

Internal Audit Excellence in Credit Unions

Navigating NCUA Guidelines

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The role of the internal auditor in a credit union, as outlined by the National Credit Union Administration (NCUA) Supervisory Committee Handbook, involves several *key functions* and *best practices* for evaluation and interaction with the supervisory committee.

The following slide outline is a structure of these expectations, which we will discuss during this session

01. Expected Functions of the Internal Auditor
02. Evaluation of the Internal Audit Function by the Supervisory Committee
03. Expected Interactions Between the Internal Auditors and the Supervisory Committee
04. Reporting Structure

Per the NCUA Supervisory Committee Handbook....

The Expected Functions of the Internal Auditor should address:

- 1. Risk Assessment and Management**
- 2. Internal Controls Evaluation**
- 3. Compliance Monitoring**
- 4. Financial Audits**
- 5. Operational Audits**
- 6. Fraud Detection and Prevention**

Risk Assessment and Management

Conducting a risk assessment and evaluating management involves several key steps to be considered:

- **Understand the Business Environment:**
 - Gather information on the credit union's operations, objectives, and regulatory requirements.
 - Identify key stakeholders and their expectations.
- **Identify Risks:**
 - Conduct interviews and workshops with management and staff to identify potential risks.
 - Review previous audit reports, financial statements, and industry trends for insights into existing and emerging risks.
- **Assess Risk Impact and Likelihood:**
 - Evaluate the potential impact of identified risks on the credit union's objectives.
 - Assess the likelihood of occurrence using qualitative and quantitative methods.
- **Prioritize Risks:**
 - Rank risks based on their impact and likelihood to determine which require immediate attention.
 - Use a risk matrix to visualize and prioritize risks effectively.
- **Evaluate Existing Controls:**
 - Review current control measures in place to mitigate identified risks.
 - Assess the effectiveness and efficiency of these controls.
- **Develop Audit Plan:**
 - Create an audit plan that focuses on high-priority risks and areas with inadequate controls.
 - Ensure the plan aligns with the credit union's strategic goals and regulatory requirements.
- **Communicate Findings:**
 - Present risk assessment results and audit plan to management and the board.
 - Discuss potential improvements and recommendations for risk management.
- **Monitor and Review:**
 - Implement a process for continuous monitoring of risks and controls.
 - Regularly review and update the risk assessment to reflect changes in the business environment.
- **Training and Awareness:**
 - Conduct training sessions for staff on risk management practices and the importance of internal controls.
 - Promote a culture of risk awareness throughout the organization.

Internal Controls Evaluation

Evaluating internal controls is a critical function of an internal audit in a credit union.

- **Define Objectives:**
 - Establish clear objectives for the evaluation of internal controls, aligned with the credit union's strategic goals and regulatory requirements.
- **Understand Processes and Controls:**
 - Map out key processes and identify existing controls within those processes.
 - Gather documentation and conduct interviews to understand how controls are implemented.
- **Risk Assessment:**
 - Identify risks associated with each process and evaluate the adequacy of controls in mitigating those risks.
 - Use risk assessment findings to focus on areas with higher risk exposure.
- **Test Controls:**
 - Develop testing procedures to assess the design and operating effectiveness of controls.
 - Perform walkthroughs and sample testing to verify control functionality.
- **Evaluate Control Design:**
 - Assess whether controls are appropriately designed to achieve their intended objectives.
 - Identify any gaps or weaknesses in control design.
- **Assess Control Effectiveness:**
 - Determine if controls are operating as intended and consistently applied.
 - Evaluate the frequency and reliability of control operations.
- **Document Findings:**
 - Record observations, testing results, and any identified deficiencies.
 - Provide clear and concise documentation to support audit conclusions.
- **Communicate Results:**
 - Present findings to management and the board, highlighting strengths and areas for improvement.
 - Offer recommendations for enhancing control effectiveness and addressing deficiencies.
- **Follow-Up:**
 - Establish a process for monitoring the implementation of recommendations.
 - Schedule follow-up audits to ensure corrective actions are taken and controls are improved.
- **Continuous Improvement:**
 - Encourage ongoing review and enhancement of internal controls.
 - Promote a culture of continuous improvement and risk awareness within the credit union.

Compliance Monitoring

Creating an effective compliance monitoring system is essential for ensuring that a credit union adheres to regulatory requirements and internal policies.

- **Define Compliance Objectives:**
 - Clearly articulate the objectives of the compliance monitoring system in alignment with regulatory requirements and the credit union's strategic goals.
- **Understand Regulatory Requirements:**
 - Identify and document all relevant laws, regulations, and internal policies.
 - Stay updated on regulatory changes that may impact compliance obligations.
- **Risk Assessment:**
 - Conduct a compliance risk assessment to identify areas with higher risk exposure.
 - Prioritize compliance areas based on the potential impact and likelihood of non-compliance.
- **Develop Monitoring Plan:**
 - Create a comprehensive compliance monitoring plan that outlines the scope, frequency, and methods of monitoring activities.
 - Ensure the plan covers all critical compliance areas identified in the risk assessment.
- **Establish Monitoring Procedures:**
 - Develop standardized procedures for monitoring compliance, including checklists and testing protocols.
 - Use a combination of automated tools and manual processes to ensure thorough coverage.
- **Conduct Training and Awareness:**
 - Provide training sessions for staff on compliance requirements and the importance of adherence and fostering a culture of compliance awareness throughout the organization.
- **Perform Monitoring Activities:**
 - Execute monitoring activities according to the established plan, using both real-time and periodic reviews, and document findings and any instances of non-compliance.
- **Evaluate and Report Findings:**
 - Analyze monitoring results to assess the effectiveness of compliance controls.
 - Prepare reports for management and the board, highlighting compliance status and areas needing improvement.
- **Implement Corrective Actions:**
 - Work with management to develop and implement corrective actions for identified compliance issues, and track the progress of corrective actions to ensure timely resolution.
- **Continuous Improvement:**

- Regularly review and update the compliance monitoring system to reflect changes in regulations and business operations.
- Encourage feedback and suggestions for improving the monitoring process.

Financial Audits

Oversight of financial audits is a crucial responsibility of the internal audit function in a credit union to ensure accuracy, transparency, and compliance with financial reporting standards.

- **Establish Audit Objectives:**
 - Define clear objectives for the oversight of financial audits, ensuring alignment with the credit union's strategic goals and regulatory requirements.
- **Understand Financial Reporting Requirements:**
 - Familiarize with relevant accounting standards, regulatory requirements, and internal financial policies applicable to the credit union.
- **Plan the Audit Oversight:**
 - Develop an oversight plan that outlines the scope, objectives, and timeline for reviewing financial audits.
 - Coordinate with external auditors to understand their audit plan and approach.
- **Evaluate Audit Processes:**
 - Review the methodologies and procedures used by external auditors to ensure they are comprehensive and adhere to professional standards.
 - Assess the adequacy of audit coverage in relation to identified risk areas.
- **Monitor Audit Execution:**
 - Observe audit activities to ensure they are conducted according to the plan and within the agreed timeline.
 - Facilitate communication between external auditors and internal stakeholders.
- **Review Audit Findings:**
 - Analyze audit reports and findings to assess the accuracy and completeness of financial statements.
 - Identify any discrepancies or areas requiring further investigation.
- **Assess Internal Controls:**
 - Evaluate the effectiveness of internal controls related to financial reporting and identify any weaknesses or gaps.
 - Ensure that controls are sufficient to prevent and detect errors or fraud.
- **Communicate Results:**
 - Prepare a summary report for management and the board, highlighting key audit findings and recommendations.
 - Discuss potential improvements and corrective actions needed to address identified issues.
- **Follow-Up on Recommendations:**

- Monitor the implementation of audit recommendations and corrective actions.
 - Schedule follow-up reviews to ensure that issues are resolved and improvements are sustained.
- **Continuous Improvement:**
 - Encourage ongoing evaluation and enhancement of financial audit processes.
 - Promote a culture of transparency and accountability in financial reporting.

Operational Audits

Oversight and performance of operational audits by an internal audit function in a credit union are essential to ensure efficiency, effectiveness, and compliance with policies and procedures.

- **Define Audit Objectives:**
 - Establish clear objectives for operational audits.
- **Understand Operational Processes:**
 - Gain a thorough understanding of key operational processes and workflows.
 - Identify critical areas and functions that significantly impact operational performance.
- **Conduct Risk Assessment:**
 - Perform a risk assessment to identify operational risks and prioritize areas for focus.
 - Use the assessment to guide the scope and depth of the audit.
- **Develop Audit Plan:**
 - Create a detailed audit plan outlining the scope, objectives, methodology, and timeline for the audit.
 - Ensure the plan addresses high-risk areas and includes relevant operational aspects.
- **Gather and Analyze Data:**
 - Collect relevant data and documentation to support the audit process.
 - Use analytical tools and techniques to assess operational performance and identify trends or anomalies.
- **Evaluate Internal Controls:**
 - Assess the effectiveness and efficiency of internal controls within operational processes.
 - Identify control weaknesses or gaps that may impact operational performance.
- **Perform Audit Testing:**
 - Conduct audit testing to verify the accuracy and reliability of operational processes.
 - Use sampling to ensure comprehensive coverage and validation of findings.
- **Document Findings:**
 - Record audit observations, findings, and any identified issues in a clear and structured manner.

- Provide evidence to support audit conclusions and recommendations.
- **Communicate Results:**
 - Prepare a report for management and the board, summarizing audit findings and recommendations.
 - Highlight areas for improvement and discuss potential solutions.
- **Implement Recommendations:**
 - Work with management to develop and implement corrective actions for identified issues.
 - Monitor the progress of implementation to ensure timely resolution.
- **Continuous Improvement:**
 - Encourage ongoing review and enhancement of operational processes and controls.
 - Promote a culture of efficiency and effectiveness throughout the organization.

Fraud Detection and Prevention

- **Establish a Fraud Risk Management Framework:**
 - Develop a comprehensive fraud risk management policy that outlines the credit union's approach to preventing and detecting fraud.
 - Ensure the framework aligns with the credit union's overall risk management strategy.
- **Conduct Fraud Risk Assessment:**
 - Identify and assess potential fraud risks across various functions and processes.
 - Prioritize risks based on their likelihood and potential impact.
- **Implement Strong Internal Controls:**
 - Design and implement robust internal controls to prevent and detect fraud activities.
 - Regularly review and update controls to address emerging fraud risks.
- **Promote a Culture of Integrity:**
 - Foster a culture that emphasizes ethical behavior and zero tolerance for fraud.
 - Encourage employees to adhere to the code of conduct and ethical standards.
- **Provide Fraud Awareness Training:**
 - Conduct regular training sessions for employees on recognizing and reporting fraudulent activities.
 - Educate staff on common fraud schemes and red flags to watch for.
- **Establish a Whistleblower Program:**
 - Implement a confidential reporting mechanism for employees and stakeholders to report suspected fraud.
 - Ensure protection against retaliation for whistleblowers.
- **Perform Data Analytics:**
 - Use data analytics tools to identify unusual patterns or anomalies that may indicate fraudulent activities.

- Conduct continuous monitoring of transactions and activities for signs of fraud.
- **Conduct Fraud Audits:**
 - Consider Including targeted fraud audits in the internal audit plan, high-risk areas.
 - Use forensic audit techniques to investigate suspected fraud incidents.
- **Investigate Allegations Promptly:**
 - Establish a protocol for investigating fraud allegations swiftly and thoroughly.
 - Collaborate with legal and compliance teams as necessary during investigations.
- **Report and Remediate:**
 - Document and report findings of fraud investigations to management and the board.
 - Work with management to implement corrective actions and strengthen controls to prevent recurrence.
- **Review and Improve:**
 - Regularly review the effectiveness of fraud detection and prevention measures.
 - Continuously improve strategies and controls based on lessons learned and industry best practices.

Per the NCUA Supervisory Committee Handbook....

An Effective Evaluation by the Supervisory Committee of the Internal Audit Function Should Consider:

1. **Performance Metrics**
2. **Audit Quality**
3. **Follow-up on Recommendations**

Performance Metrics

When evaluating the effectiveness of the internal audit function, a Supervisory Committee should consider a range of performance metrics, such as:

- **Audit Coverage:**
 - Percentage of high-risk areas audited annually.
 - Number of audits completed versus planned audits.
- **Audit Quality:**
 - Accuracy and reliability of audit findings.
 - Frequency of audit recommendations accepted and implemented by management.
- **Timeliness:**
 - Average time taken to complete audits.
 - Timeliness of reporting audit findings to management and the board.
- **Resource Utilization:**
 - Efficiency in the use of audit resources (e.g., staff hours, budget).
 - Ratio of audit staff to auditable entities or processes.
- **Compliance and Risk Management:**
 - Effectiveness in identifying and mitigating compliance and operational risks.
 - Number of compliance violations or incidents detected through audits.
- **Follow-Up and Resolution:**
 - Percentage of audit recommendations successfully implemented.
 - Time taken to resolve audit findings and implement corrective actions.
- **Continuous Improvement:**
 - Evidence of ongoing improvements in audit processes and methodologies.
 - Adoption of best practices and innovative audit techniques.
- **Professional Development:**
 - Investment in training and development of audit staff.
 - Certifications and qualifications held by audit team members.

Audit Quality

When evaluating the effectiveness of an internal audit function, a Supervisory Committee should consider various indicators of audit quality. These indicators can be categorized into **POSITIVE** and **NEGATIVE** aspects:

Positive Indicators of Audit Quality:

- **Comprehensive Audit Coverage:**
 - Audits effectively cover all high-risk areas and critical processes within the credit union.
 - The audit plan is aligned with the credit union's strategic objectives and risk profile.
- **Accuracy and Reliability:**
 - Audit findings are accurate, well-supported by evidence, and provide reliable insights into the credit union's operations.
 - Reports are free from significant errors or omissions.
- **Timely Reporting:**
 - Audit reports are delivered promptly, allowing management to address issues in a timely manner.
 - The audit function adheres to the planned audit schedule without significant delays.
- **Constructive Recommendations:**
 - Recommendations are practical, actionable, and contribute to process improvements and risk mitigation.
 - Management values and implements audit recommendations, indicating their relevance and usefulness.
- **Strong Stakeholder Relationships:**
 - Positive feedback from management and the board regarding the audit function's contributions and collaboration.
 - The audit team maintains open and effective communication with stakeholders.
- **Continuous Improvement:**
 - The audit function regularly updates its methodologies and practices to incorporate industry best practices and emerging risks.
 - Evidence of ongoing professional development and training for audit staff.

Negative Indicators of Audit Quality:

- **Inadequate Audit Coverage:**
 - Key risk areas or critical processes are consistently overlooked or inadequately audited.
 - The audit plan lacks alignment with the credit union's risk priorities.
- **Inaccurate or Unreliable Findings:**

- Audit reports contain errors, inconsistencies, or lack sufficient evidence to support conclusions.
 - Findings are frequently disputed by management due to inaccuracies.
- **Delayed Reporting:**
 - Audit reports are consistently delayed, hindering timely corrective actions by management.
 - The audit function frequently misses deadlines or fails to complete audits as scheduled.
- **Vague or Impractical Recommendations:**
 - Recommendations are unclear, not actionable, or fail to address root causes of identified issues.
 - Management frequently disregards audit recommendations due to perceived lack of value.
- **Poor Stakeholder Engagement:**
 - Negative feedback from management or the board regarding the audit function's effectiveness or communication.
 - The audit team struggles to maintain productive relationships with key stakeholders.
- **Lack of Adaptation and Growth:**
 - The audit function shows little evidence of adapting to changes in the regulatory environment or industry practices.
 - Limited investment in the professional development of audit staff.

Follow-up on Recommendations

An effective system for follow-up on audit recommendations is crucial for ensuring that identified issues are addressed and improvements are implemented.

Indicators of an Effective Follow-Up System:

- **Structured Follow-Up Process:**
 - There is a clearly defined process for tracking and following up on audit recommendations, including timelines and responsibilities.
 - The process is documented and consistently applied across all audits.
- **Timely Implementation:**
 - Recommendations are addressed within the agreed-upon timeframe, demonstrating prompt action by management.
 - The audit function regularly monitors recommendations to ensure timely resolution.
- **Comprehensive Tracking System:**
 - A centralized tracking system is in place to record all audit recommendations and their implementation status.

- The system allows for easy access and review by relevant stakeholders, including management and the board.
- **Regular Reporting:**
 - The audit function provides regular updates to management and the Supervisory Committee on the status of recommendation implementation.
 - Reports highlight any delays or challenges in implementing recommendations, along with proposed solutions.
- **Management Accountability:**
 - Management demonstrates accountability by actively participating in the follow-up process and prioritizing the implementation of recommendations.
 - There is clear ownership of recommendations, with designated individuals responsible for implementation.
- **Effective Communication:**
 - The audit function maintains open communication with management to discuss progress, challenges, and any adjustments needed for implementation.
 - Feedback from management is incorporated into the follow-up process.
- **Resolution of Issues:**
 - Recommendations lead to tangible improvements in processes, controls, or risk management, indicating successful resolution of identified issues.
 - Audit verifies that implemented actions effectively address the root causes of issues.
- **Continuous Improvement:**
 - Lessons learned from the follow-up process are used to enhance future audits and recommendation tracking.
 - The audit function regularly reviews and refines its follow-up procedures to ensure ongoing effectiveness.

Per the NCUA Supervisory Committee Handbook....

Interaction between the Supervisory Committee and the Internal Audit Function should focus on:

1. Regular Communication

- Maintain open lines of communication with the supervisory committee.
- Provide regular updates on audit findings, risk assessments, and compliance issues.

2. Reporting

- Submit detailed audit reports to the supervisory committee for review.
- Discuss significant findings and recommendations in meetings.

3. Advisory Role

- Serve as an advisor to the supervisory committee on matters of risk management and internal controls.
- Provide insights and recommendations for improving governance and oversight.

Reporting Structure

Direct Reporting Line

- As a best practice per NCUA guidelines, the internal audit function should report directly to the Supervisory Committee. This ensures independence and objectivity in the audit process.
- The internal auditor should have unrestricted access to the Supervisory Committee to discuss any concerns or findings.

These guidelines ensure that the internal audit function effectively supports the credit union's governance framework, enhances risk management, and promotes accountability and transparency.