Comptroller of the Currency
Administrator of National Banks

Thank you for participating in our November 1, 2000 Telephone Seminar, *Issues in Community Bank Audit and Internal Controls: The OCC Approach.* Following are questions submitted by seminar participants along with the OCC's responses. Please submit a question to our Telephone Seminar Mailbox.

Q&As
OCC Telephone Seminar, "Issues in Community Bank Audit and Internal Controls: The OCC Approach"

Q1. How do I order certain reference materials mentioned during the seminar.

Response:

1) The "National Bank Director's Toolkit" package was sent to the chairpersons of all national banks in September. That packet contained the following publications:
   - *Red Flags in Board Reports – A Guide for Directors*
   - "A Pocket Guide to *Red Flags in Board Reports*"
   - "Internal Controls – A Guide for Directors"
   - *The Director's Book – The Role of a National Bank Director*

   The packet should have also included an order form for additional copies of the publications. Attached to this message is an electronic version of the order form. Please print the order form, fill it out, and mail it to the address indicated to order additional copies of the publications included in the Toolkit. You can also find the publications on the OCC's Web site at www.occ.treas.gov/toolkit.htm.

2) During the first quarter of 2001, the OCC will send all national banks a CD for bankers, called "e-files." To request additional copies of the CD when they become available, send your request and payment of $10 each to: Comptroller of the Currency, P.O. Box 70004, Chicago, IL, 60673-0004.

3) Audiocassette tapes and written transcripts of the seminar can be ordered from the seminar's vendor, KRM, at https://www.krm.com/regonline/occvcregs.nsf/occ5894-0.

Q2. Is there any intention to define specifically the assessments of internal audit (strong, satisfactory, and weak), or will it remain under the subjectivity of the examiner?

Response:
The OCC has developed a rating matrix that is now being field-tested by our community bank examiners in assessing audit. A final version will be included in the revised "Community Bank Supervision" booklet of the *Comptroller's Handbook.* We expect that booklet to be published early in 2001.

Q3. During the seminar, someone mentioned that when a function is outsourced, a person (i.e., audit manager or some other title) should be designated to review internally the scope of work, reports, etc.

1. Isn't this the responsibility of the audit committee?
2. Doesn't this imply a certain level of expertise about internal auditing and what would be relevant scopes of work? How can a person make those determinations if no one in management has that background, which is probably one reason that internal audit was outsourced initially?
3. Doesn't this raise issues of independence since that person is probably in charge of some operations areas that will be audited? That person could affect the scope/report if he or she is responsible for reviewing those items.

The new guidance for audit committees relates to the independence and technical competence of its committee members. Therefore, this approach of appointing a person at the management level seems to contradict the efforts related to audit committee governance.

Response:
You are correct, an institution's board of directors must ensure that all internal audit outsourcing or cosourcing of internal audit activities are managed competently, and they may choose to delegate management responsibilities to an audit committee or management. The OCC believes that a bank should designate an employee, who is independent, as responsible for managing the outsourced relationship with the outside firm or vendor and to report to the board or its audit committee. That belief is based on AICPA interpretation (101-13) and rulings (101, 103, 104, and 105), and a December 22, 1997 interagency policy statement on the internal audit function and its outsourcing. We realize and accept that small community banks, lacking sufficiently experienced or knowledgeable staff, may have to rely on the board of directors or an audit committee to deal directly with the outsourced vendor. However, we expect, and it is quite common, that larger and more complex banks will have a person or staff designated to manage outsourced internal audit activities. The "Internal and External Audits" booklet of the *Comptroller's Handbook* provides further detail on our policy guidance pertaining to outsourced internal audit. You can find this booklet on our Web site (www.occ.treas.gov).

Q4. During the seminar, several Internet sites were mentioned that may be helpful to internal control within a bank. Could you please repeat those sites? They were given too quickly during the seminar for me to copy correctly.

Response:
The specific Web sites mentioned during the seminar were:
www.sec.gov – Securities and Exchange Commission
www.aicpa.org – American Institute of Certified Public Accountants
www.cpaindependence.org – Independence Standards Board
www.theiia.org – The Institute of Internal Auditors

You can access OCC publications and issuances, including those that pertain to audit and control, at the OCC's Web site (www.occ.treas.gov).

Q5. How many of the listing sites for the telephone seminar were reserved for OCC personnel compared with those purchased by banking offices, etc.? Our bank is preparing for an examination to be commenced in January 2001, and some of the information given during the seminar is updated from what we have been doing in the past. Will the examiners for our bank be up to speed?

Response:
There were two sites devoted to OCC headquarters personnel; OCC field staff did not listen to the call. The philosophies and concepts presented during the seminar form the foundation of the revised community bank audit and control examination procedures and supplemental training provided to our community bank examiners in the second quarter of 2000. In August, our examiners received copies of the new "Internal and External Audits" booklet. We are also making the transcript and audiocassette of the seminar available to our examiners. Your examiners will be familiar with the OCC's reemphasis on audit and control.

Q6. Could the OCC furnish a more detailed outline of the seminar format? The handout received prior to the seminar was too vague, and key points made during the seminar were missed because there was not enough time to take adequate notes.

Response:
We do not have a more detailed outline of the seminar. However, audiocassette tapes and written transcripts of the seminar can be ordered from the seminar's vendor, KRM, at https://www.krm.com/regonline/occvcregs.nsf/occ5894-0. If you order the audiocassette or transcript, you should receive them within two weeks of the order date. Those documents will provide you with the full details of the seminar discussion.

Q7. Is the OCC's internal control guidance (i.e., handbook and internal control questionnaires [ICQs]) all that an audit department needs? Or are these only guidelines, and a bank would need more in-depth ICQs? Getting a good set of ICQs and keeping them current has always been a problem.

Response:
The OCC's Internal Control handbook, the National Bank Director's Toolkit, and other booklets and ICQs in the Comptroller's Handbook provide a good foundation for a bank's internal audit department. However, an internal audit department should adapt and apply the guidance to the bank's particular circumstances (i.e., its size, the nature of its activities, and its risk profile). In some cases, more in-depth ICQs and procedures may be needed for some areas. The internal auditor may want to contact the bank's external audit firm or other industry group for additional guidance (e.g., the AICPA's Audit and Accounting Guide for Banks and Savings Institutions, industry internal audit manuals, etc.).

Q8. Does the OCC require or only recommend highly that bank staff take two consecutive weeks of vacation or be out of the bank for two consecutive weeks? Should this apply to the entire bank staff or only to certain positions?

Response:
The OCC considers as sound control activities vacation requirements that employees be absent from the bank for at least a consecutive two-week period each year. We recommend highly that national banks have such controls in place. The OCC recognizes that, for some community banks with small staff, this may be difficult. In such cases, banks should be concerned primarily about bank staff in sensitive positions or involved in risk-taking activities having influence or control over financial records and access to assets (e.g., areas such as information processing or investment or trading activities). Unannounced rotation of duties is a control that might be useful in small community banks.

Q9. Are there any guidelines for the performance of the self-assessment of internal controls? How often should it be performed B monthly, quarterly, semi-annually, or annually?

Response:
Guidance on control self-assessment can be obtained from several sources: Committee of Sponsoring Organizations of the Treadway Commission (COSO) "Internal Control – Integrated Framework" report, Volume 2, *Framework*; the Institute of Internal Auditors; your external audit firm; or other industry publications and organizations. The extent to which control self-assessment is implemented, including frequency, depends on a bank's size, the nature and complexity of its activities, and its risk profile.

Q10. Is a bank which has less than $500 million in total assets and which is an affiliate of a multi-billion dollar bank subject to FDICIA requirements?

Response:
No, an insured affiliate bank with total assets less than $500 million as of the beginning of its fiscal year is not subject to the requirements of FDICIA (i.e., 12 CFR 363).

Q11. What would the OCC consider an adequate-sized internal audit staff? Our bank was acquired recently by a multi-bank holding company with eight affiliates, each having multiple branches. The audit function is consolidated under the bank holding company.

Response:
There is no hard and fast rule for the size of an internal audit staff. OCC examiners consider several factors when assessing the adequacy of the size of internal audit staff. Those factors include vacancies in approved staff levels, turnover rates, whether annual audit plans, audit cycles and other established audit goals are being met, and whether audit work is being completed in an effective and timely manner. Having the internal audit function centralized at the holding company level is a common and acceptable practice.

Q12. How does the OCC determine whether a bank's board of directors knows its responsibilities? How can a bank's internal auditor verify the training that board members have received and the materials that have been provided?

Response:
The OCC's review of a bank's audit function is intended to determine whether the board or its audit committee effectively oversees that function in accordance with statutory requirements and regulatory guidance (e.g., 12 CFR 30, 12 CFR 363, interagency policy statements, etc.). For example, examiners read board/committee minutes for discussion of audit issues and approvals of audit policies, annual audit plans, etc., including any documentation supporting the board's determination that audit committee members meet requirements of 12 CFR 363 if applicable. Examiners also review audit information presented to the board or audit committee and actions taken by the board or audit committee on audit issues, reports, and information, including the timeliness of follow-up on audit or control weaknesses/deficiencies. Examiners also meet with the board or audit committee to discuss examination findings.

Internal auditors should be able to gain access to all records, files, data and other information necessary to conduct an audit properly and determine compliance with laws and regulations, including audit committee membership requirements.

Q13. Does the OCC view the internal and external audit functions as being different, i.e., approaches to audit, audit scope, and areas audited?

Response:
Yes. Internal audit's primary role is to review and evaluate independently and objectively bank activities to help maintain or improve the efficiency and effectiveness of a bank's risk management, internal control, and corporate governance. External auditors generally focus on auditing and reporting on a bank's financial statements and the controls over financial reporting.

Q14. Does the OCC have any advice for bank internal auditors in dealing with bank management on audit findings and internal controls?

Response:
The authorities and responsibilities of internal auditors, as well as management accountability for addressing audit or control weaknesses, should be established by the board of directors or its audit committee and communicated to all bank personnel. Clear communication between the board, internal auditors, and management is critical to timely identification and correction of audit or control weaknesses. Internal auditors should meet with the appropriate level of management to review draft audit reports, correct any inaccurate information in the report, and reach agreement on management's commitments and actions to address any noted weaknesses. A copy of the final audit report should be given to the management official authorized and responsible for implementing agreed-upon corrective action, and management should respond in writing on corrective action taken on weaknesses noted in the report. The internal auditor should perform follow-up activities to confirm the status and effectiveness of corrective actions and report results of those follow-up activities to the board or its audit committee.

Q15. Does the OCC have a regulation on the frequency of internal audit examinations to be performed by the financial units and, if so, could I ask you to please quote the section of the OCC regulation, so that we would be able to refer to it.

Response:
Except for trust audits (12 CFR 9.9), the OCC does not have a statutory requirement for the frequency of internal audits. Our "Internal and External Audits" booklet states that internal audit frequency and audit cycle length is usually based on risk assessments of business activities or areas to be audited. For example, high-risk areas normally warrant annual audits, with moderate- or low-risk areas audited less frequently (generally a maximum of 24 months and 36 months, respectively). However, the internal auditor's judgment and other circumstances at each bank play a role in determining appropriate audit frequencies and cycles.