

SUMMARY TABLE OF CONTENTS

VOLUME 1

ROLE OF INTERNAL AUDITOR

Chapter 1 Changing Role of the Internal Auditor

Chapter 1.1 Implementing Control Self Assessments

REGULATORY AND ACCOUNTING REQUIREMENTS

Chapter 2 Federal Regulators and the Accounting Profession Set the Stage for Risk Based Auditing

SARBANES-OXLEY ACT

Chapter 3 Analysis and Impact of the Sarbanes-Oxley Act

Chapter 3.1 Internal Control Framework

Chapter 3.1A Methods for Evaluating and Testing Internal Controls

Chapter 3.1B Internal Control Questionnaires (ICQs)

Chapter 3.2 Audit Function Quality Assurance Review Procedures

AUDIT COMMITTEE RESPONSIBILITIES

Chapter 4 Complying with New Audit Committee Responsibilities

RISK BASED AUDIT PROCESS

Chapter 5 Overview of the Risk Based Internal Audit Process

Chapter 5.1 Understanding Enterprise Risk Management (ERM)

CONDUCTING RISK ASSESSMENTS

Chapter 6 Conducting Risk Assessment Surveys

VOLUME 2**PRODUCTS, SERVICES, AND FUNCTIONS**

Chapter 7 Risk Assessments and Audit Programs for Banking Products, Services, and Functions

Chapter 7.1 Risk Based IT Audits

Chapter 7.2 Evaluating Residential Real Estate Credit Risk

Chapter 7.3 Conducting Loan Quality Review

Chapter 7.4 Identifying and Controlling Commercial Real Estate Concentrations

Chapter 7.5 Evaluating Fair Lending Risks

Chapter 7.6 How to Identify, Measure, Monitor, and Control Interest Rate Risks

Chapter 7.7: Risk Based Audits of Liquidity

Chapter 7.8: Risk Based Audits of Payment and Settlement Systems

Chapter 7.9: Risk Based Audits of Risk Management and Insurance

Chapter 7.10: Risk Based Audits of Director Duties and Responsibilities

Chapter 7.11: Conducting a Risk Assessment of Cloud Computing

Chapter 7.12: Conducting ERM Risk Assessments

FRAUD DETECTION

Chapter 8 Risk Based Auditing for Fraud Detection

ADMINISTRATION

Chapter 9 Internal Audit Administration — Making a New Start with Risk Based Auditing

OUTSOURCING

Chapter 10 Outsourcing the Internal Audit Function

CASE STUDY

Chapter 11 Conducting a Risk Based Audit — A Case Study

TABLE OF CONTENTS

About the Author	iii
How to Use This Manual	v
Summary Table of Contents	xv

VOLUME 1

Role of Internal Auditor

CHAPTER 1

Changing Role of the Internal Auditor

Defining Traditional and Risk Based Auditing	1-1
New Approach to Internal Auditing	1-1
Internal Auditing as a Management Tool	1-3
Risk Based Auditing Focus.....	1-3
Serving as an Advisor to Management and the Board.....	1-3
Step 1: Adopt the COSO Control Definition	1-4
Step 2: Adopt Internal Audit Best Practices.....	1-5
Step 3: Become an Advisor.....	1-6
Step 4: Develop a Strategic Plan	1-6
Step 5: Deliver Advisory Services and Communicate Findings	1-6
Five Types of Internal Audits	1-7
Conducting Operational Audits.....	1-7
Components of an Operational Audit.....	1-8
Report Format	1-8
Audit Procedures	1-8
Tools Available to the Operational Auditor	1-9
Targets for Operational Audits.....	1-10
Checklist for Review and Critique of Written Reports	1-10
Understand the Audience.....	1-10
Check for Readability	1-11
Control Self-Assessment and Risk Based Auditing	1-13
Transitioning to Risk Based Auditing	1-14
Institute of Internal Auditors Identifies Major Challenges	1-15
Establishing an Effective Risk Management Structure	1-16
Exhibits on CD	1-17
Exhibit 1.1: Internal Auditor’s Role	
Exhibit 1.2: Flowchart for Evaluating the Effectiveness, Efficiency, and Economy of a Bank’s Policies and Procedures	

- Exhibit 1.3: Typical Questions in an Operational Audit Evaluating the Goals and Objectives of the Bank
- Exhibit 1.4: Sample Communications Model for Integrating Risk Management and Internal Auditing

CHAPTER 1.1

Implementing Control Self Assessments

What Is CSA?	1.1-1
CSA vs. Traditional Internal Auditing	1.1-2
Choosing Topics for CSA Sessions	1.1-7
Methods for Conducting CSA Sessions	1.1-8
Examples.....	1.1-8
A Sample Pre-Audit Self-Assessment Questionnaire	1.1-8
Exhibit 1.1-2: Sample Pre-Audit Self-Assessment Questionnaire.....	1.1-11
Customized Questionnaire Scenario and Sample	1.1-15
Implementing Control Self-Assessment Sessions	1.1-15
Procedures for Holding CSA Sessions	1.1-18
Identify Audit Area (Step A1).....	1.1-19
Purpose.....	1.1-19
Procedures	1.1-20
Approach	1.1-21
Success Checklist	1.1-21
Define Session Objectives (Step A2).....	1.1-22
Purpose.....	1.1-22
Procedures	1.1-22
Approach	1.1-23
Success Checklist	1.1-24
Select Correct Meeting Process (Step A3)	1.1-24
Purpose.....	1.1-24
Procedures	1.1-25
Approach	1.1-25
Checklists	1.1-26
Self-Assessment Meeting Checklist	1.1-26
Strategic/Creative Meetings Checklist.....	1.1-27
Pre-Session Preparation (Step A4)	1.1-27
Purpose.....	1.1-27
Procedures	1.1-28
Approach	1.1-29
Success Checklist	1.1-30
Gain Appropriate Attendance (Step A5).....	1.1-32
Purpose.....	1.1-32
Procedures	1.1-33
Approach	1.1-33

Success Checklist	1.1-34
Use Appropriate Process Skills (Step B1)	1.1-35
Purpose.....	1.1-35
Procedures	1.1-35
Approach	1.1-36
Success Checklist	1.1-37
Use Appropriate Technology (Step B2).....	1.1-37
Purpose.....	1.1-37
Procedures	1.1-38
Approach	1.1-38
Success Checklist	1.1-39
Achieve Appropriate Detail Level (Step B3)	1.1-40
Purpose.....	1.1-40
Procedures	1.1-40
Approach	1.1-41
Success Checklist	1.1-42
Lead Group Toward Consensus (Step B4)	1.1-42
Purpose.....	1.1-42
Procedures	1.1-43
Approach	1.1-43
Success Checklist	1.1-44
Recording Session Data (Step B5)	1.1-45
Purpose.....	1.1-45
Procedures	1.1-46
Approach	1.1-46
Success Checklist	1.1-47
Document Sessions for Participants (Step C1)	1.1-48
Purpose.....	1.1-48
Procedures	1.1-48
Approach	1.1-49
Success Checklist	1.1-51
Report Results to Auditees/Process Owner (Step C2).....	1.1-51
Purpose.....	1.1-51
Procedures	1.1-52
Approach	1.1-52
Success Checklist	1.1-53
Follow Up On Action Items (Step C3).....	1.1-54
Purpose.....	1.1-54
Procedures	1.1-54
Approach	1.1-55
Success Checklist	1.1-55
Long-Term Issues Implementation (Step C4)	1.1-56
Purpose.....	1.1-56
Procedures	1.1-56

Approach	1.1-56
Success Checklist	1.1-57

Regulatory and Accounting Requirements

CHAPTER 2

Federal Regulators and the Accounting Profession Set the Stage for Risk Based Auditing

Regulatory Guidance on Risk and Internal Auditing	2-1
Evolution of Internal Controls	2-3
The Committee of Sponsoring Organizations of the Treadway Commission	2-6
Establishing a System of Internal Controls.....	2-6
Limitations of Internal Control.....	2-8
FFIEC Interagency Guidance on Internal Audit and Outsourcing	2-8
Responsibilities	2-8
Outsourcing and Independence	2-9
Blue Ribbon Committee Report	2-10
Exchanges Issue New Audit Committee Requirements	2-10
OCC Examination Manual on Internal and External Audits	2-11
OCC Examination Objectives	2-11
Evaluation of the Internal Audit Function.....	2-12
Effective Internal Audit Independence and Oversight	2-12
Internal Auditor Competence and Qualifications	2-13
SEC Issues Independence Requirements for Auditors	2-13
Basel Committee on the Management and Supervision of Operational Risk	2-14
Sound Practices for the Management and Supervision of Operational Risk Summary.....	2-14
Developing an Appropriate Risk Management Environment	2-14
Risk Management: Identification, Measurement, Monitoring, and Control.....	2-14
Role of Supervisors	2-15
Role of Disclosure.....	2-15
The Sarbanes-Oxley Act of 2002	2-15
Publicly Held Banking Organizations	2-15
Non-Publicly Held Banking Organizations	2-16
Provisions of the Act	2-16
Audit Committee Structure and Responsibilities.....	2-16
Insider Lending	2-16
Outside Auditors	2-17
Financial Disclosure and Reporting Obligations	2-18
Other Provisions Affecting Public Banking Organizations.....	2-19
Foreign Banking Organizations.....	2-20
SEC Regulations and Federal Reserve Supervisory Guidance	2-20
NYSE Corporate Governance Final Rule	2-20
Removal, Suspension, and Debarment of Accountants from Performing Audit Services	2-21

Appendices on CD	2-21
Appendix 2.1: OCC 2003-12 Bulletin	
Appendix 2.2: Interagency Policy Statement on the Internal Audit Function and Internal Audit Outsourcing	
Appendix 2.3: Final NYSE Corporate Governance Rules	
Appendix 2.4: Removal, Suspension, and Debarment of Accountants from Performing Audit Services	

Sarbanes-Oxley Act

CHAPTER 3

Analysis and Impact of the Sarbanes-Oxley Act

Corporate Scandals: The Genesis of Sarbanes-Oxley	3-2
Regulatory and Enforcement Authority	3-3
Overview of the Sarbanes-Oxley Act	3-4
Title-by-Title Summary	3-5
Public Company Accounting Oversight Board (Title I).....	3-5
Auditor Independence (Title II)	3-5
Activities Outside the Scope of Auditors (Title II, Section 201)	3-5
Preapproval of Non-Audit Services (Title II, Section 202).....	3-6
Audit Partner Rotation (Title II, Section 203)	3-7
Auditor Reports to Audit Committee (Title II, Section 204)	3-7
Conflict of Interest (Title II, Section 206).....	3-7
Corporate Responsibility (Title III).....	3-8
Audit Committees (Title III, Section 301)	3-8
Executive Certification of Disclosures in Company Reports (Title III, Section 302)	3-9
Improper Influence on the Conduct of Audits (Title III, Section 303).....	3-12
Forfeiture of Certain Bonuses and Profits (Title III, Section 304)	3-12
Officer and Director Bars and Penalties (Title III, Section 305)	3-12
Insider Trading During Pension Fund Blackout Periods (Title III, Section 306).....	3-12
Enhanced Financial Disclosures (Title IV)	3-16
Disclosures in Periodic Reports (Title IV, Section 401)	3-16
Prohibition on Personal Loans to Executives (Title IV, Section 402)	3-17
Application of the Sarbanes-Oxley Insider Lending Prohibitions to Banking Organizations	3-18
Expedited Disclosure of Transactions Involving Management and Principal Stockholders (Title IV, Section 403)	3-19
Management Assessment of Internal Controls (Title IV, Section 404).....	3-19
Disclosures of Code of Ethics/Audit Committee Financial Expert (Title IV, Sections 406, 407)	3-20
Real-Time Disclosures (Title IV, Section 409)	3-23
Analyst Conflicts of Interest (Title V)	3-24
SEC Resources and Authority (Title VI)	3-24
Studies and Reports (Title VII)	3-24
Corporate and Criminal Fraud Accountability (Title VIII)	3-24

Records Destruction (Title VIII, Section 802)	3-25
Debts Nondischargeable (Title VIII, Section 803)	3-25
Statute of Limitations for Securities Fraud (Title VIII, Section 804)	3-25
Whistleblower Protection (Title VIII, Section 805).....	3-25
White-Collar Crime Penalty Enhancements (Title IX)	3-25
Corporate Responsibility for Financial Reports (Title IX, Section 906).....	3-25
Corporate Tax Returns (Title X).....	3-26
Corporate Fraud and Accountability (Title XI)	3-26
Record Tampering or Impeding an Official Proceeding (Title XI, Section 1102).....	3-26
Authority to Freeze Extraordinary Payments (Title XI, Section 1103)	3-26
Authority to Prohibit Persons from Serving as Officers or Directors (Title XI, Section 1105).....	3-26
Related Rules and Guidance for Banking Organizations	3-26
Federal Reserve Board Guidance	3-27
Federal Deposit Insurance Corporation Guidance.....	3-27
Joint Regulatory Actions	3-28
Self-Regulatory Actions.....	3-28
Conclusion	3-29
Exhibit on CD	3-29
Exhibit 3.1: FDIC Guidance for Insured Depository Institutions with \$500 Million or More in Assets (FIL-17-2003, March 5, 2003)	

CHAPTER 3.1

Internal Control Framework

COSO Framework	3.1-1
Objectives	3.1-2
Components	3.1-2
PCAOB Standard No. 5 Requirements	3.1-3
Risk Assessment Standards for Private Companies	3.1-4
Internal Controls and the Auditor	3.1-5
Internal Control Concepts	3.1-6
Responsibility for Internal Control	3.1-6
Overlapping of Control Functions.....	3.1-6
Reasonable Assurance	3.1-6
Control Environment	3.1-7
Systemization.....	3.1-7
Competent Employees.....	3.1-7
Documentation	3.1-7
Fraud Communications System	3.1-7
Types of Controls.....	3.1-8
Operational Controls.....	3.1-9
Accounting Controls.....	3.1-9
Specific Control Procedures	3.1-10
Validation Procedures	3.1-10
Completeness Checking Procedures.....	3.1-11

Review Procedures	3.1-12
Discipline Procedures.....	3.1-12
Corporate Governance.....	3.1-13
FDIC-Supervised Banks That Are Public Companies or Subsidiaries of Public Companies	3.1-14
Non-Public FDIC-Supervised Banks with Less Than \$500 Million in Total Assets.....	3.1-14
Part 363 Annual Reports.....	3.1-14
Institutions with \$500 Million or More but Less Than \$1 Billion in Total Assets.....	3.1-14
Institutions with \$1 Billion or More in Total Assets	3.1-15
Other Requirements — All Institutions with \$500 Million or More in Total Assets.....	3.1-16
Regulatory Examinations	3.1-16
Overall Evaluation of Internal Controls	3.1-16
Review of Audit Systems and Reports	3.1-16
Direct Verification Methods.....	3.1-17
Recommendations to Management or the Board of Directors.....	3.1-17
Regulatory Requirements for Audit	3.1-18
Board Responsibilities.....	3.1-19
Organizational Controls.....	3.1-20
Directors' Approvals.....	3.1-21
Segregation of Duties	3.1-21
Rotation of Personnel.....	3.1-21
Sound Personnel Policies.....	3.1-21
Vacation Policies	3.1-22
Controls Over Customer Data	3.1-22
Implementing Personnel Security.....	3.1-24
Securing Contractor and Consultant Access Controls	3.1-25
Hiring Risks.....	3.1-26
Mitigating Personnel Security Risks	3.1-26
Develop Appropriate Policies and Enforcement Methods.....	3.1-26
Consider a Variety of Risk Mitigation Methods	3.1-27
Enhance Access Controls	3.1-27
Implement Technology Solutions.....	3.1-28
Manage Evolving Threats.....	3.1-28
Consider an Enterprise Security Management Platform	3.1-28
Setting Up a Credential Management System	3.1-29
Using Mobile Phones as a Security Device	3.1-29
How the Computer Chips Work.....	3.1-29
Accounting Procedures Controls	3.1-30
Operating Responsibilities	3.1-30
Current Records.....	3.1-30
Subsidiary Control Accounts.....	3.1-30
Audit Trail.....	3.1-30
Recordkeeping Deficiencies	3.1-30
Pre-Numbered Documents	3.1-31
Accounting Manual	3.1-31
Internal Control Issues Involving Derivatives	3.1-32
Effect of Derivatives on Standard Investment Risk.....	3.1-32

Credit Risk	3.1-32
Market Risk	3.1-33
Legal Risk	3.1-33
Control Risk.....	3.1-33
Guidelines for Managing Derivatives Risk.....	3.1-33
Questions Relating to Internal Control Over Derivatives	3.1-33
General Questions	3.1-34
Specific Questions.....	3.1-35
Checklists of Internal Control Considerations for Derivatives Activities.....	3.1-39
Control Environment	3.1-39
Integrity and Ethical Values	3.1-39
Management’s Commitment to Employee Competence	3.1-40
Board of Directors and Audit Committee Members.....	3.1-40
Management’s Philosophy and Operating Style.....	3.1-41
Organizational Structure.....	3.1-41
Assignment of Authority and Responsibility	3.1-42
Human Resources.....	3.1-42
Risk Assessment	3.1-42
Risk Assessment for the Entity as a Whole	3.1-42
Derivatives Activity Level Objectives.....	3.1-42
Control Activities.....	3.1-44
Existence of a System to Control Activities	3.1-44
Monitoring.....	3.1-45
Ongoing Monitoring.....	3.1-45
Information and Communication.....	3.1-46
Information	3.1-46
Communication	3.1-47
Protection of Physical Assets.....	3.1-47
Cash Control	3.1-48
Joint Custody or Dual Control	3.1-48
Joint Custody	3.1-48
Dual Control.....	3.1-49
Employee Hiring Procedures.....	3.1-49
Emergency Preparedness Plans	3.1-49
Reporting Shortages.....	3.1-49
Evaluating the Audit Function	3.1-50
Audit Committee.....	3.1-50
Internal Audit	3.1-50
Required Elements.....	3.1-50
Key Characteristics of the Internal Audit Function	3.1-51
Internal Audit Structure.....	3.1-51
Management, Staffing, and Audit Quality.....	3.1-52
Scope	3.1-53
Communication	3.1-54
Coordinate with External Auditors	3.1-54
Coordinate with Other Internal Resources.....	3.1-56

Include Coverage of High Risk Areas.....	3.1-57
Contingency Planning	3.1-58
Internal Audit Outsourcing Arrangements.....	3.1-58
Outsourcing Contracts	3.1-58
Outsourcing Controls.....	3.1-59
External Audits	3.1-59
Independence of the Independent Public Accountant	3.1-59
External Audit Regulatory Requirements	3.1-60
External Audit of the Financial Statements	3.1-60
Alternative External Auditing Programs	3.1-60
Sample Procedures for External Auditors' Reports.....	3.1-62
Troubled Banks.....	3.1-62
Regulatory Requirements	3.1-63
Reporting Requirements	3.1-63
Audit Committee Duties	3.1-64
Holding Company Subsidiary Institutions.....	3.1-64
Mergers.....	3.1-65
Part 363 Compliance Reviews.....	3.1-65
Communication with External Auditors	3.1-66
Workpaper Review Procedures.....	3.1-67
Complaints Against Accountants	3.1-68
Institutions Contracting with a Third Party To Perform Specific Work at the FDIC's Request.....	3.1-69
Sample Engagement Letter Language.....	3.1-70
Audit Rating Guidance — Community Banks	3.1-70
Strong.....	3.1-71
Board/Audit Committee Oversight.....	3.1-71
Audit Management and Processes	3.1-71
Audit Reporting.....	3.1-72
Internal Audit Staffing	3.1-72
Satisfactory.....	3.1-73
Board/Audit Committee Oversight	3.1-73
Audit Management and Processes	3.1-73
Audit Reporting	3.1-73
Internal Audit Staffing	3.1-74
Weak.....	3.1-74
Board/Audit Committee	3.1-74
Audit Management and Processes	3.1-74
Audit Reporting	3.1-75
Internal Audit Staffing	3.1-75
Audit Rating Guidance — Large/Mid-Sized Banks.....	3.1-75
Strong.....	3.1-76
Audit Committee.....	3.1-76
Audit Management and Processes	3.1-77
Audit Reporting.....	3.1-78
Internal Audit Staffing	3.1-78

Satisfactory.....	3.1-79
Audit Committee.....	3.1-79
Audit Management and Processes	3.1-79
Audit Reporting.....	3.1-80
Internal Audit Staffing	3.1-80
Weak.....	3.1-80
Audit Committee.....	3.1-81
Audit Management and Processes	3.1-81
Audit Reporting.....	3.1-82
Internal Audit Staffing	3.1-82
Core Audit Procedures.....	3.1-82
Exhibits on CD:.....	3.1-83
Exhibit 3.1.1: Board/Audit Committee Oversight Questionnaire	
Exhibit 3.1.2: Core Audit Procedures Questionnaire	

CHAPTER 3.1A

Methods for Evaluating and Testing Internal Controls

PCAOB Standard No. 5 Requirements	3.1A-1
Risk Assessment Standards for Private Companies.....	3.1A-2
Internal Auditor’s Responsibilities for Testing Internal Controls.....	3.1A-3
Testing Design Effectiveness.....	3.1A-3
Gathering Sufficient Evidence	3.1A-4
Nature of Tests.....	3.1A-5
Timing of Tests	3.1A-5
Extent of Tests	3.1A-6
Professional Resources for Testing Internal Controls.....	3.1A-6
The Treadway Commission	3.1A-6
American Institute of Certified Public Accountants.....	3.1A-6
U.S. Government Agencies	3.1A-8
The COSO Report	3.1A-8
Philosophy Underlying the COSO Report.....	3.1A-8
Introduction to COSO Report	3.1A-9
Contribution of Internal Controls.....	3.1A-9
Definition of Internal Control	3.1A-9
Effectiveness of Internal Control Systems.....	3.1A-9
Components of an Effective Internal Control System.....	3.1A-10
Control Environment	3.1A-10
Risk Assessment.....	3.1A-10
Control Activities.....	3.1A-10
Information and Communication.....	3.1A-11
Monitoring.....	3.1A-11
External Reports on Internal Control.....	3.1A-12
Control Components and Objectives.....	3.1A-13
Control Environment	3.1A-13
Integrity and Ethical Values	3.1A-14

Commitment to Competence	3.1A-14
Board of Directors or Audit Committee.....	3.1A-14
Management Philosophy and Operating Style	3.1A-17
Risk-Assessment Component	3.1A-18
Establishing Objectives	3.1A-18
Evaluating Risk Factors.....	3.1A-20
Managing Change	3.1A-20
Control Activities Component	3.1A-21
Control Over Safeguarding of Assets.....	3.1A-22
Information and Communication Component	3.1A-22
Turning Data into Usable Information	3.1A-23
Designing a Communication Process.....	3.1A-23
Monitoring Component	3.1A-24
Ongoing Monitoring	3.1A-24
Separate Evaluations of the Internal Control Structure.....	3.1A-25
Reporting Deficiencies.....	3.1A-25
Reengineering the Internal Control Function	3.1A-25
Identify the Objectives of the Process, Department, or Function.....	3.1A-27
Assess the Risks to the Institution	3.1A-28
Documentation	3.1A-29
Measures of Success.....	3.1A-29
Quantitative Data.....	3.1A-29
Risks to the Institution.....	3.1A-30
Assessing Internal Controls after Reengineering	3.1A-31
Mitigating Controls	3.1A-31
Monitoring Controls.....	3.1A-31
Choosing the Right Internal Controls after Reengineering.....	3.1A-31
Developments in Internal Control Tools and Techniques	3.1A-32
Exhibits on CD:	3.1A-32
Exhibit 3.1A.1: Sample Charter for an Audit Committee Authority	
Exhibit 3.1A.2: Questions to Be Considered in Evaluating an Internal Control Structure within a Financial Institution	
Exhibit 3.1A.3: Checklist for Internal Controls	

CHAPTER 3.1B

Internal Control Questionnaires (ICQs)

Types of Internal Controls	3.1B-1
Organizational Controls.....	3.1B-1
Directors' Approvals.....	3.1B-2
Segregation of Duties.....	3.1B-3
Rotation of Personnel	3.1B-3
Sound Personnel Policies.....	3.1B-3
Vacation Policies	3.1B-3
Accounting Procedures Controls.....	3.1B-4
Operating Responsibilities	3.1B-4

Current Records	3.1B-4
Subsidiary Control Accounts	3.1B-4
Audit Trail	3.1B-4
Recordkeeping Deficiencies	3.1B-4
Pre-Numbered Documents	3.1B-5
Accounting Manual	3.1B-5
Protection of Physical Assets	3.1B-5
Cash Control	3.1B-6
Joint Custody or Dual Control	3.1B-6
Joint Custody	3.1B-6
Dual Control	3.1B-7
Employee Hiring Procedures.....	3.1B-7
Emergency Preparedness Plans.....	3.1B-7
Reporting Shortages.....	3.1B-7
Regulatory Examinations	3.1B-8
Overall Evaluation of Internal Controls	3.1B-8
Review of Audit Systems and Reports	3.1B-8
Direct Verification Methods.....	3.1B-8
Positive Verification	3.1B-8
Negative Verification.....	3.1B-9
Recommendations to Management or the Board of Directors.....	3.1B-9
Sample Internal Control Questionnaires.....	3.1B-9
Payroll Controls.....	3.1B-10
Payroll Processing Controls	3.1B-11
Payroll Disbursement Controls.....	3.1B-12
Purchasing Controls	3.1B-14
Receiving Controls	3.1B-16
Accounts Payable Controls.....	3.1B-16
Cash Disbursement Controls	3.1B-18
Asset Controls.....	3.1B-19
General Ledger Controls	3.1B-20
Income Tax Accounting Controls.....	3.1B-24
Computer Program Controls	3.1B-25
Trust Accounting Controls.....	3.1B-25
Lending Operation Controls.....	3.1B-31
Role of Management.....	3.1B-31
Self-Assessment of Loans and Appropriate Calculation of the Amount of Write-Offs and Provisioning.....	3.1B-31
Criteria to Use in Self-Assessment	3.1B-31
Organization for Self-Assessment	3.1B-32
Adequacy and Accuracy of Self-Assessment	3.1B-32
Reporting of Self-Assessment Results to Management	3.1B-32
Integrated Management Credit Risk	3.1B-33
Integrated Risk Management System	3.1B-33
Setting of Credit Limits and Avoidance of Credit Concentration	3.1B-33
Sophistication of Management Methods	3.1B-33

Reporting System	3.1B-34
Loan Discipline.....	3.1B-34
Authority of Local Credit Officers	3.1B-34
Credit Administration by the Head Office	3.1B-34
Follow-Up of Lending Conditions	3.1B-34
Violation of Loan Discipline	3.1B-35
Manuals	3.1B-35
Staff Training and Education.....	3.1B-35
Training and Education for Upgrading the Level of Credit Officers	3.1B-35
Credit Approval	3.1B-35
Credit Analysis of Firms and Business Proprietors	3.1B-35
Use of Funds.....	3.1B-36
Screening of Business Prospects, Usage of Funds and Examination of Debt-Servicing Capacity	3.1B-36
Follow-Up.....	3.1B-36
Regular Monitoring of Borrower's Business Performance	3.1B-36
Monitoring of Large Exposures	3.1B-36
Monitoring of Company Groups	3.1B-37
System Support.....	3.1B-37
Financial Analysis System	3.1B-37
Information-Gathering for Credit Management of Consumer Loans	3.1B-37
Management of Substandard Borrowers.....	3.1B-37
Administration System for Substandard Borrowers	3.1B-37
Business Guidance to Delinquent Borrowers	3.1B-38
Collateral and Guarantees	3.1B-38
Maintenance and Appraisal of Collateral	3.1B-38
Confirmation of Guarantor's Ability and Intention to Warrant Loans.....	3.1B-39
Country Risk	3.1B-39
Information Gathering and Analysis	3.1B-39
Country Rating	3.1B-39
Credit Limits by Country	3.1B-39
Loan Accounting Controls.....	3.1B-40
Loan Policy Control.....	3.1B-43
Loan Review Controls.....	3.1B-44
Controls Over Past-Due and Charge-Off Loans.....	3.1B-45
Controls Over Other Real Estate Owned (OREO)	3.1B-46
Foreclosed Property Controls	3.1B-46
ALLL Controls	3.1B-47
Physical Safeguards Over Loan Collateral.....	3.1B-48
Compliance with Regulation O and Regulation B	3.1B-48
Controls Over Customer Data.....	3.1B-49
Implementing Personnel Security	3.1B-50
Background Checks and Screening	3.1B-51
Confidentiality Agreements	3.1B-51
Job Descriptions	3.1B-51
Training.....	3.1B-51

Employee Supervision and Controls	3.1B-52
Securing Contractor and Consultant Access Controls	3.1B-52
Hiring Risks	3.1B-52
Mitigating Personnel Security Risks	3.1B-53
Develop Appropriate Policies and Enforcement Methods.....	3.1B-53
Consider a Variety of Risk Mitigation Methods	3.1B-53
Enhance Access Controls	3.1B-54
Implement Technology Solutions.....	3.1B-54
Manage Evolving Threats	3.1B-55
Consider an Enterprise Security Management Platform	3.1B-55
Setting Up a Credential Management System	3.1B-55
Using Mobile Phones as a Security Device	3.1B-55
How the Computer Chips Work.....	3.1B-56

CHAPTER 3.2

Audit Function Quality Assurance Review Procedures

Regulatory Assessment Approach	3.2-1
General Procedures	3.2-1
Necessary Information	3.2-2
Audit Review Scope	3.2-2
Audit Policies, Procedures, and Plans	3.2-2
Audit Committee.....	3.2-3
Internal and External Audits	3.2-3
Regulatory Examinations	3.2-3
Preliminary Evaluation of Information.....	3.2-4
Board and Committee Oversight Quality	3.2-5
Compliance with 12 CFR 363	3.2-5
Compliance with Certain SEC Requirements	3.2-8
Internal Audit Reviews	3.2-8
Adequacy of Internal Audit Function.....	3.2-8
Internal Audit Independence and Competence	3.2-13
Internal Auditor Work Adequacy and Reliability.....	3.2-14
Outsourced Internal Audit Effectiveness and Reliability.....	3.2-17
Adequacy, Effectiveness, and Quality of Directors' Examination	3.2-21
Internal Risk Analysis Processes Adequacy.....	3.2-22
Fiduciary Audit Program Compliance.....	3.2-23
External Audit Reviews	3.2-23
External Audit Function Board Oversight Adequacy	3.2-24
External Auditor Work Extent and Reliability	3.2-26
External Audit Function Independence and Objectivity.....	3.2-30
Overall Conclusions	3.2-33
Planning for Corrective Action.....	3.2-35
Conclude the Quality Assurance Review	3.2-36
Statutory and Regulatory Requirements	3.2-36
Operational and Managerial Standards.....	3.2-36

Compliance Activities	3.2-36
Bank Secrecy Act (BSA)	3.2-36
Federal Securities Laws	3.2-37
Annual Independent Audit and Reporting Requirements	3.2-37
Part 363 Annual Reports	3.2-38
Institutions with \$500 Million or More but Less Than \$1 Billion in Total Assets	3.2-38
Institutions with \$1 Billion or More in Total Assets	3.2-39
Other Requirements — All Institutions with \$500 Million or More in Total Assets	3.2-39
Special Reporting Situations	3.2-40
Reporting by Insured U.S. Branches of Foreign Banks	3.2-40
Reporting by Merged or Consolidated Institutions	3.2-40
Audit Committee Requirements	3.2-41
Special Audit Committee Situations	3.2-41
Branches of Foreign Banks	3.2-42
Independent Accountant Eligibility Requirements	3.2-42
Risk-Based Capital Guidelines	3.2-43
Overview	3.2-43
Basel II Accord	3.2-44
Basel II Impact on U.S. Institutions	3.2-44
Capital Requirement Approaches and Methodologies	3.2-45
Capital Requirements for Core and Non-Mandatory Banks	3.2-45
Basel II Considerations	3.2-46
Minimum Requirements for A-IRB and AMA	3.2-46
Transitional Arrangements	3.2-47
Appendices on CD	3.2-47
Appendix 3.2.1: Internal Audit Review Questionnaire	
Appendix 3.2.2: External Auditor Independence Questionnaires	

Audit Committee Responsibilities

CHAPTER 4

Complying with New Audit Committee Responsibilities

Defining Corporate Governance	4-1
Requirements for Structuring the Audit Committee	4-2
Audit Committee Membership Requirements	4-2
Independence Requirements for Members	4-2
Business Relationships Definition	4-3
Gross Revenue Test	4-3
Direct Business Relationships Definition	4-4
Standard No. 1, Independence Discussions with Audit Committees	4-4
Financial Literacy	4-5
FDICIA Requirements for Audit Committees	4-5
Audit Committee Charter	4-6
Audit Committee Roles and Responsibilities Under the Charter	4-7

Audit Committee Duties Under FDICIA	4-8
Audit Committee Liability Issues	4-9
SEC Independence Guidance.....	4-10
SEC and Accounting Certifications and Disclosures.....	4-11
Communications Requirements.....	4-11
Materiality in Financial Statements.....	4-12
Requirements for Audit Adjustments	4-13
Action Plan to Form or Restructure the Audit Committee	4-13
Audit Committee's Evaluation of the Internal Audit Function	4-14
Tool No. 1: FFIEC Interagency Guidance on the Internal Audit Function and its Outsourcing	4-15
Internal Audit Evaluation Checklist.....	4-17
Tool No. 2: Audit Ratings Guidance.....	4-25
Audit Ratings Guide.....	4-25
Strong.....	4-25
Satisfactory.....	4-28
Weak.....	4-30
Final Assessment Rating	4-32
Board of Directors Risk Management Action Plan	4-32

Risk Based Audit Process

CHAPTER 5

Overview of the Risk Based Internal Audit Process

Overview of the Risk Based Audit Steps	5-1
Step 1: Learn About the Financial Institution's Business.....	5-2
Step 2: Perform a Comprehensive Risk Assessment	5-2
Risk Assessment Objectives.....	5-2
Identifying Risk Issues	5-3
Key Areas to Cover	5-3
Internal Auditor's Role in the Risk Assessment Process.....	5-4
The Preliminary Risk Assessment	5-4
Consider Regulatory Risks.....	5-5
Consider Risks Related to New Products and Services	5-5
Risk Factors Checklist.....	5-5
Step 3: Plan for the Risk Based Audit.....	5-7
Develop an Effective Internal Audit Plan	5-7
Scope of Coverage.....	5-8
Step 4: Update the Institution's Risk Assessment	5-9
Step 5: Revise/Develop a Risk Based Audit Program	5-9
Financial Audit Objectives	5-10
Using Audit Procedures to Obtain the Desired Level of Assurance	5-10
Inherent Risk.....	5-10
Control Risk.....	5-11

Detection Risk.....	5-11
Developing an Audit Program	5-12
Techniques for Gathering Audit Evidence.....	5-15
Sample Audit Procedures	5-24
Exhibit 5.1: Sample Procedures for Teller Cash, Deposits, and Loans.....	5-25
Summary of Audit Program Development.....	5-28
Step 6: Perform Audit Procedures and Document Findings	5-28
Step 7: Communicate Results in the Audit Report.....	5-29
Step 8: Communicate Results in an Exit Meeting	5-30
Step 9: Communicate Audit Findings to the Audit Committee.....	5-30
Appendix on CD.....	5-30
Appendix 5.1: OCC 2004-20	

CHAPTER 5.1

Understanding Enterprise Risk Management (ERM)

Recent History of ERM.....	5.1-1
Interrelationships Among ERP, Budgeting, Internal Control, And ERM	5.1-2
Enterprise Resource Planning.....	5.1-3
Budgeting	5.1-3
Internal Control System.....	5.1-3
Broad Characteristics of ERM.....	5.1-4
Categories of Bank Objectives.....	5.1-5
Strategic Objectives	5.1-5
Operations Objectives	5.1-5
Reporting Activities	5.1-6
Compliance Activities.....	5.1-6
Components of ERM	5.1-6
Internal Environment	5.1-7
Objective Setting	5.1-7
Identification of Events.....	5.1-7
Risk Assessment.....	5.1-7
Risk Response.....	5.1-7
Control Activities	5.1-8
Information and Communication	5.1-8
Monitoring	5.1-8
A Dynamic Process.....	5.1-8
Contributions of ERM	5.1-8
Alignment of Strategy with Risk	5.1-9
Growth of the Institution Linked with Risk and Return.....	5.1-9
Determination of Risk Response Decisions.....	5.1-10
Management of Operational Surprises	5.1-10
Management of Cross-Enterprise Risks.....	5.1-10
Integrated Responses to Multiple Risks	5.1-11
Managing Opportunities	5.1-11
Integration of Risk and Control Processes.....	5.1-11

Allocation of Resources	5.1-11
Limitations of ERM	5.1-12
Interrelationship of Internal Control and ERM.....	5.1-12
ERM and Internal Auditing.....	5.1-13
Defining ERM Components.....	5.1-15
Coordinating an ERM Strategy.....	5.1-15
Using ERM Concepts in the Auditing Process	5.1-16
Annual Planning.....	5.1-16
Conducting Audits	5.1-17
Internal Audit Reporting and Communication.....	5.1-17

Conducting Risk Assessments

CHAPTER 6

Conducting Risk Assessment Surveys

Risk Scoring Method	6-1
Inherent Risk Rating Instructions	6-1
Management of Risk Rating Instructions	6-2
Risk Assessment Rating Recap	6-2
Inherent Risk Survey	6-2
Inherent Risk Survey Instructions	6-2
Standards for Evaluation	6-3
Sample Inherent Risk Survey Form	6-3
Conducting a Management of Risk Survey	6-3
Management Survey Instructions.....	6-4
Standards for Evaluation	6-4
The Management of Risk Survey Form	6-5
Exhibits on CD	6-5
Exhibit 6.1: Risk Assessment Rating Recap Form	
Exhibit 6.2: Risk Categories, Definitions, and Examples	
Exhibit 6.3: Inherent Risk Survey Form	
Exhibit 6.4: Management of Risk Survey Form	

VOLUME 2

Products, Services, and Functions

CHAPTER 7

Risk Assessments and Audit Programs for Banking Products, Services, and Functions

Step 1: Define Risk Categories	7-1
Step 2: Develop a Risk Assessment Checklist	7-4
Sample Risk Assessment Checklists	7-4
Credit Risk	7-4
Market/Interest Rate Risk	7-5
Liquidity Risk.....	7-5
Human Resource Risk	7-6
Operational Risk.....	7-6
Legal/Compliance Risk.....	7-7
Strategic Risk.....	7-8
Reputation Risk.....	7-8
Other Risks.....	7-8
Non-Traditional Financial Services Risks	7-9
Step 3: Perform Risk Assessments	7-9
Sample Risk Assessments.....	7-10
Step 4: Establish Internal Audit Coverage Based on Risk Assessments	7-10
Incorporating Risk Assessments of Products, Services, and Functions.....	7-11
Determining Audit Cycles (1-, 2-, or 3-Year Rotation).....	7-12
Step 5: Conduct a Risk Based Audit	7-13
Risk-Based Audit Work Programs	7-14
Instituting Risk-Based Audit Work Programs	7-14
Draft a Mission Statement or Audit Charter	7-15
Conduct Risk Assessments.....	7-15
Develop an Overall Audit Plan	7-19
Establish Audit Cycles.....	7-20
Design Audit Work Programs	7-20
Select Sampling Methods and Techniques	7-22
Prepare Audit Reports.....	7-23
Conduct Follow-Up Activities	7-25
Conduct Professional Development Programs	7-25
Conduct Quality Assurance Programs.....	7-25
Ensuring Independence and Competence	7-26
Providing Consulting Activities.....	7-27
Risk-Based Audit Program Examples.....	7-28
Sample Risk-Based Audit Work Programs	7-30

Credit Risk Audits	7-30
Loan Administration.....	7-30
Subprime Lending Risk Management	7-38
Subprime Auto Lending.....	7-47
Subprime Residential Real Estate Lending	7-48
Subprime Credit Card Lending.....	7-56
Payday Lending	7-57
Liquidity Risk Audits	7-65
Tellers and Cash.....	7-65
Correspondent Bank Accounts.....	7-65
Insider Loans	7-66
Deposits.....	7-66
Capital Adequacy Risk Audits	7-69
Level and Quality of Capital	7-70
Emerging Needs for Additional Capital	7-70
Problem Assets and Valuation Reserves	7-70
Balance Sheet Composition	7-71
Earnings and Dividends.....	7-72
Prospects and Growth Plans.....	7-72
Access to Capital.....	7-73
Uniform Financial Institution Rating System.....	7-73
Allowance for Loan and Lease Losses (ALLL).....	7-75
Responsibility of the Board and Management.....	7-76
Factors to Consider in Estimating Credit Losses	7-78
Risk-Based Audit Responsibilities	7-79
Regulatory Reporting of the ALLL	7-80
Accounting and Reporting Treatment	7-80
Layering.....	7-81
Common Methodology Elements	7-82
Regulatory Guidance on the ALLL: 2006 Policy Statement.....	7-83
Overview — To Comply with the 2006 ALLL Policy Statement.....	7-83
FASB 5 (July 1975)	7-84
FASB Interpretation 14 (September 1976).....	7-84
FASB 114 (December 1994).....	7-85
SOP 94-6 (December 1994)	7-85
EITF Topic D-80 (May 1999)	7-85
NCUA Interpretive Rulings and Policy Statements 02-3 (May 2002)	7-86
Statement of Position 01-6 (May 2004)	7-86
SEC Staff Accounting Bulletin 102 (SAB 102)	7-86
2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL) and Questions and Answers on Accounting for Loan and Lease Losses	7-87
Trends in ALLL Analysis.....	7-87
FASB 5: Historical Loss Experience Rates	7-88
FASB 5: Possible Allowance Pools.....	7-88

FASB 114 Policy Issues	7-89
Charge Offs and Recoveries	7-90
Delinquent Loan Reserves	7-90
Unallocated Reserves.....	7-90
International Transfer Risk Considerations	7-91
Credit Union Issues	7-92
Financial Statement Disclosures.....	7-92
Disclosures Concerning Credit Quality Related to Loans.....	7-93
Disclosing Credit Risk Exposures.....	7-93
Disclosing Accounting Policies.....	7-93
Disclosing ALLL Activity by Type.....	7-94
Disclosing Components of ALLL.....	7-95
Developing a Systematic Methodology for the ALLL.....	7-95
Process Overview	7-95
FASB 114 Loans.....	7-99
FASB 114 Documentation Requirements Example.....	7-103
FASB 5 Loans.....	7-104
Final Steps to Take Before Publishing the ALLL.....	7-110
PCAOB ALLL Audit Issues	7-112
Additional Regulatory Guidance	7-113
Loan Review Systems.....	7-114
Qualifications and Independence of Loan Review Personnel.....	7-114
Frequency of Reviews.....	7-116
Scope of Reviews	7-116
Depth of Reviews.....	7-116
Review of Findings and Follow-Up.....	7-117
Workpaper and Report Distribution.....	7-118
Loan Classification or Credit Grading Systems	7-118
Factors to Consider in the Estimation of Credit Losses	7-119
Estimating Losses on Loans Individually Reviewed for Impairment but Not Considered Individually Impaired — FASB 114 Analysis.....	7-120
Estimating Losses on Loans Individually Reviewed for Impairment but Not Considered Individually Impaired — FASB 5 Analysis.....	7-121
Documenting Loans That Were Individually Reviewed for Impairment but Are Not Considered Individually Impaired	7-122
Substandard Assets.....	7-123
Pass Loans.....	7-124
Amounts Designated as “Unallocated”	7-125
Loans with Low or Zero Historical Losses.....	7-126
Financial Reporting Risk Audits.....	7-128
Suspense Accounts.....	7-128
General Ledger Accounts	7-128
Income and Expense Accounts.....	7-129
Operational Risk Audits.....	7-130

Identifying Fraud and Insider Abuse Risks	7-130
Auditing the Remote Deposit Capture (RDC) Function: Developing and Implementing a Risk-Based Approach.....	7-137
Information Technology.....	7-152
Management Information Systems.....	7-153
Internet Banking Authentication	7-155
Authentication Step 1 — Identify Reasonably Foreseeable Internal and External Threats....	7-158
Authentication Step 2 — Assess the Likelihood and Potential Damage of Identified Threats.....	7-162
Authentication Step 3 — Assess the Sufficiency of Policies and Procedures	7-167
Authentication Step 4 — Evaluate Control Effectiveness	7-168
Authentication Step 5 — Evaluate Customer Information Disposal Process.....	7-170
Authentication Step 6 — Prioritize Risks and Assign Risk Ratings.....	7-170
Key Risk Assessment Practices.....	7-172
Hiring an Outside Consultant To Conduct the Risk Assessment.....	7-174
Engaging in an Ongoing Risk Assessment Process.....	7-175
Electronic Funds Transfer Services	7-175
Remote Deposit Capture	7-176
ACH Transactions	7-177
Risk Management.....	7-179
Risk Management Step 1 — Review ACH Operations	7-180
Risk Management Step 2 — Evaluate ACH Risks.....	7-186
Risk Management Step 3 — Implement an ACH Risk Management Program	7-207
Risk Management Step 4 — Conduct ACH Audits.....	7-211
Lost and Stolen Securities Program (SEC Rule 17f-1).....	7-221
Suspicious Activity Reports.....	7-225
Improper and Illegal Payments.....	7-225
Exhibits on CD	7-228
Exhibit 7.1: Sample Risk Assessment for Treasury	7-228
Exhibit 7.2: Sample Risk Assessment for Commercial and Consumer Lending	7-228
Exhibit 7.3: Sample Risk Assessment for Internet Banking.....	7-228
Exhibit 7.4: Sample Risk Assessment Policy for Branch Security.....	7-228
Exhibit 7.5: Risk Assessment Rating Weights	7-228
Exhibit 7.6: Risk Assessment Ratings	7-228
Exhibit 7.7: Risk-Weighted Rating Matrix.....	7-228
Exhibit 7.8: Sample Financial Institution Audit Coverage Matrix Internal Audit Year Ended December 31	7-228
Exhibit 7.9: Sample Loan Operations Risk Based Audit Program	7-228
Exhibit 7.10: ACH Terms	7-228

CHAPTER 7.1

Risk Based IT Audits

IT Audit Program Overview	7.1-1
Audit Program Objectives	7.1-1

Audit Coverage	7.1-2
Performing Risk Assessments	7.1-3
Risk Scoring System.....	7.1-4
Assessing Roles and Responsibilities.....	7.1-7
Board of Directors and Senior Management.....	7.1-8
Audit Committee Regulatory Requirements.....	7.1-8
Board and Audit Committee Responsibilities.....	7.1-9
IT Audit Management	7.1-11
Internal IT Audit Staff.....	7.1-11
Operating Management.....	7.1-13
External Auditors.....	7.1-13
Evaluating Staff Independence.....	7.1-14
Independence.....	7.1-14
Staffing	7.1-16
Central IT Audit Organization	7.1-17
Integrated Audit Approach.....	7.1-17
Outsourcing the IT Audit Function.....	7.1-18
Independence.....	7.1-18
External Auditor Independence Issues.....	7.1-18
Issues of Outsourcing Arrangement To Consider.....	7.1-19
Oversee Vendor Activities	7.1-20
Due Diligence.....	7.1-20
Contingency Plan	7.1-20
Written Contract	7.1-21
Competent Management	7.1-22
Effective Communication	7.1-23
Developing the Internal IT Audit Program	7.1-23
IT Audit Program	7.1-23
IT Audit Policies and Procedures.....	7.1-25
Computer-Assisted Audit Techniques (CAATs) Procedures	7.1-26
Application Development, Acquisition, Conversions, and Testing.....	7.1-28
Independent Review Guidelines.....	7.1-29
Post Implementation Reviews	7.1-29
Third-Party Reviews of Technology Service Providers	7.1-30
SAS 70 Reviews	7.1-32
Trust Services Reviews	7.1-33
SysTrust	7.1-34
WebTrust.....	7.1-35
Complying With Examination Procedures.....	7.1-35
Tier I Objectives and Procedures.....	7.1-36
Objective 1	7.1-36
Objective 2	7.1-37
Objective 3	7.1-38
Objective 4	7.1-39

Objective 5	7.1-39
Objective 6	7.1-40
Objective 7	7.1-40
Objective 8	7.1-41
Objective 9	7.1-41
Objective 10	7.1-42
Objective 11	7.1-43
Objective 12	7.1-46
Objective 13	7.1-46
Conclusions	7.1-47
Objective 14	7.1-47
Tier II Objectives and Procedures	7.1-48
Management.....	7.1-48
Systems Development and Acquisition	7.1-49
Operations.....	7.1-50
Information Security.....	7.1-51
Payment Systems	7.1-53
Outsourcing	7.1-55
Glossary	7.1-57

CHAPTER 7.2

Evaluating Residential Real Estate Credit Risk

Residential Real Estate Loans	7.2-1
Acceptable Types of Residential Real Estate Loans for Underwriting	7.2-1
Loan Structuring and Documentation Sources.....	7.2-2
Compliance with Regulations	7.2-3
Subprime Mortgage Lending.....	7.2-4
Underwriting and Structuring Analysis	7.2-6
Employment and Income	7.2-6
Closing Funds.....	7.2-7
Credit History	7.2-7
Collateral	7.2-8
Fees and Charges.....	7.2-10
Second Review Program.....	7.2-11
Land Loans	7.2-11
Underwriting	7.2-12
Proper Land Loan Structure.....	7.2-13
Term.....	7.2-13
Equity	7.2-14
Loan-to-Value.....	7.2-14
Interest Rate and Fees.....	7.2-14
Release Provisions.....	7.2-14
Wetlands Designation	7.2-15

Construction Lending for Residential Real Estate	7.2-15
Acceptable Types of Real Estate Construction Loans to Underwrite	7.2-15
Loan Structure	7.2-16
Term	7.2-16
Loan-to-Value (LTV) Ratio	7.2-16
Interest Reserve	7.2-16
Interest Rate and Fees	7.2-17
Repayment	7.2-17
Underwriting and Servicing	7.2-17
Borrower/Guarantor Analysis	7.2-17
Third-Party Contractor	7.2-18
Project Analysis	7.2-19
Contractor Analysis	7.2-20
Project Monitoring	7.2-20
Insurance and Taxes	7.2-21
Tax Lien Certificate Procedures	7.2-21
Tax Lien Certificate Risks	7.2-22
Risk Management Expectations	7.2-23
Risk Rating, Accounting, and Risk-Based Capital Considerations	7.2-24
Home Equity and Home Improvement Lending	7.2-25
Underwriting and Structuring Procedures	7.2-26
Maturities	7.2-26
Interest Rates	7.2-26
Loan-to-Value Ratios	7.2-26
High Value Properties Are Subject to the Following LTV Procedures	7.2-27
Title Insurance	7.2-27
Flood Hazard Determination	7.2-27

CHAPTER 7.3

Conducting Loan Quality Reviews

Regulatory Requirements	7.3-1
Loan Review System	7.3-2
Loan Review System Attributes	7.3-4
Elements of Loan Review Systems	7.3-5
Qualifications of Loan Review Personnel	7.3-6
Independence of Loan Review Personnel	7.3-6
Frequency of Reviews	7.3-7
Scope of Reviews	7.3-7
Depth of Reviews	7.3-8
Review of Findings and Follow-Up	7.3-9
Workpaper and Report Distribution	7.3-9
Loan Review Procedures	7.3-10
Managing Credit Grade Disputes	7.3-11

Periodic Full Scope Portfolio Reviews.....	7.3-11
Reporting Procedures.....	7.3-12
Quality Control Review Process.....	7.3-13
Well-Managed CRE Lending Program Example.....	7.3-13
Components of a Well-Managed CRE Program.....	7.3-14
Managing CRE Risks.....	7.3-14
CRE Risk Management Profiles.....	7.3-15
Strong Credit Management.....	7.3-15
Satisfactory Credit Management.....	7.3-15
Fair Credit Management.....	7.3-16
Unsatisfactory Credit Management.....	7.3-16
What to Look for in CRE Loans.....	7.3-16
Analysis of Borrower's Cash Flow.....	7.3-17
Analysis of Borrower's Liquidity.....	7.3-17
Analysis of Borrower's Leverage and Capitalization.....	7.3-18
Analysis of Borrower's Reputation and Experience.....	7.3-18
Third-Party Contractor Analysis.....	7.3-19
Project Cash Flow Analysis (Acquisition and Development Loan).....	7.3-20
Project Market Feasibility Analysis.....	7.3-20
Guarantors.....	7.3-20
Wetlands Designation.....	7.3-21
Loan Maturity Structure.....	7.3-21
Loan Equity Structure.....	7.3-21
Loan-to-Value (LTV) Structure.....	7.3-22
Loan Interest Reserve Structure.....	7.3-22
Loan Interest Rate and Fees Structure.....	7.3-22
Loan Repayment and Release Structure.....	7.3-23
Loan Servicing.....	7.3-23
Safety and Soundness Requirements.....	7.3-24

CHAPTER 7.4

Identifying and Controlling Commercial Real Estate Concentrations

CRE Regulatory Guidance.....	7.4-1
Capital Management Guidance.....	7.4-3
Risk Management Guidance.....	7.4-3
Step 1 — Review and Update Policies and Procedures.....	7.4-5
Board and Management Oversight Policy.....	7.4-6
Board and Management Oversight Procedures.....	7.4-6
Procedures to Closely Manage ADC and CRE Loan Portfolios.....	7.4-7
CRE Risk Management Policy.....	7.4-7
CRE Risk Management Policy Contingency Plan.....	7.4-7
CRE Risk Management Procedures.....	7.4-8
CRE Lending Policy.....	7.4-11

Procedures to Maintain Updated Financial and Analytical Information	7.4-13
Procedures to Bolster the Loan Workout Infrastructure.....	7.4-14
Construction and Development Loan Policy.....	7.4-14
Procedures to Manage ADC Loans	7.4-15
Capital Management Policies	7.4-15
Capital Adequacy Procedures	7.4-16
Allowance for Loan and Lease Losses Policy	7.4-16
ALLL Procedures	7.4-17
CRE Portfolio Management Policy	7.4-18
Management Information System (MIS) Policy	7.4-18
MIS Report Procedures.....	7.4-19
Risk Assessment Policy.....	7.4-20
Board and Management Oversight	7.4-20
Credit Underwriting Standards and Product Pricing.....	7.4-20
Concentration Testing Procedures.....	7.4-21
Correlation Analysis Procedures.....	7.4-21
Step 2 — Expand Market Monitoring and Analysis for CRE Loans	7.4-22
Market Analyses Policy.....	7.4-26
Market Analysis Procedures.....	7.4-26
Procedures for Monitoring Speculative Single-Family Housing Development	7.4-28
Step 3 — Re-evaluate Credit Underwriting Standards and Administration	7.4-28
Step 4 — Reinforce Portfolio Management Practices.....	7.4-30
Step 5 — Evaluate Credit Risk Rating and Review Practices	7.4-33
Credit Risk Review Policy	7.4-35
Credit Risk Rating Policy.....	7.4-35
Credit Risk Rating Procedures	7.4-36
Step 6 — Conduct Portfolio Stress Testing and Sensitivity Analyses.....	7.4-37
Portfolio Stress Testing and Sensitivity Analysis Policy.....	7.4-38
Portfolio Stress Testing and Sensitivity Analysis Procedures	7.4-38
Step 6A — Conduct Transactional Sensitivity Analyses.....	7.4-38
Step 6B — Conduct Stressed Loss Rates Tests.....	7.4-41
Step 6C — Conduct Scenario Analyses	7.4-43
Step 6D — Conduct Ratings Migration Analyses	7.4-44

CHAPTER 7.5

Evaluating Fair Lending Risks

Evaluating Fair Lending Risks	7.5-1
Fair Lending Laws	7.5-1
Types of Illegal Credit Discrimination.....	7.5-2
Risk-Focused Fair Lending Examinations.....	7.5-3
Conducting Risk-Focused Fair Lending Examinations	7.5-3
Types of Examination Analysis Performed.....	7.5-4
Underwriting.....	7.5-4

Terms and Conditions	7.5-5
Redlining.....	7.5-5
Credit Scoring	7.5-5
Steering.....	7.5-6
Evaluate Preventive Measures	7.5-6
Conducting Self Examinations.....	7.5-10
Self-Assessment Checklists	7.5-13
Management Systems Checklist.....	7.5-13
Home Mortgage Disclosure Act (HMDA) Data Review Checklist.....	7.5-13
Comparative Analysis Checklist.....	7.5-14
Disparate Impact Checklist.....	7.5-14
Review Residential Loan Products.....	7.5-15
Identify Types of Residential Loan Products.....	7.5-15
Identify Residential Lending Discrimination Risk Factors.....	7.5-16
Organize and Focus Residential Risk Analysis.....	7.5-22
Evaluate Other Types of Credits.....	7.5-23
Conducting a Credit Scoring Analysis.....	7.5-23
Structure and Organization of the Scoring System	7.5-23
Disparate Treatment in the Application of Credit Scoring Programs	7.5-25
Credit Scoring Systems That Include Age.....	7.5-26
Age as an Explicit Variable	7.5-27
Age-Split Scorecards.....	7.5-28
Consider Contracting with Outside Testers.....	7.5-28
Appendixes on CD.....	7.5-29
Appendix 7.5.1:Risk-Based Fair Lending Examination Procedures.....	7.5-29
Appendix 7.5.2:Glossary of Terms.....	7.5-29

CHAPTER 7.6

How to Identify, Measure, Monitor, and Control Interest Rate Risks

Identifying the Types of IRR to Measure	7.6-1
Repricing or Maturity Mismatch Risk.....	7.6-1
Basis Risk.....	7.6-3
Market Financial Instruments Example.....	7.6-3
Managed Rates Example	7.6-4
Lagging Indices Example	7.6-4
Hedging with Derivative Contracts Example	7.6-4
Yield Curve Risk	7.6-5
Yield Curve Twist Risk	7.6-7
Yield Curves Basics	7.6-7
Why It Is Easy To Miss Twist Risk	7.6-8
Twist Risk Is Significant	7.6-8
Measuring Twist Risk.....	7.6-8
Pick a Pivot Point.....	7.6-9
Recommendation.....	7.6-9

Option Risk	7.6-10
Parties to an Option.....	7.6-10
Prepayment Options.....	7.6-11
Early Withdrawal Options.....	7.6-11
Nonmaturity Deposit Pricing Option.....	7.6-11
Caps or Floors	7.6-11
Effectively Testing for Basis Risk and Yield Curve Shape Risk in Interest Rate Risk Analyses.....	7.6-12
A Multi-Dimensional View of Interest Rate Risk	7.6-14
Case Studies.....	7.6-14
Differences Between Outcomes.....	7.6-15
Profiles Presentations	7.6-15
Conclusion	7.6-16
How to Measure Interest Rate Risk.....	7.6-16
Types of IRR Measurement Systems.....	7.6-16
Setting Up an IRR Measurement System	7.6-17
Step 1: Gather IRR Data.....	7.6-18
Data and Information To Be Collected	7.6-18
Sources of Data and Information	7.6-19
Data Aggregation.....	7.6-19
Step 2: Develop IRR Forecast Scenarios and Assumptions	7.6-19
Developing Interest Rate Forecasts and Assumptions	7.6-20
Developing Interest Rate Forecast Scenarios.....	7.6-21
The Deterministic Approach.....	7.6-22
The Stochastic Approach.....	7.6-22
Choosing the Right Interest Rate Scenario.....	7.6-23
Business as Usual — Most Likely Interest Rate Scenario	7.6-23
Stressed Markets and Sensitivity Tests	7.6-24
Worst-Case Scenarios.....	7.6-25
Making Repricing Assumptions	7.6-26
Step 3: Compute Interest Rate Risk Levels.....	7.6-28
Risk to Reported Earnings	7.6-28
Risk to Capital.....	7.6-29
Monitoring and Controlling IRR	7.6-29
Integrate IRR with New Business Strategies	7.6-30
Manage Interest Rate Risk Limits.....	7.6-31
Earnings-at-Risk Limits	7.6-32
Capital-at-Risk (EVE) Limits.....	7.6-32
Gap Limits	7.6-33
Pricing Limits and Funds Transfer Pricing Systems	7.6-33
Establish Interest Rate Risk Reporting	7.6-34
Audit the Interest Rate Risk Measurement Process	7.6-35
Measuring Value-Based Interest Rate Risk Using Rate Shocks	7.6-37
Risk Comparison Methodology	7.6-37
Using the 4Step Method	7.6-38
Instrument Level Comparisons	7.6-38
Rate Shocks and EVE-at-Risk	7.6-39

Concluding Observations.....	7.6-39
Exhibit 7.6-1: The 4Step VBIRR Measure	7.6-41
Exhibit 7.6-2: Representative Risk Graph	7.6-42
Exhibit 7.6-3: Unhedged and Hedged Risk Results for Three Products.....	7.6-43
Exhibit 7.6-4: Unhedged and Hedged Risk Profiles for Selected Products.....	7.6-44
Exhibit 7.6-5: Percentage of Outcomes with More Risk Than Occurred in Parallel Rate Shocks	7.6-45
Exhibit 7.6-6: Balance Sheets Used to Evaluate EVE-at-Risk	7.6-46
Exhibit 7.6-7: Hedging Results of Balance Sheets 1 and 2	7.6-47
Exhibit 7.6-8: Unhedged and Hedged Balance Sheets.....	7.6-48
Appendix on CD	7.6-49
Appendix 7.6-1: News Release NR 2004-53	

CHAPTER 7.7

Risk Based Audits of Liquidity

Conducting A Risk-Based Liquidity Audit	7.7-2
Determine the Scope of the Liquidity Review	7.7-2
Determine Whether Available Liquidity Sources Are Adequate to Meet Current and Potential Needs	7.7-2
Determine Impact of the Cost of Liquidity on the Institution's Ability to Generate Reasonable Profits	7.7-4
Determine Stability, Credit and Rate Sensitivity, and Character of the Financial Institution's Deposit Structure.....	7.7-4
Evaluate Level of Risk in Wholesale and Other Non-Deposit Funding Activities	7.7-5
Determine Whether Adequate Contingent Funds Are Available to Meet the Needs Required in Liquidity Stress or Crisis Scenarios	7.7-6
Assess Appropriateness and Integrity of Corporate Governance over Liquidity Risk Management.....	7.7-7
Determine that Liquidity Policies, Procedures, and Limits Are Appropriate for Size, Complexity, and Sophistication of the Financial Institution.....	7.7-7
Assess Adequacy of the Institution's Liquidity Risk Measurement Systems	7.7-8
Determine Whether Policies and Practices Regarding Wholesale Funding Are Adequate.....	7.7-9
Assess Adequacy of Liquidity CFPs	7.7-9
Determine Significance of Liquidity Risk by Using Findings from Meeting the Foregoing Objectives.....	7.7-10
Determine Whether to Expand the Procedures or Develop a Plan for Corrective Action.....	7.7-10
After Completing Expanded Procedures, Determine Whether Additional Verification Procedures Should Be Performed.....	7.7-10
Assessing Liquidity Risks Related To Correspondent Bank Concentrations	7.7-10
Regulation F Compliance	7.7-11
Regulation F Limitations	7.7-11
Correspondent Bank Monitoring Reports.....	7.7-11
Correspondent Bank Exposure Limits.....	7.7-12
Credit Risk Exposures.....	7.7-12
Measuring Credit Exposure.....	7.7-14

Assessing Credit Risk Exposures.....	7.7-19
Monitoring Ratios	7.7-19
Evaluating Correspondent Bank Funding Risks	7.7-20
Conducting Due Diligence and Identifying and Monitoring Concentrations.....	7.7-26
Establish Management Responsibilities.....	7.7-26
Conduct Reviews to Identify Concentrations.....	7.7-26
Establish Appropriate Due Diligence Policies.....	7.7-27
Establish Correspondent Bank Exposure Ranges, Tolerances, Limits.....	7.7-27
Establish a Correspondent Classification System.....	7.7-27
Establish an Internal Credit Exposure Limit Policy	7.7-28
Credit Exposure Limits	7.7-28
Identify and Monitor Concentration Risks	7.7-29
Early Warning Indicators	7.7-29
Correspondent Bank Exposure Limit Compliance Exceptions	7.7-30
Establish Risk Mitigation Plans.....	7.7-31

CHAPTER 7.8

Risk Based Audits of Payment and Settlement Systems

Retail Payment System Risk Assessments And Audits.....	7.8-1
General Objectives and Procedures	7.8-2
Objective 1: Assess the Level of Risk in Retail Payment Systems Function	7.8-2
Objective 2: Establish the Scope and Objectives of the Risk-Based Audit of the Retail Payment Systems Function	7.8-3
Objective 3: Assess the Quality of Oversight and Support Provided by the Board of Directors and Management.....	7.8-5
Objective 4: Assess the Quality of Policies, Procedures, and Limits Supporting Retail Payment Services	7.8-6
Objective 5: Assess the Quality of Management Information Systems and Reports Used to Manage Retail Payment Services	7.8-6
Objective 6: Assess the Quality of Risk Management and Support for Bankcard Issuance and Acquiring (Merchant Processing) Activity	7.8-7
Objective 7: Assess the Quality of Risk Management and Support for EFT/POS Processing Activity	7.8-8
Objective 8: Assess the Quality of Risk Management and Support for ACH Processing Activity	7.8-9
Objective 9: Assess the Quality of Risk Management and Support for Electronic Banking Related Retail Payment Transaction Processing	7.8-10
Objective 10: Assess the Quality of Risk Management and Support for Checks	7.8-11
Objective 11: Assess the Quality of Risk Management of New and Emerging Technology Risks	7.8-12
Documenting General Findings	7.8-12
Detailed Objectives and Procedures.....	7.8-13
EFT/POS and Bankcard Agreements and Contracts	7.8-13
Personal Identification Numbers (PINs).....	7.8-13
Information Security.....	7.8-14

Card Issuance.....	7.8-15
Business Continuity Planning.....	7.8-16
EFT/POS and Bankcard Accounting and Transaction Processing.....	7.8-16
EFT/POS Operational Controls.....	7.8-17
ACH ODFI and RDFI Responsibilities.....	7.8-18
ACH Accounting and Transaction Processing.....	7.8-20
ACH Funding and Credit.....	7.8-22
Web and Telephone-Initiated ACH Transactions.....	7.8-22
ACH Contingency Plans.....	7.8-23
Check 21.....	7.8-24
Remote Deposit Capture Risk Management.....	7.8-26
Vendor Management.....	7.8-33
Risk Assessment of Mobile Banking Security.....	7.8-35
Data Security Risks.....	7.8-35
Handset Risks.....	7.8-36
Mobile Channel Risks.....	7.8-37
Application Risks.....	7.8-37
Service Risk.....	7.8-37
Transaction Volumes.....	7.8-37
Technology Risks.....	7.8-38

CHAPTER 7.9

Risk Based Audits of Risk Management and Insurance

Categories of Risk.....	7.9-1
Risk Management Stages.....	7.9-1
Risk Identification and Analysis.....	7.9-2
Risk Control.....	7.9-2
Risk Treatment.....	7.9-3
Board Responsibilities.....	7.9-3
Working with an Insurance Agent.....	7.9-4
Fidelity Bond Coverage.....	7.9-4
Underwriting Procedures.....	7.9-4
Reporting Losses.....	7.9-4
Discontinuing Coverage.....	7.9-5
Form of Fidelity Bond.....	7.9-5
Coverage Contained in Form 24.....	7.9-6
Other Specialized Forms of Bank Insurance.....	7.9-7
Combination Safe Depository.....	7.9-7
Directors' and Officers' Liability.....	7.9-8
Mortgage Errors and Omissions.....	7.9-8
Fraudulent Accounts Receivable and Fraudulent Warehouse Receipts.....	7.9-8
Single Interest.....	7.9-8
Transit Cash Letter Insurance.....	7.9-9
First Class, Certified, and Registered Mail Insurance.....	7.9-9
Other Types of Insurance.....	7.9-9

Automobile, Public Liability and Property Damage	7.9-9
Boiler and Machinery	7.9-9
Extra Expense	7.9-9
Fine Arts	7.9-9
Fire	7.9-10
General Liability	7.9-10
Keyman Insurance	7.9-10
Trust Operations Errors and Omissions	7.9-10
Umbrella Liability	7.9-10
Valuable Papers and Destruction of Records Policy	7.9-11
Recordkeeping	7.9-11
Bonding Claims and Capital Deficiencies	7.9-11
Internal Control Questionnaire	7.9-12
Audit Procedures	7.9-13

CHAPTER 7.10

Risk Based Audit of Director Duties and Responsibilities

Legal Issues	7.10-1
Directors' Responsibilities	7.10-2
Objectives	7.10-2
Duties	7.10-2
Select and Keep Competent Executive Officers	7.10-3
Effectively Supervise the Bank's Affairs	7.10-3
Adopt and Follow Sound Policies and Objectives	7.10-3
Avoid Self-Serving Practices	7.10-3
Be Informed of the Bank's Condition and Management Policies	7.10-4
Compliance with Formal and Informal Administrative Actions	7.10-5
Depository Institution Management Interlocks Act	7.10-6
Audit Procedures	7.10-6
Checklist for the Review of Director Duties and Responsibilities	7.10-6

CHAPTER 7.11

Conducting a Risk Assessment of Cloud Computing

Defining Cloud Computing	7.11-1
Service Delivery Models	7.11-1
Benefits of Cloud Computing	7.11-3
Appropriate Uses	7.11-3
Assessing Cloud Computing Risks	7.11-3
Worksheet 7.11.1: Determining Risk	7.11-3
Identifying and Mitigating Risks	7.11-5
Worksheet 7.11.2: Data Confidentiality and Privacy	7.11-5
Internal Audit Participation	7.11-9
Cloud Security Alliance	7.11-11
Cloud Computing Is a Strategic Decision	7.11-12

CHAPTER 7.12

Conducting ERM Risk Assessments.

Areas of Guidance Under COSO	7.12-1
Directors' Responsibilities for Enterprise Risk Management	7.12-2
Capital Productivity and Adequacy	7.12-2
Establishing the Board's Risk Appetite	7.12-3
Risk Assessment Considerations.....	7.12-4
Communicating the Results.....	7.12-4
Role of Internal Audit	7.12-5
Defining ERM Objectives	7.12-5
Considering Large Risks.....	7.12-5
Implementing ERM Objectives	7.12-6
Integration within the Institution.....	7.12-7
Assessing the Adoption of ERM.....	7.12-8
Committees and Subcommittees.....	7.12-9
ERM Risk Committee Members	7.12-9
Credit Risk Subcommittee.....	7.12-9
Other Subcommittees.....	7.12-9
Developing an ERM Risk Identification Process	7.12-9
Market Risk	7.12-10
Operational Risk.....	7.12-10
Reputation Risk	7.12-10
Strategic Risk	7.12-11
Credit Risk	7.12-11
Legal/Compliance Risk	7.12-12
Liquidity Risk	7.12-12
Creating ERM Risk Reports	7.12-13
Performance-Oriented ERM Process.....	7.12-14
Type of Indicator	7.12-14
Example of Indicator	7.12-15
Short-Term Perspective.....	7.12-15
Long-Term Perspective.....	7.12-15
Conducting ERM Risk Assessments	7.12-16
Detecting When ERM Is Not Working.....	7.12-16
ERM Review Checklist	7.12-17
Application of ERM	7.12-17

Fraud Detection

CHAPTER 8

Risk Based Auditing for Fraud Detection

Risk Assessment and Fraud	8-2
Management Is Responsible for Fraud Detection	8-2

Exhibit 8.1: Characteristics of Fraud Opportunities	8-5
Developing a Risk Assessment Approach.....	8-6
Risk Identification	8-6
Risk Measurement	8-7
Risk Prioritization.....	8-8
Exhibit 8.2: Fraud Risk Assessment Matrix.....	8-9
Profile of Fraud Criminals	8-10
Fraud Perpetrators.....	8-10
Dealing with Fraud Risks.....	8-11
Personally Created Opportunities	8-11
Organizationally Created Opportunities	8-12
Internal Auditors Must Consider All Fraud Risks.....	8-12
Motives for Committing Fraud	8-12
Fraud Deterrence	8-13
Internal Auditor’s Role in Deterrence of Fraud.....	8-13
The Internal Auditor’s Role in the Detection of Fraud.....	8-14
Varieties of Fraud Deterrent.....	8-14
Bank Secrecy Act /Anti-Money Laundering and Fraud Detection Compliance	8-16
Requirements.....	8-17
Communication of Supervisory Concerns	8-18
Enforcement Actions	8-18
1. Failure to Establish and Maintain a Program	8-19
Violation Examples.....	8-19
2. Failure to Correct a Previously Reported Problem.....	8-20
3. Other Enforcement Actions.....	8-22
BSA Reporting and Recordkeeping Requirements.....	8-22
Suspicious Activity Reporting	8-22
Other Requirements	8-23
Enforcement Actions for Non-Program BSA/AML Requirements	8-24
Conditions Conducive to Fraud	8-24
Indicators of Poor Controls	8-26
Fraud Detection Techniques	8-28
Deterrents to Detecting Fraud	8-30
If Fraud Is Discovered	8-30
Fraud Investigations	8-31
Step 1 — Conduct Initial Interview.....	8-32
Step 2 — Gather Information.....	8-32
Step 3 — Get a Confession	8-33
Forensic and Expert Evidence.....	8-35
Prosecution	8-36
Examples of Fraud	8-36
Warning Signs.....	8-36
Sample Loan Fraud Cases.....	8-41
Case No. 1: Making Fraudulent Personal Loans.....	8-41

Case No. 2: Making Fraudulent Student Loans.....	8-42
Case No. 3: Lapping Installment Loan Payments.....	8-43
Case No. 4: Withholding Consumer Loan Payments.....	8-44

Administration

CHAPTER 9

Internal Audit Administration — Making a New Start with Risk Based Auditing

Selling Internal Audit	9-1
Developing a High Impact Audit Department	9-2
Setting Standards and Expectations	9-3
Establishing a Measurement System for Audit Effectiveness	9-4
Using Creative Thinking to Identify Potential Problems and Opportunities	9-5
Perform a Post-Audit Self-Evaluation	9-6
Administering the Internal Audit Function	9-8
Regulatory Requirements	9-8
Expanded Responsibilities	9-9
Ensuring Adequate Scope of Coverage	9-10
Maintaining Effective Internal Audit Programs	9-11
Developing Effective Audit Reports	9-13
Audit Report Outline.....	9-14
Preparing the Audit Report	9-15
Establishing a Preferred Writing Style.....	9-15
Writing Audit Report Comments.....	9-16
Preparing Effective Recommendations	9-17
Developing Paper Documentation Standards	9-18
Establishing Effective Audit Committee Communications	9-19
Developing an Internal Audit Policy	9-19
Exhibit 9.1: Sample Internal Audit Policy on CD.....	9-21

Outsourcing

CHAPTER 10

Outsourcing the Internal Audit Function

Evaluating Proposals for Outsourced Internal Audit Services	10-1
Exhibit on CD Only	10-2
Exhibit 10.1: Request for Proposal for Internal Audit Services	

Case Study

CHAPTER 11

Conducting a Risk Based Audit — A Case Study

Case Study — Aggressive Bank’s Lending Risk	11-1
Using Audit Procedures to Obtain the Desired Level of Audit Assurance	11-4
Exhibit 11.1: Assessment of Audit Risk and the Amount of Audit Evidence Required.....	11-5
Exhibit 11.2: Planned Audit Assurance Matrix	11-10
Exhibit 11.3: Audit Evidence Mix	11-11
Conducting a Risk Based Audit of the Credit Scoring Process	11-11
Credit Scoring Process Risk Based Audit	11-12
Audit Report	11-16
Exit Meeting	11-18
Audit Committee Update	11-18