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# Auditing Sensitive Areas

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# Session Objectives



Discuss key communication considerations related to auditing sensitive areas



Address audit approaches for sensitive areas



Address one of the leading considerations when auditing sensitive areas



# The Basics



**Does everybody have the following?**

Internal audit charter

Dual reporting relationship

- Supervisory committee
- CEO



**How many follow IIA standards in completing audits?**

# Reporting Relationship

- IIA Standard 1100
  - Independence
    - Freedom from conditions that threaten the ability for internal audit to carry out their responsibilities in an unbiased manner
    - Direct and unrestricted access to senior management and the supervisory committee
    - Report to a level within the organization that allows internal audit to fulfill responsibilities
  - Objective
    - Unbiased mental attitude that results in no quality compromises
    - Auditors do not subordinate their judgment to audit related items to others



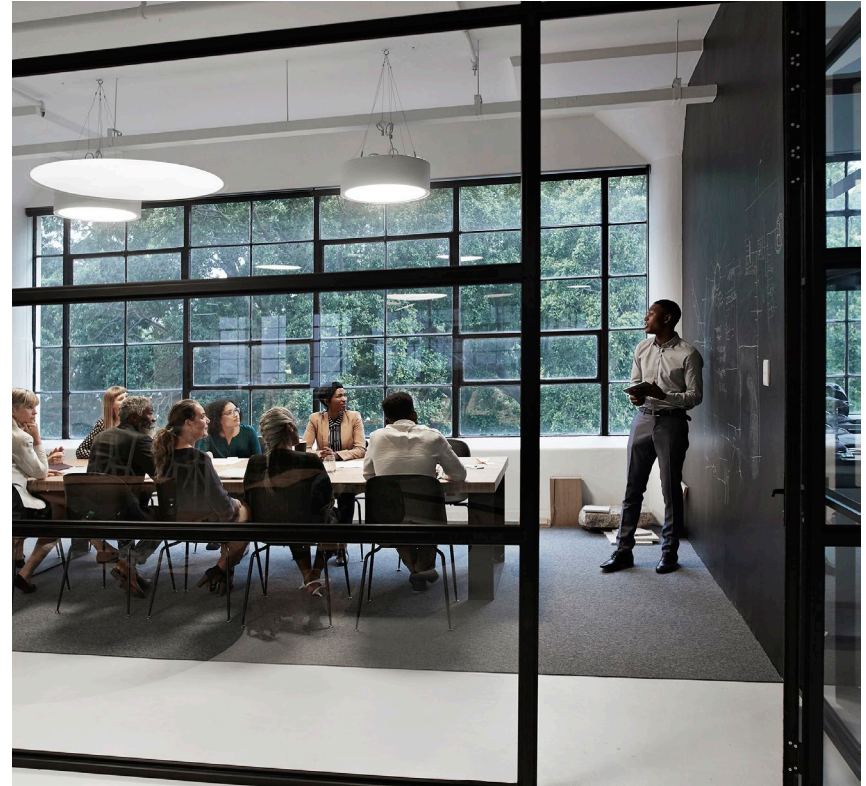
# Working with the Supervisory Committee

- To have an effective relationship the following are key considerations:
  - Communicating openly and candidly with the supervisory committee
  - Reporting regularly and timely, which can be both formal and informal
  - Follow the audit plan that was approved



# Working with the Supervisory Committee

- To have an effective relationship the following are key considerations:
  - Enhance internal audit's role and activities are clearly understood by the committee
  - Internal audit function is responsive to the needs of the committee
  - Keep the committee informed



# Working with the Supervisory Committee

- Communicating Sensitive Matters
  - Consider need to consult with key members of management, including legal counsel
    - Facts and details are available and documented
    - Findings can be verified and any opinions and conjecture are clearly articulated as such
    - Communication is timely and urgent





# Working with the Supervisory Committee

- Communicating Sensitive Matters
  - Internal auditor might see management attempts to delay or omit certain information
    - Consider reporting obligations in accordance with professional standards or policies
      - IIA
      - AICPA
      - Internal audit charter
      - Credit union code of conduct



# Quality Communications

## 01

Gather, evaluate, and summarize data and evidence with care and precision

## 02

Identify and express observations, conclusions, and recommendations without prejudice, partisanship, personal interests, and the undue influence of others

## 03

Improve clarity by avoiding unnecessary technical language and providing all significant and relevant information in context



# Quality Communications

- Develop communications with the objective of making each element meaningful but succinct
- Adopt a positive, well-meaning content and tone that focuses on the credit union's objectives
- Enhance communication is consistent with the credit union's style and culture
- Plan the timing of presenting the results of the engagement to avoid unnecessary delay



# Employee Accounts

- Risk of employee accounts
  - Access to information that other members do not have to
  - Performing transactions on their own accounts or family members
  - Inappropriate activity including fraud through journal entries



# Employee Accounts

- Testing Procedures
  - Obtain an understanding of the monitoring process and controls in place related to employee and official accounts
    - Monitoring process for day to day activities
      - Most credit unions struggle to monitor employee account activity consistently
    - Process for approval of employee and official loans
    - Process to monitor changes to employee and family member accounts



# Employee Accounts

- Testing Procedures
  - Obtain list of employee and official accounts
    - Determine whether they are appropriately flagged or restricted
    - Select a sample of accounts and perform the following
      - Review loans for proper approval and compliance with credit union policies
      - Determine whether any loan advances were performed by the employee
      - Review deposit account activity for reasonableness and employees not performing transactions on their own accounts



# Employee Expense Reports

- Risk – expenses that are reimbursed:
  - Personal in nature and should not have been reimbursed by the credit union
  - Unauthorized
  - Excessive



# Employee Expense Reports

- Testing Procedures:
  - Obtain an understanding of the process for employee expense reimbursement through:
    - Reading policies and procedures
    - Discussion with staff responsible for processing employee expense reports
  - Select a sample of employee expense reports and perform the following:
    - Expense report completed fully and signed by the appropriate supervisor
    - Expenses properly classified on the general ledger
    - Receipts are attached as required by policy





# Corporate Credit Cards

- Risk – payment of items circumvents the accounts payable process. Nature of abuses are similar to employee expense reimbursement, except item is paid for prior to approval



# Corporate Credit Cards

- Testing Procedures:
  - Obtain an understanding of the process for corporate credit cards through:
    - Reading policies and procedures
    - Discussion with staff responsible for processing corporate credit card payments
  - Select a sample of corporate credit cards and perform the following:
    - Corporate credit card statement included and approved by the appropriate supervisor
    - Expenses properly classified on the general ledger
    - Receipts are attached as required by policy



# Corporate Credit Cards & Expense Reports

- Consider the following as it relates to expense reports and corporate credit cards:
  - Proper reporting of any mileage reimbursement
  - Does policy address items such as:
    - Additional charges at hotels such as movies, mini-bar, etc.
    - Guidelines for meals
    - Flight and room upgrades
  - Is corporate credit card being used to circumvent accounts payable process?
    - Fixed asset purchases
    - Items that might not meet approval through accounts payable



# Payroll

- Risks relate to:
  - Payment of unauthorized payroll
  - Abuse in employee benefits
  - Creation of fictitious employees
  - Reporting of executive compensation
  - Improper accounting and reporting of fringe benefits



# Payroll

- Testing Procedures:
  - Obtain an understanding of the payroll process
    - Complete internal control questionnaire
      - Segregation of duties related to approval and processing
      - Reconciliation to general ledger separate from processing
      - Restricted access to blank payroll checks, facsimile signature plates, personnel records
      - Adequate authorization of vacation and overtime
      - Adequate knowledge of legal, regulatory, actuarial, and accounting requirements
    - Document process including use of third party payroll processor
      - For third party processors has credit union obtained SOC report?



# Payroll

- Testing Procedures:
  - Reconcile payroll reports to general ledger and 941 filings
  - Select a sample of employees to assess accuracy of information as compared to employee personnel file:
    - Hire date, start date, social security number, pay rate, W-4 withholding, other payroll deductions
    - Verify the following is included in employee file: application, resume, employee handbook acknowledgement, background check, credit report



# Payroll

- Testing Procedures:
  - Select a sample of employees with 401(k) deductions identified in the payroll register and perform the following:
    - Verify proper authorization in employee file
    - Trace funds withheld to recording in general ledger
    - Trace to payment with 401(k) administrator
  - Select a sample of employees with charitable contributions in the payroll register and perform the following:
    - Verify proper authorization in employee file
    - Trace funds withheld to recording in general ledger
    - Trace to payment with charity



# Payroll

- Testing Procedures:
  - Validate employees listed on payroll register with list of active employees
  - Select a sample of terminated employees and determine whether employees were removed timely
  - Assess whether credit union requires employees to take five consecutive days of vacation annually and test for compliance
  - Assess reporting and approval of executive benefit plans
  - Assess recording and reporting of fringe benefits to employees





# Payroll

- Testing Procedures:
  - Assess reporting of executive compensation for items such as:
    - Deferred compensation
    - Loans to executives that are part of employee benefits
      - Collateral assignment split dollar life insurance loans
    - Employee use of credit union owned vehicle
    - Other benefits
    - Considerations
      - Board approval of CEO compensation?
      - Benchmarking studies?
      - Include all in summary of compensation and benefits?



# Fringe Benefit - Definition

A fringe benefit is a form of pay (including property, services, cash or cash equivalent) in addition to stated pay for performance of services.



# Fringe Benefit Audit - Benefits

Better control  
over credit  
union activities

Develop better  
internal  
policies

More equitable  
employee  
plans

More accurate  
financial  
reporting

Minimize tax  
consequences

Better  
employee  
moral



# Auditing Fringe Benefits

- How to identify
  - Interview management
  - Miscellaneous or other expense
  - Expense reports
  - Corporate credit cards



# Auditing Fringe Benefits

- Are the expenses within policy/Is it clear
  - Clearly defined policy
  - Defined business purpose
  - Documentation requirements
  - Clearly defined eligibility
  - Clearly defined terms
- Are they recorded correctly
  - If discovered through policy – probably ok
  - If discovered from management inquiries – possibly ok
  - If discovered any other way – probably redo



# Auditing Fringe Benefits

- Are the tax effects reported
  - Accountable plan
    1. Must be a business connection
    2. Must be adequate accounting/reasonable period of time
    3. Excess must be returned
  - Nonaccountable plan
    1. Taxable wages



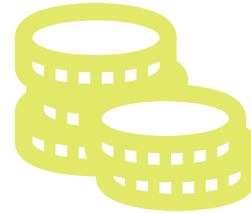
# Tax Consequences



## Accountable to Nonaccountable

Withholding of social security, Medicare and income taxes

Employer matching of social security and Medicare



## The IRS Taxable Fringe Benefit Guide

# Identification – the List

- Working Condition Fringe Benefits (slide)
- De Minimis Fringe Benefit (slide)
- No Additional Cost Fringe Benefits (slide)
- Qualified Employee Discounts
- Qualified Transportation Fringe Benefits
- Health and Medical Benefits
- Travel and Transportation Expenses
- Moving Expenses
- Meals and Lodging





# Identification – the List (Cont)



Use of Employee-Owned Vehicle



Employer – Provided Vehicle



Equipment and Allowances



Other types of Compensation



Awards and Prizes



Professional Licenses and Dues



Educational Reimbursements



# Working Condition Fringe Benefits



Property of services that, if the employee had paid for, he or she could have deducted as a business expense



Uniform

# De Minimis Fringe Benefit

- Small and infrequent
  1. Personal use of photocopier
  2. Group meals
  3. Coffee, donuts, or soft drinks
  4. Flowers for special circumstances
  5. Local phone calls
  6. Birthday or holiday gifts (not cash) with a low FMV
  7. Commuting use of employer's car < 1 day per month



# De Minimis Fringe Benefit

- Not De Minimis
  1. Cash
  2. Cash equivalent such as gift cards
  3. Transportation passes
  4. Use of employer's apartment, vacation home, boat
  5. Commuting use of employer's car > 1 day per month
  6. Membership in a country club or athletic facility



# Other Benefits

- No Additional Cost Fringe Benefits
  - A service provided to employees the does not impose any substantial additional cost.
  - Use of the credit union meeting facilities after hours.
- De Minimis Fringe Benefit
  - An employer gives employees snacks each day valued at 75 cents. Even though small in amount, the benefit is provided on a regular basis and is, therefore, taxable as wages.



# Qualified Employee Discounts



Excludable if:

Merchandise – less than the employers gross profit percentage time the price charged the member

Services – less than 20% of the price charged the member



Difficult to find



Policy may or may not be clear



Accounting is usually ok



# Qualified Transportation Fringe Benefits

1. Commuter transportation in a commuter highway vehicle
  2. Transit passes
  3. Qualified Parking
  4. Qualified bicycle commuting expenses
- Difficult to find
  - Policy may or may not be clear
  - Accounting is usually ok



# Moving Expenses

- Often buried in “other”
- Often no clear policy
- Tax effect is often wrong
  1. Time test – 39 weeks full time
  2. New job is +50 miles further from the former home than the old job was from the former home
  3. Moving of household goods and travel costs only
  4. Must actually incur the expenses





# Use of Employee-Owned Vehicle



Not difficult to find



Policy may or may not be clear



Accounting is usually ok



Taxes – federal standard mileage rate



# Employer Provided Vehicle

- Not difficult to find
- Policy may or may not be clear
- Accounting is usually ok
- Taxes –
  1. If records are provided then personal use is wages to the employee
  2. If records are not provided then all use is wages to the employee



# Other Types of Compensation

- Performance bonuses
- Signing, recruiting or relocation bonuses
- Awards for outstanding service or performance
- Back Pay
- Severance pay
- Administrative pay
- Legal settlements/damages related to performance
- Grossed-up wages to pay for taxes



# Employee Awards

- Easy to find
- Probably not in policy
- Accounting probably ok
- Tax effect –
  1. Must be length of service or safety only
  2. Cannot be cash, cash equivalent, vacation, meal, lodging, theater or sports ticket, stocks or bonds
  3. Other special rules – no more than 10% can receive, etc



# Club Membership

- Can be difficult to find
- Policy may not be clear
- Probably recorded in “other”
- Tax effect –
  1. Taxable to the employee
  2. Employee may deduct business use



# Education Reimbursements

- Not hard to find
- Policy probably fairly clear
- Accounting probably ok
- Tax effect –
  1. Must not be minimum requirements of current job
  2. Must not qualify employee for a new job
  3. Subject to verification requirements







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Questions