



Office of the State Bank Commissioner

Regulatory Mailing

RM2003-4

TO: All Kansas State-Chartered Banks
FROM: Clarence W. Norris, Bank Commissioner
DATE: December 22, 2003
RE: Revised Minimum Audit Guidelines

Attached please find the Office of the State Bank Commissioner's revised "Minimum Audit Guidelines". These guidelines, which are effective immediately, should represent a reduction in the regulatory burden imposed on banks in the area of auditing.

Minimum Audit Requirements

A written internal audit program shall be approved by the Board of Directors. The program will define the scope of the audit, be reviewed on a periodic basis, and revised by the Board when necessary. The Board of Directors or an auditor selected by the Board should perform the actual audit. A comprehensive internal audit program should include, but may not be limited to:

Quarterly Functions

- 1) Balance all subsidiary records with respective general ledger accounts.
- 2) Verify a portion of teller cash. This process should be unannounced; the timing and selection varied to avoid recognizable patterns.
- 3) Reconcile cash items determining their legitimacy and collectibility.
- 4) Reconcile correspondent bank accounts. Outstanding items should be reviewed for legitimacy and collectibility. Monthly reconciliation records should be reviewed for completeness, timeliness of compilation and appropriate follow-up regarding outstanding items.
- 5) Reconcile official checks. Determine that checks paid since the previous audit are appropriately cancelled and filed. Compliance with signature requirements should also be ascertained.
- 6) Reconcile dormant accounts and ascertain that controls are adequate. Verify that entries posted since the previous audit where appropriate.
- 7) Ascertain and verify that collateral and items held for safekeeping are properly recorded and protected.
- 8) Review compliance with operating policies established by the Board, i.e., Loan Policy, Investment Policy, etc.
- 9) Verify a cross-section of income and expense from source to general ledger, including accrual and prepaid accounts.
- 10) Prepare and retain complete work papers detailing each audit function.

Annual Functions

- 1) Verify securities held off premise.
- 2) Verify all loan participations purchased.
- 3) Ascertain that all Other Real Estate and Other Assets acquired since the previous audit were properly recorded at the lower of appraised value or the corresponding loan balance, that expenses and income associated with this property are recorded to the proper bank expense and

Minimum Audit Requirements (Continued)

income accounts, and that the property is carried in compliance with K.S.A. 9-1102 and K.S.A. 9-1112.

- 4) Ascertain that loan losses and recoveries are properly recorded and that ledgers pertaining to charged off accounts are accurately maintained.
- 5) Trace transactions to insure proper audit trails.
- 6) Evaluate fidelity and casualty insurance.
- 7) Review the available audit report of the bank's in-house electronic data processing department or perform a full scope EDP examination, if applicable.
- 8) If the bank obtains a certified opinion audit by a CPA firm, the OSBC will accept their percentage sampling. In lieu of a certified opinion audit, direct verification of loan and deposit accounts will be, at a minimum, 5% of the actual number of loan accounts and 2.5% of the actual number of deposit accounts. The sampling should be random enough to include loan and deposit accounts of various sizes.

Implementation of an audit program should locate differences in accounts, safeguard assets, and reduce violations. A record of each quarterly audit's results should be noted in the Board of Directors' minutes, and working papers should be kept for Directors' and examiners' review.