



DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

Phone: (360) 902-8701

FAX: (877) 330-6870

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Outsourcing the Internal Audit Function

The purpose of this bulletin is to provide guidance to credit unions that may decide to outsource their internal audit function and to show how examiners will evaluate the outsourcing function during an examination. This guidance is consistent with the requirements contained in RCW 31.12.335 Supervisory committee—Duties, and mirrors policy statements from the FDIC¹ and the Federal Financial Institutions Examination Council. As stated in the Interagency Policy Statement on the Internal Audit Function and Its Outsourcing (Policy):

Effective internal control is a foundation for the safe and sound operation of a financial institution (institution). The board of directors and senior management of an institution are responsible for ensuring that the system of internal control operates effectively. Their responsibility *cannot* be delegated to others within the institution or to outside parties. An important element in assessing the effectiveness of the internal control system is an internal audit function.

The Policy goes on to say that under the interagency guidelines adopted, each financial institution should have an internal audit function that is appropriate to its size and the nature and scope of its activities. As such, the statement makes clear that "...many institutions have been engaging independent public accounting firms and other outside professionals (outsourcing vendors) in recent years to perform work that traditionally has been done by internal auditors." Furthermore, it states that outsourcing may be beneficial if it is properly structured; however these outsourcing arrangements do not relieve directors and senior management of their responsibility for maintaining an effective system of internal control and the internal audit function.

Examiners will exercise their judgment in determining the quality and scope of an institution's internal audit function, regardless of whether it is performed internally or externally. According to the guidance contained in the Policy, examiners may consider the following in their evaluation:

- The internal audit function's control risk assessment, audit plans, and audit programs are appropriate for the institution's activities;

- The internal audit activities have been adjusted for significant changes in the institution's environment, structure, activities, risk exposures, or systems;
- The internal audit activities are consistent with the long-range goals and strategic direction of the institution and are responsive to its internal control needs;
- The audit committee (supervisory committee) promotes the internal audit manager's impartiality and independence by having him or her directly report audit findings to it;
- The internal audit manager is placed in the management structure in such a way that the independence of the function is not impaired;
- The institution has promptly responded to significant identified internal control weaknesses;
- The internal audit function is adequately managed to ensure that audit plans are met, programs are carried out, and results of audits are promptly communicated to senior management and members of the audit committee and board of directors;
- Work papers adequately document the internal audit work performed and support the audit reports;
- Management and the board of directors use reasonable standards, such as the IIA's Standards for the Professional Practice of Internal Auditing, when assessing the performance of internal audit; and
- The audit function provides high-quality advice and counsel to management and the board of directors on current developments in risk management, internal control, and regulatory compliance.

The examiner should assess the competence of the institution's internal audit staff and management by considering the education, professional background, and experience of the principal internal auditors.

In addition, when reviewing outsourcing arrangements, examiners should determine whether:

- The arrangement maintains or improves the quality of the internal audit function and the institution's internal control;
- Key employees of the institution and the outsourcing vendor clearly understand the lines of communication and how any internal control problems or other matters noted by the outsourcing vendor are to be addressed;

- The scope of the outsourced work is revised appropriately when the institution's environment, structure, activities, risk exposures, or systems change significantly;
- The directors have ensured that the outsourced internal audit activities are effectively managed by the institution;
- The internal audit reports are the property of the institution, that the institution will be provided with any copies of the related work papers it deems necessary, and that employees authorized by the institution will have reasonable and timely access to the work papers prepared by the outsourcing vendor;
- The outsourced internal audit services provided by the vendor are subject to regulatory review and examiners will be granted full and timely access to the internal audit reports and related work papers prepared by the outsourcing vendor;
- The arrangement with the outsourcing vendor satisfies the independence standards described in this policy statement and thereby preserves the independence of the internal audit function, whether or not the vendor is also the institution's independent public accountant; and
- The institution has performed sufficient due diligence to satisfy itself of the vendor's competence before entering into the outsourcing arrangement and has adequate procedures for ensuring that the vendor maintains sufficient expertise to perform effectively throughout the arrangement.

Credit unions must ensure their supervisory committee complies with its duties and responsibilities and it may retain professional advisors or consultants as necessary to perform the duties under this section; see RCW 31.12.335.

If you have any questions about this bulletin, please contact Keith Schuster, Chief of Safety and Soundness Examinations, at Keith.Schuster@dfi.wa.gov or (360)-902-8718.

¹ For complete details, see FDIC 5000 – Statements of Policy INTERAGENCY POLICY STATEMENT ON THE INTERNAL AUDIT FUNCTION AND ITS OUTSOURCING: <https://www.fdic.gov/regulations/laws/rules/5000-3250.html>