

BankDirector.

Breakout 1:
**Bank Director 101:
Audit Primer**

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#BBTF23



Smart decisions. Lasting value.™

Audit 101

Session Agenda



External Audit terminology basics



Importance of an effective Audit Committee and how Board Members can contribute



Questions to ask during Audit Committee Meetings or Presentations



Definition of an External Audit

The definition of an audit is a formal examination of an entity's or individual's accounts or financial situation.

An audit is the highest level of assurance services that a CPA performs and it is intended to provide users a level of comfort on the accuracy of financial statements.

As CPAs we will issue a formal report that expresses an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework.

Phases of an External Audit

Planning & Risk Assessment Phase

Interim Phase

Year-end
Fieldwork
Phase

Completion &
Evaluation of
Results Phase

Reporting
Phase

Categories of Control Deficiencies for External Audits




Material weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

- Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.
- Probable. The future event or events are likely to occur.



Significant deficiency. A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit the attention of Those Charged with Governance



Center for Audit Quality – Key 2023 Audit Themes

- Audit Committee Survey:
 - Of 164 surveyed audit committee members
 - 53% - Cybersecurity
 - 43% - Enterprise Risk Management
 - 34% - ESG disclosures and reporting (a 24% increase over the prior year)
 - In reaction
 - Audit Committees are looking to increase in size or add members with specialized skills
 - Enhance training

(source – CAQ)

Audit Committee Purpose

Audit Committees help the Board of Directors fulfill its oversight responsibilities for:

- Integrity of the company's financial statements
- Company's compliance with financial-related legal and regulatory requirements
- External auditor's qualifications and independence
- Performance of the company's internal audit function and external auditors and effective utilization of resources
- Oversight and accountability for corporate governance, internal control environment, and risk management



Characteristics of High Performing Audit Committees

Clear independence

Active participation and leadership

- Research
- Continuing education
- Facility visits
- Seek to understand best practices

Include two financial experts rather than minimum of one

Increase communication with external auditors regarding scope and plan

Active involvement in setting internal audit budget, scope, compensation

Proactive involvement with director of internal audit

Active participation in strategic plan development

Understand risks and risk appetite



Audit Committee Skills

- Professional Skepticism
 - A skeptical state of mind
 - Enables a person to recognize that circumstances may exist that cause the financial statements to be materially misstated
 - Causes a person to be alert and remain cautious about such information and events that indicate the existence of material misstatement in the financial statements
 - Continually challenges results of internal audit
- Trust, But Verify
 - Audit Committees are first line of defense for Board and shareholders by providing:
 - Oversight over management's design and implementation over internal controls
 - Consideration of fraud risks and potential regulatory non-compliance risk
 - Understanding of changing accounting guidance
 - Assurance that good corporate governance is in place
 - Comfort with competency and independence of external auditors
 - Oversight and support of internal audit function

How to move from.....

- Good
 - Stay organized
 - Invite Experts to the meeting
 - Monitor staff capacity and Advocate for teams
 - Facilitate Constructive dialogue and engage different personalities
- Great
 - Spot new risks
 - Challenge executives
 - Push back when necessary
 - Ask the tough questions



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Typical Audit Committee Pitfalls

- Not identifying or addressing complex accounting issues
 - Ensure members are trained on accounting issues affecting your institution
 - Use third-party expert if necessary
 - Understand impact of implementation of new standards
- Lack of open lines of communication to functional managers
- Failure to respond to warning events
 - Whistle blower
 - Management letters and internal audit reports
- **RED FLAG** issues that can impact the success of the Audit Committee
 - Receive audit committee book without sufficient time to digest
 - Remediation of audit findings does not occur
 - Members do not actively participate
 - “Good Report” syndrome



Questions to ask the External Auditors



Did you discuss any major accounting or auditing issues with management prior to your retention, your responses to which were, or might be considered to be, a condition of your retention?



Are there any concerns with how management controls key business processes? Have the key processes been appropriately identified?



What criteria do you use to determine materiality?



How does the planned scope of your audit differ from the prior year?





Are there any proposed accounting, auditing, tax or reporting rules that could materially affect the organization's financial statements?





How do you ensure independence? Are there any matters that might reasonably be thought to bear on your independence?


Questions to ask the Internal Auditor


 Were there any areas of concern that were not reviewed due to budget or other limitations?

 Have your audits identified areas of concern to the overall entity environment? Have any specific locations or areas been identified?

 Does management give appropriate consideration to your views?

 How are risks identified?

 How is the internal audit staff remaining current with respect to changes in accounting and financial reporting requirements? Are there appropriate training mechanisms in place?

 What procedures are in place to prevent/address the risk of management override of controls?

Questions to ask Accounting Management



Were there any changes in operations this year?



Are there any areas that require special attention due to high business or financial risks?



What are the organization's policies and procedures to deter conflicts of interest and illegal acts, and how are they monitored?



How does the organization minimize the risk of fraudulent financial reporting?



Were there any significant changes in accounting estimates or models used in making accounting estimates? If yes, what changes were made and what are the financial statement effects?



Does management have the appropriate resources to assess the effectiveness of internal control over financial reporting?


The Power of an Executive Session


Benefits of Executive Session


Questions to ask your External auditors:


- Were you provided with all the information you requested? Do you have any reason to believe that information was withheld from you or that management representations were incorrect?
- Were there any disagreements regarding accounting, auditing or reporting matters between you and management? If so, how were they resolved?
- Are the accounting principles used by the organization overly conservative or aggressive? What would be the effect of using alternative principles? Do the accounting principles conform to industry practice?

Executive Session with Internal Audit or Management


 What is your opinion of the auditing services performed by the external auditors?


 Were any problems or difficulties identified as a result of the audit that we should know about?

 Were there any other deficiencies identified that were not reported to the audit committee?

 What is your reaction to the suggestions contained in the external auditors' management letter?

 What is your evaluation of the external auditors' services this past year?

 What additional work could you do to reduce the work of the external auditors?

 Do you feel your staffing is adequate?

Takeaways

- Understand your responsibility and get help from outside resources related to complex issues
- Manage Audit Committee meeting agenda
 - It is your meeting
- Meet with external auditors and have a working knowledge of financial statements
- Support Internal Audit
 - They are your eyes and ears
- Be honest about the capacities of members
 - Make changes if needed
- Communicate Communicate Communicate



Questions??





Thank You

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