in line
- Gives indication of internal control/compliance health of the organization



# Additional Items

- Continuing education - a necessity!
- Quality Assurance Program - allow external party to review internal audit program
- External feedback makes the process better and eliminates becoming STALE
- Outsourcing considerations are sometimes necessary and sometimes needed and wanted

