



AuditOne Advisory

From Bud Genovese, CEO

More Regulatory Hot Spots and WIB Survey Request

As you know, it is impossible to cost effectively eliminate risk from our banking institutions. Instead, we attempt to minimize risk down to a level we can live with. As bankers, we are in the business of risk management and must make the difficult decisions on where to place our scarce risk management dollars. The risk assessment is the best tool to help us implement this allocation of risk dollars. In their role as guardians of the deposit insurance fund and defender against systemic risk to the American financial system, regulators also must take a risk based approach. Clearly, those activities that are criticized most often in examination reports are examples of high risk activities. They provide useful clues to bankers as to risks they should be thinking hard about.

We have been very busy lately with this topic of regulatory hot spots. AuditOne president Kevin K. Watson will be moderating the regulatory panel at Western Independent Bankers (WIB) upcoming CFO conference, and we've been working closely with WIB in the development of an on-line survey exploring regulatory "hot spots." We encourage you to participate in the survey by May 6th if you haven't already done so. Simply connect to the following link:

<http://surveys.quadsurvey.com/frmMain.aspx?SV=SVGFLBJ63341481635EV53>

In last month's AuditOne Advisory, we presented the top ten regulatory hot spots based on our experiences performing internal audits at over 140 financial institutions. The feedback from that column was so positive that we've decided to expand the list of activities that have the regulators' attention. Here then, to help improve the efficiency and effectiveness of your internal audit programs, are six more examination hot spots on which regulators are currently focusing keen attention.

Appraisals

With a significant decline in residential valuations and with commercial real estate following in the same tracks, a renewed focus is placed on collateral support. This is especially true for construction loans that will rely on takeout financing or sale of the completed property as the primary source of repayment. Bankers should be increasing focus on the quality of the appraisals they are receiving. In particular, pay close attention to the timing and appropriateness of comparable sales. Also, appraisals currently on file may no longer be valid due to declines in valuations. In some cases, new appraisals will need to be ordered by the bank. Appraisals ordered by the borrower will be deemed unacceptable by the examiners.

Wire Transfer

Due to the potentially large losses associated with unauthorized or unfunded wire transfers, examiners are looking closely at this function. They also expect to see that internal audit has reviewed the wire transfer function at least annually. For institutions using the Fedline Advantage system, the FRB has published useful guidelines. Banks should document any justifications for deviating from the guidelines.

CRA

Regulators haven't forgotten about the Community Reinvestment Act. Bankers should ensure the CRA file and disclosures are in order and that the CRA Assessment Area matches the reality of lending practices. Bankers should also be aware of how they stand in regard to the percent of loans made to low and moderate income areas as compared to the same ratio for the entire Assessment Area.

Flood Insurance

A number of banks have been criticized for violating the timing and disclosure requirements for collateral properties located in flood zones. Also, some of the flood zone determination services were using outdated maps. Katrina continues to hold a spotlight on Regulation H.

Audit Committee Independence

Increased regulatory focus on the internal audit function has resulted in several banks being criticized for not documenting in Audit Committee minutes that at least part of the meeting was held without the presence of management. Also, audit proposals should be addressed and directed to the Audit Committee.

Internal Audit

Financial institutions are being criticized when internal audit scope is inadequate. One way to reduce this risk is to complete a functional risk assessment annually. This will help to determine which departments should be audited annually and which can be covered on audit cycles longer than one year. In addition, you should take a close look at specific audit scopes, especially for higher risk areas such as information technology, BSA, credit review, or compliance, to ensure the audit department or outsourcing firm is covering the appropriate activities and that depth of coverage is adequate. Finally, the internal audit policy should address how audit scopes and frequencies are determined as well as the due diligence requirements used to choose an outsourcing firm.

I trust that knowledge of these additional regulatory hot spots will improve your bank's internal audit function. Please feel free to forward it to the people in your bank responsible for internal audit... and please contact me to discuss any aspect of your internal audit strategy and program. Thank you. --Bud

Bud Genovese is founder and CEO of AuditOne LLC, a California-based internal audit firm that focuses only on banks and their service providers. Mr. Genovese pioneered the concept of providing comprehensive, affordable, independent internal audit and credit review services by gathering wide-ranging, extraordinary expertise within one firm. AuditOne now serves over 140 clients throughout the Western United States, and nationally. Contact Bud Genovese at 408-980-8099 or bud.genovese@audit-one.com