

External Audit Program

EXAMINATION OBJECTIVES

To determine how audit procedures, findings, and recommendations affect the scope of the planned examination.

To evaluate how much the examiner can rely on the audit work to limit or supplement the examination scope.

To communicate with auditors to obtain a better understanding of high-risk or complex activities of the association.

To ensure that the auditor met regulatory requirements in the preparation and presentation of the audit report.

To determine if the association corrected deficiencies noted by the auditors.

To determine that the auditor's client is the board of directors and not management.

MONITORING AND EXAMINATION PROCEDURES

LEVEL I

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Supervisory Monitoring Procedures (Examination managers)

1. Obtain copies of the audit report, report on system of internal control (report on internal control), engagement letter, audited financial statements, Securities and Exchange Commission (SEC) filings, and any other audit-related reports the regional office receives. (Also obtain a copy of all comments pertaining to any supervisory or compliance reviews performed by the regional accountant.)

Determine the type of opinion (unqualified, qualified, adverse, or disclaimer) rendered by the external auditor. If the external auditor rendered other than an unqualified opinion, find out why.

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2. Read the reports for supervisory issues (at a minimum, verify that the regulatory capital figures in the footnotes to the audited financial statements agree with the Thrift Financial Report (TFR) for the same period).
 - Complete the Audit-Related Report checklist in Appendix A for audit-related reports.

3. Determine whether any identified supervisory concerns require immediate follow-up. If not, use the checklists to document needed follow-up by examination personnel.
 - Determine if there are any material weaknesses in internal control. Discuss any communication of weaknesses between management and the external auditor.

4. Determine whether any supervisory concerns have subsequently been reported in the association's TFR or the examination.

5. Update the regulatory profile for any identified supervisory concerns.

Examination Planning Procedures

6. Obtain the examination file copy of the Audit-Related Report checklist prepared since the last examination.
 - Review the checklist for any documented supervisory concerns.
 - Schedule field examination follow-up on documented supervisory concerns.

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7. Make inquiries of association management and the external auditor to determine whether the external auditor performed any special reviews of specific departments or areas of the association since the previous examination that the association did not supply to OTS.
- Obtain copies of the reports and discuss any supervisory concerns with the auditor and management.
 - Complete the Audit-Related Report checklist.
 - Update the regulatory profile for any identified supervisory concerns and required examination follow-up.
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8. Determine whether you can use the audit to supplement the examination procedures.
- Review the audit work papers to identify areas where the audit work can supplement examination procedures.
 - Identify audit work that you can rely on to limit examination procedures, keeping in mind the limitations on relying on audit work.
 - Consider the auditor's competence, integrity, independence, and knowledge of regulatory matters (consult the regional accountant).
 - Determine if the institution prepared a management report, and review management's assessment of the effectiveness of internal control structures and procedures as of the end of the fiscal year, and its compliance with laws and regulations during the year.
 - Determine if the external auditor has examined, attested to, or reported separately on management's assertions concerning the internal control structure for financial reporting.
 - Consider having the auditor perform specific procedures. (This request should coincide with the auditor's normal annual audit work whenever possible.)
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Examination Field Procedures

9. Perform recommended follow-up for all items as indicated in the regulatory profile and the Audit-Related Report checklist.

10. Review the preceding report of examination and all external audit-related exceptions noted and determine whether management has taken appropriate corrective action.

11. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

12. Discuss matters of supervisory concern and material transactions that require complex analysis with the external auditor.

13. Ask association management and the external auditor about any account adjustments resulting from the most recent audit.
 - Obtain a schedule of the adjustments.
 - Review the adjustments to identify entries that indicate poor accounting records or controls.

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- Review the adjustments to determine whether management has given appropriate attention to the affected areas and to determine whether management reported the adjustments on the TFR in the appropriate period. *Do not require restatement of the TFR unless the error is material.* An error is material if it is related to a failure of a capital requirement, a change in a PCA category, a change in a component rating, or has significance for regulatory reporting purposes.
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14. Review Level II procedures and perform those necessary to test, support, and present examination conclusions derived from performing Level I procedures.
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LEVEL II

Examination Field Procedures

15. If you plan a review of the audit work papers, arrange for the auditor to make the work papers available at the association's office. Only sign a document to acknowledge receipt of the copies of the work papers. (Alternatively, the accountant may request that you review the work papers in the auditor's office.)
- Gather evidence on identified matters as necessary to substantiate stated examination objectives.
 - Prepare a list of work papers to copy, if needed.
 - Submit the list to the auditor and obtain a firm commitment on the delivery date, if needed.
 - Determine whether work papers support conclusions by the external auditor.
 - Modify the examination scope as considered necessary.
 - If there are questions or concerns about the application of generally accepted accounting principles or generally accepted auditing standards based on the work paper review, consult the regional accountant.
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16. Assess the CPA's independence and competence.

- Evaluate the independence, objectivity, and competence of those providing the external audit.
- Determine if the institution has recently changed auditors. If so, discuss the reason for the change.
- Make inquiries of the appropriate association officials concerning their knowledge of any improper relationship (stockholder, significant unsecured borrower, officer, or director) or business affiliations with the CPA.
- Obtain and review loan listings, contracts, and stockholder listings to substantiate representations of independence, if circumstances warrant.
- Determine that the audit committee of the board of directors verified that the audit engagement staff was independent and competent to audit the association.
- Determine that the outside directors on the audit committee monitor the relationship between the auditor and management. The auditor works for the board of directors, not management. The auditor should not be an advocate for management.

17. Review and determine whether the board of directors or its audit committee at least annually reviews and approves any policies pertaining to the institution's external audit function.

18. Meet with the external auditor to discuss significant audit findings.

19. Ensure that your review meets the Objectives of this Handbook Section. State your findings and conclusions, and appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

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EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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