

How to Use This Manual

Examining banks for their safety and soundness is the number one concern of federal regulators. And a key way bankers are being asked to demonstrate their safety and soundness is with a complete set of policies and procedures for every operating area of their bank. In addition, the board of directors must approve these policies and procedures.

The responsibilities of banks and their chief executive officers (CEOs) and boards of directors, however, do not stop there. Senior management and the board have the additional responsibility of making sure that the policies and procedures they have adopted are in fact being carried out as they were approved. And the only way this can be done is by conducting periodic internal audits of each of the areas for which the bank has adopted policies and procedures.

There's no way around it – bank examiners are pushing for written policies and procedures and regular internal audits. Policies, procedures, and internal audits have been identified as a key for heading off trouble before it happens, and pushing the board of directors to increase oversight is viewed as an additional safeguard. Complaints of having one more regulatory burden heaped on you or the unavailability of trained bank personnel won't be accepted.

Bank Internal Audit: A Working Guide to Regulatory Compliance is designed as the final link in the policies, procedures, and internal auditing process. Sheshunoff already publishes separate manuals on bank policies and procedures, and this manual provides a complete set of internal auditing procedures.

Bank Internal Audit: A Working Guide to Regulatory Compliance provides sample internal audit procedures for each functional area of the bank. You can use *Bank Internal Audit* alone, as a comprehensive source for bankwide audit procedures, or you can use it along with *Bank Policies: A Working Guide to Regulatory Compliance* and *Bank Procedures: A Working Guide to Regulatory Compliance* (both published by Sheshunoff Information Services), which include policies and procedures for the same areas as *Bank Internal Audit*. All three books are organized by functional area to make it easy to go back and forth among them. Or, again, each book can be used independently of the others.

The manual is divided into the following parts:

- The process of developing internal audit procedures
- Sample internal audit procedures
- Appendix

Each part is described below.

PART I: DEVELOPING INTERNAL AUDIT PROCEDURES

There are four chapters in this part.

- Chapter 1, An Overview of the Internal Audit Function, provides an overview of the importance of the internal audit function, focusing on:
 - Why the board of directors needs an independent source of testing

- What the board of directors, through an internal audit function, is seeking in terms of advisory insights or reporting

The chapter also discusses the role of the internal auditor, the specific importance of independent auditors, and the banking regulators' emphasis on valid, independent internal audit.

- Chapter 2, *Organizing the Internal Audit Function*, directs you in developing internal audit policies, drafting an internal auditor's job description, developing the organizational design of an audit program, and identifying staffing requirements. This chapter also addresses the position of part-time internal auditor and how this position affects the job at hand. Reporting requirements also are provided.
- Chapter 3, *Developing Audit Scope*, helps you set audit objectives. This discussion considers the effects of several variables on setting these objectives, including the bank's environment, both internal and external. Understanding audit risk and how to assess it to identify the scope of your audit objectives also is discussed. This chapter ends with a discussion about other issues affecting scope coverage, such as cost/benefit evaluations, frequency and amount of coverage, and the types of tests that can be performed.
- Chapter 4, *Preparing Internal Audit Procedure Work Papers, Performing Audit Sampling, and Using Internal Audit Policy Checklists*, instructs you on how to use the sample internal audit procedures in Part II as your work papers. More specifically, you learn how to classify the different tasks set forth in the audit procedures, how to organize them in a filing system, and when and where to store them. The last section of this chapter concentrates on sampling techniques to use.

PART II: SAMPLE INTERNAL AUDIT PROCEDURES

Part II contains the sample internal audit procedures and audit checklists for each primary functional area of a bank. You can use these or modify them as you see fit. These functional areas are:

- Executive
- Lending
- Finance
- Operations
- Data Processing

Sample Internal Audit Procedures

The audit procedures should be used as a starting point from which you can then tailor them to meet your bank's own specific situation or requirements. Each procedure includes the following components:

- *Audit Objectives*. These are the internal auditor's objectives. Generally, they ensure that the policies and procedures are in writing, are supported by management, and are implemented effectively.
- *Scope*. The scope primarily covers the areas the internal auditor will address under the specific policy.
- *Internal Audit Procedures*. These are the detailed audit procedures to be implemented. They fall into the categories listed under Scope.
- *Performed by, Reviewed by, W/P Reference*. This information appears at the upper right-hand corner of every page. It should be completed by the appropriate individuals.
- *Date Completed*. Each task outlined under the internal audit procedures should be dated as completed.

Sample Internal Audit Checklists

There is a similarity between the audit procedures and the audit checklists; however, some auditors prefer one format over the other. In order to keep your print manual to a manageable size, but also provide you the option of using them in your audit function, the audit checklists are included on the CD that accompanies this manual. Load the files onto your desktop computer, and you can easily customize and print internal audit checklists by topic or functional area.

PART III: APPENDIX

The appendix includes copies of major discussion or position documents, which underscore the importance of the internal audit function. These documents are important reference materials, which are available on the CD that accompanies this manual.

- *Appendix A.* FDIC FIL-96-99, 10-25-99 RE: Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations
- *Appendix B.* Comptroller of the Currency's *Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks*. This contains specific commentary referring to the correlation between problem and/or failed banks and the absence of sound internal audit policies, procedures, and controls.
- *Appendix C.* Comptroller of the Currency *Internal and External Audit Policy*. This is a checklist to be used for evaluating an external and internal audit policy.
- *Appendix D.* *Comptroller's Handbook for National Bank Examiners*, sections 502.1 through 502.4.
- *Appendix E.* OCC Bulletin OCC 2003-12, 3-17-2003 RE: Interagency Policy Statement on Internal Audit and Internal Outsourcing: Revised Guidance.

These references plus others are provided in the appendix and underscore the increased emphasis on internal bank audit coverage by bank regulatory agencies. In addition, various regulatory agencies like the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have adopted a regulatory risk evaluation approach when rating management. Specifically, the "M" component of the CAMEL rating is receiving a much more thorough review by examiners. The appendix details information noted in the *Comptroller's Handbook for National Bank Examiners*, section 502.1, regarding the examination of the "M" elements, particularly controls testing (e.g., internal audit function).

YOUR COMPANION CD

As part of your subscription to *Bank Internal Audit* you receive a companion CD. This disc contains all of the information in your print manual that shows you how to make sure your policies and procedures are being followed and accomplishing what they were intended to do.

Insert your CD into your desktop computer, and the autoplay feature will assist you in navigating the files. You can search quickly and easily for specific guidance and audit procedures.

Customize Your Audit Procedures

From credit risk to integrated financial software systems, the CD contains sample procedures for every key area of the bank, checklists, examples of documentation, and clear guidelines you can use for your own internal audit of your operation.

You can easily customize the documents on the CD using Microsoft Word so that you keep your audit function current with the latest compliance issues. Sample internal audit procedures are provided for each key area that you can easily adapt to your bank's specific requirements.