



FDICIA Seminar

Virtual Live-Stream Session

April 20-21, 2022



About ICBA and Community Banker University®

The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.

With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly \$5.9 trillion in assets, over \$4.9 trillion in deposits, and more than \$3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America.

The goal of Community Banker University is *building better community bankers™* by delivering the very best education solutions for community bankers who want to grow and expand within the industry. Unparalleled educational offerings have been a staple of the ICBA education program, and Community Banker University will expand those offerings for the benefit of our members by bringing a fresh, modern approach to community banker education.

Community Banker University is affiliated with the prestigious Barret School of Banking to provide community bankers with an opportunity for a graduate degree in banking.

Community Banker University representatives and workshop instructors on-site at each seminar and workshop are always available to answer your questions. If you have additional comments or questions or would like more information on Community Banker University programs, products or services, please call (800)422-7285 or visit www.communitybankeruniversity.com.

Taunja Moe

Director, Product & Training Development
Community Banker University®

Independent Community Bankers of America®

d: 320-352-7332 | m: 320-429-4062 | p: 800-422-7285, ext. 7332

Taunja.Moe@ICBA.org

518 Lincoln Road | Sauk Centre, MN 56378 | www.icba.org

Joshua M. Juergensen, CPA

CLA (CliftonLarsonAllen LLP)

Principal
Minneapolis, Minnesota

612-397-3261
joshua.juergensen@CLAconnect.com



Profile

Joshua joined CLA in 2007 in the financial institutions group. Josh devotes 100 percent of his time serving financial institutions with varying levels of complexity, with asset sizes ranging from \$25 million to over \$5 billion. He focuses on certified audits, internal audits, loan file reviews, directors' examinations, and other consulting services for community banks.

Joshua also spends a portion of his efforts working with financial institutions in their partnership efforts with financial technology (Fintech) companies. This includes Fintech companies with a focus on lending, efficiency improvement, and alternative finance sources.

Technical experience

- Business, accounting, and regulatory issues for community banks
- Internal audit of a variety of areas for community banks
- Performing opinion audits of financial statement audits
- Loan file review engagements
- Financial reporting for banks and holding companies
- Risk assessments for financial institutions
- Loan loss reserve analysis
- Mergers and acquisitions

Education and professional involvement

- Bachelor's of arts, double-major in accounting and legal studies in business from the University of St. Thomas, St. Paul, Minnesota - 2006
- Graduate School of Banking, Boulder, Colorado - 2014
- Certified Public Accountant in the state of Minnesota
- American Institute of Certified Public Accountants
- Minnesota Society of CPAs

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David Heneke, CPA, CISA

CliftonLarsonAllen LLP

Principal
St. Cloud, Minnesota

320-203-5621

david.heneke@CLAconnect.com



Profile

David is a principal with the financial institutions group, dedicated to certified audits, directors' examinations, internal audits, and general control reviews. David began his career with CliftonLarsonAllen in 2005, and has ten years of experience working with financial institutions.

Technical expertise

- Community Banking
- Financial Statement Audit
- Directors' Examinations
- Internal Audit
- IT General Controls Review
- HUD FHA Compliance
- Acquisition Accounting
- Failed Bank Transactions
- FDICIA/SOX Internal Control Auditing
- Industry Data Analysis
- Data Analytics

Education/professional involvement

- Bachelor's of Business Administration with a major in accounting from the University of Iowa, Iowa City, Iowa
- Masters of Accountancy with an emphasis in management of information systems from the University of Iowa, Iowa City, Iowa
- Graduate School of Banking, Boulder, Colorado
- American Institute of Certified Public Accountants
- Minnesota Society of Certified Public Accountants
- Information Systems Audit and Control Association

Speaking engagements

- ICBA Internal Audit Course Instructor
- Purchase Loan Accounting Presenter

Community involvement

- Board Member, Junior Achievement of the St. Cloud Area

Mackenzie Rooney

CLA (CliftonLarsonAllen LLP)

Senior Associate
Minneapolis, MN

320.282.7915
Mackenzie.rooney@CLAconnect.com



Areas of specialization

- Business, accounting, and regulatory issues for financial institutions
- Internal audit of a variety of areas for financial institutions
- Performing opinion audits of financial statement audits
- Financial reporting for financial institutions and holding companies
- Risk assessments for financial institutions
- Loan loss reserve analysis
- Loan file review engagements
- Trust audits
- FDICIA engagements
- Core System financial analysis

Education

- Master of Education in Kinesiology, University of Minnesota
- Bachelor of Arts in Accounting, College of Saint Benedict

Years of experience

- 7 years of experience

Civic Involvement

- CliftonLarsonAllen Internal JA Corporate Council – Junior Achievement (JA) of the Upper Midwest – 2013 – Present
- CliftonLarsonAllen Young Advisory Council (YAC) – 2018 - Present

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Erica Kottabi, CPA

CLA (CliftonLarsonAllen LLP)

Principal
Peoria, Illinois

309-495-6909
erica.kottabi@CLAconnect.com



Profile

Erica is an assurance principal specializing in auditing, accounting, and consulting services for primarily financial institutions in the Peoria, Illinois office. With more than 22 years of experience in public accounting, Erica has supervised the audits for a variety of financial institution clients. Erica leads our Financial Institutions Internal Audit practice. Her client experience includes banks, insurance companies, mutual funds, and broker-dealers of both privately held and SEC registrants.

Technical experience

- Leads risk-based audits of banks and insurance companies ranging in asset size from \$15 million to more than \$100 billion
- Extensive experience with implementation and compliance of FIDICA, Model Audit Rule, and Sarbanes-Oxley 404
- Reviewing registration statements and other filings for SEC registrants
- Leading co-sourced and outsourced risk-based internal audit engagements

Education and professional involvement

- Bachelor of arts, accounting, Illinois State University
- American Institute of Certified Public Accountants
- Illinois CPA Society
- Community Bankers Association of Illinois
- Illinois Bankers Association of Illinois



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Liz Rider

CLA (CliftonLarsonAllen LLP)

Principal
Des Moines, IA

515-346-3663
liz.rider@CLAconnect.com



Overview

- Manages audits, internal audits and Sarbanes Oxley compliance for public and privately held financial institutions with assets of up to \$3 billion.
- 17 years of experience with audit and accounting services for financial institutions
- Consulting experience includes providing loan review, FDICIA, HUD, SBLF, SOX, internal audit, and operational review services for financial institutions
- Experienced with overseeing multi-bank charter engagements
- Knowledgeable in the area of policy and procedure review and recommendation
- Specializes in assisting banks with FDICIA transition plans at \$500 million and \$1 billion in total assets

Education/professional involvement

- Masters of Business Administration, Drake University, Des Moines, Iowa
- Bachelor of Accountancy, Accounting, Graceland University, Lamoni, Iowa

In the Community

- American Institute of Certified Public Accountants
- Certified Public Accountant in the state of Iowa
- Iowa Society of Certified Public Accountants
- Young Professionals Connection with the Greater Des Moines Partnership
- Former AIB College of Business adjunct professor and Accounting Advisory Committee Member





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Preparing for FDICIA Across All Asset Sizes

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Today's Presenters



Joshua Juergensen, CPA
Principal – Financial Institutions



Erica Kottabi, CPA
Principal – Financial Institutions

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Today's Presenters



David Heneke, CPA, CISA
Principal – Financial Institutions



Mackenzie Rooney, CIA, CCBIA
Manager – Financial Institutions



The Federal Deposit Insurance Corporation Improvement Act of 1991

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The Federal Deposit Insurance Corporation Improvement Act of 1991

- Commonly referred to as FDICIA
- Implemented in response to the savings and loan crisis to strengthen the power of the Federal Deposit Insurance Corporation (FDIC)
- Federal banking agencies were required to take supervisory actions when capital of an institution declined, and grade institutions on a 1 to 5 scale, which we now know as the CAMELS rating
- FDICIA applies to individually chartered institutions, so asset thresholds are applicable on a bank-by-bank basis.

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The Federal Deposit Insurance Corporation Improvement Act of 1991

- Items such as “Prompt Corrective Action” and “Least Cost Resolution” were also created as a part of this act
- Implemented specific requirements that affect organizations over \$500 million and \$1 billion in assets
- The measurement date for these asset thresholds is the beginning of the fiscal year

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Current Industry Trends

- Significant consolidation
- Asset size of banks is growing

Date	Number of FDIC-insured institutions	Average asset size	8-year % increase	Median asset size	8-year % increase
12/31/2020	4,998	\$4,378,095	114%	\$281,411	67%
12/31/2017	5,721	\$3,046,146		\$210,040	
12/31/2012	7,092	\$2,046,090		\$168,020	

Information based on data extracted from filed call reports for all FDIC-insured banks for the relevant quarters.

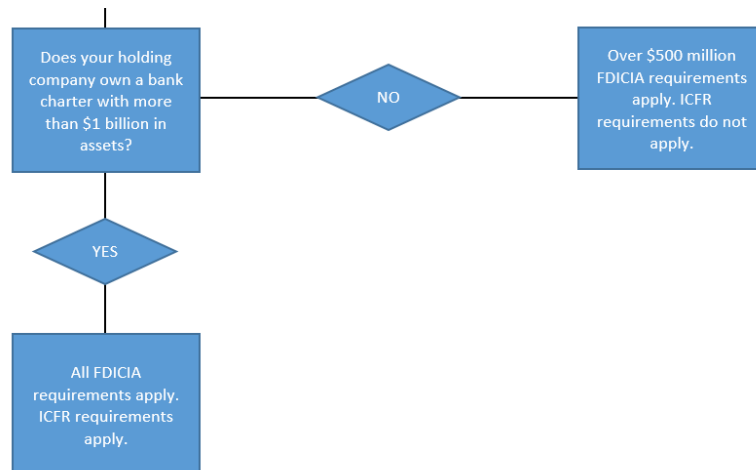
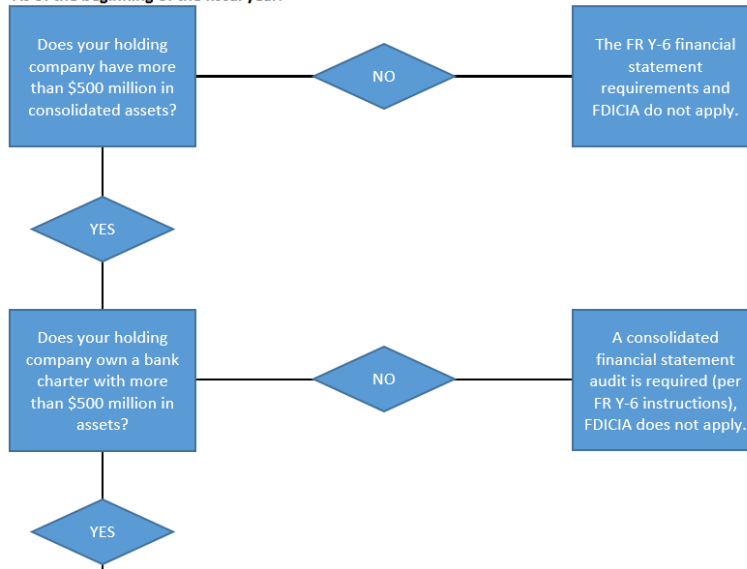


Does FDICIA Apply to Me?

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As of the beginning of the fiscal year:





Crossing \$500 Million in Assets

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\$500 Million Requirements

Audited Financial
Statements

Financial Statement
Auditor Independence

Auditor Reports

- Governance Communication
 - Internal Control Communication, if applicable

Management Reports
attesting to
management
responsibilities

Audit Committee

- All outside directors, majority independent of management

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Crossing \$500 Million Requirements

- Audited Financial Statements
 - An institution must submit audited financial statements to the appropriate Federal Bank Agency within 120 days of the end of the fiscal year for a non-public institution, or 90 days if the institution is publically traded
 - The financial statements must be comparative, but for institutions which have not been audited in the past, statements for the earlier year may be presented on an unaudited basis
 - Can be consolidated or bank only



Crossing \$500 Million Requirements

- Financial Statement Auditor Independence
 - FDICIA requires that the auditor comply with the most restrictive independence standards and interpretations of the AICPA, the SEC, and the PCAOB
 - In most situations, the SEC and PCAOB rules are the most restrictive, thus there are services not allowed to be provided by your auditor that would be in other situations, such as:
 - Preparation of individual tax returns for individuals in a financial reporting oversight role
 - Preparation of financial statements



Crossing \$500 Million Requirements

- Financial Statement Auditor Independence
 - The audit also requires partner rotation, which requires a new signing partner be brought onto the audit engagement every five years
 - Partners that perform other functions on the audit, but are not the signing partner, are required to rotate every seven years



Crossing \$500 Million Requirements

- Auditor Reports
 - As a part of a financial statement audit, you will also receive reports from your auditors which need to be filed with the appropriate Federal Bank Agency within 15 days of receipt, which include:
 - Governance Communication – Required communication with governance (contains the auditor's responsibilities, corrected and uncorrected misstatements, any disagreements with management, etc.)
 - Internal Control Communication (if applicable) – Communication of any material weaknesses or significant deficiencies in internal control noted during the audit.



Crossing \$500 Million Requirements

- Management Reports
 - In addition to the submission of audited financial statements, institutions are also required to submit a statement of management's responsibilities (signed by the CEO and CFO, or equivalent positions), and assessment of these responsibilities, for:
 - Preparing the institution's annual financial statements
 - Establishing and maintaining an adequate internal control structure and procedures for financial reporting
 - Complying with laws and regulations relating to safety and soundness that are designed by the FDIC and the appropriate Federal banking agency.



Crossing \$500 Million Requirements

- Audit Committee
 - Institutions are required to have a separate audit committee
 - Specific duties of the audit committee include:
 - The appointment, compensation, and oversight of the independent public accountant who performs services required under FDICIA
 - Reviewing with management and the independent public accountant the basis for the reports issued under FDICIA



Crossing \$500 Million Requirements

- Audit Committee Member Independence
 - Has been, within the last three years, an employee of the institution or any of its affiliates or an immediate family member is, or has been within the last three years, an executive officer of the institution or any of its affiliates
 - Serves, or has served within the last three years, as a consultant, advisor, promotor, underwriter, legal counsel, or trustee of or to the institution or its affiliates
 - Has participated in the preparation of the financial statements of the institution or any of its affiliates at any time during the last three years



Crossing \$500 Million Requirements

- Audit Committee Member Independence
 - Has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$100,000 in direct and indirect compensation from the institution, its subsidiaries, and its affiliates for consulting, advisory, or other services other than director and committee fees and pension or other forms of deferred compensation for prior service
 - Is, or an immediate family member is, or has been within the last three years, employed as an executive officer of another entity where any of the present executive officers of the institution or any of its affiliates at the same time serves or served on that entity's compensation committee



Crossing \$500 Million Requirements

- Audit Committee Member Independence
 - Is, or an immediate family member is, a current partner of a firm that performs internal or external auditing services for the institution or any of its affiliates, or was within the last three years (but no longer is) a partner or employee of such a firm and personally worked on the audit of the insured depository institution or any of its affiliates within that time
 - Is a current employee, or an immediate family member is a current executive officer, of an entity that has made payments to, or received payments from, the institution or any of its affiliates for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$200 thousand, or 5 percent of such entity's consolidated gross revenues



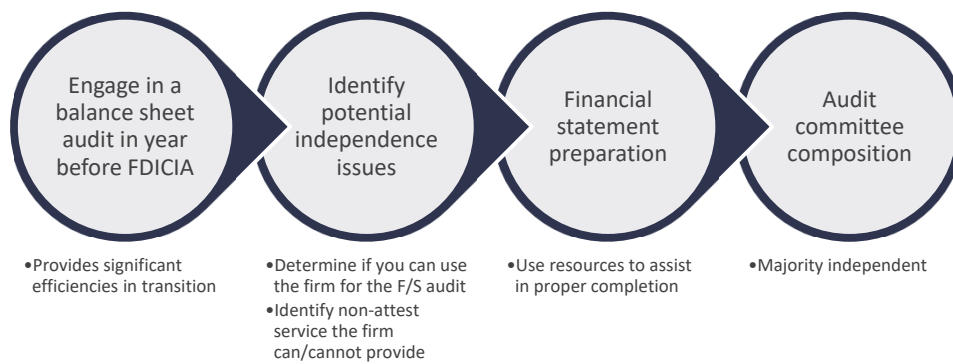
Crossing \$500 Million Requirements

- Audit Committee Member Independence
 - Key terms defined:
 - Immediate family member – A person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-laws, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home.
 - Affiliate – A person or entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.



\$500 Million Implementation Plan

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Crossing \$1 Billion in Assets

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\$1 Billion Requirements

\$500 million threshold
requirements met

Auditor Reports

- ICFR opinion

Management Reports attesting to management responsibilities

- Assessment of the effectiveness of the internal control structure
- Material weaknesses must be disclosed

Audit Committee

- All outside directors, all members must be independent of management



Crossing \$1 Billion Requirements

- Auditor Reports
 - In addition to the reports required at the \$500 million level, the financial statement auditor is also required to provide an opinion on the effectiveness of internal control over financial reporting, which is also provided to the appropriate Federal Bank Agency



Crossing \$1 Billion Requirements

- Management Reports
 - In addition to the \$500 million requirements, management must also provide an assessment of the effectiveness of the institution's internal control structure and procedures, which include:
 - A statement identifying the internal control framework used by management to evaluate the effectiveness of the institution's internal control over financial reporting
 - A statement that the assessment included controls over the preparation of regulatory financial statements in accordance with regulatory reporting instructions including identification of such regulatory reporting instructions



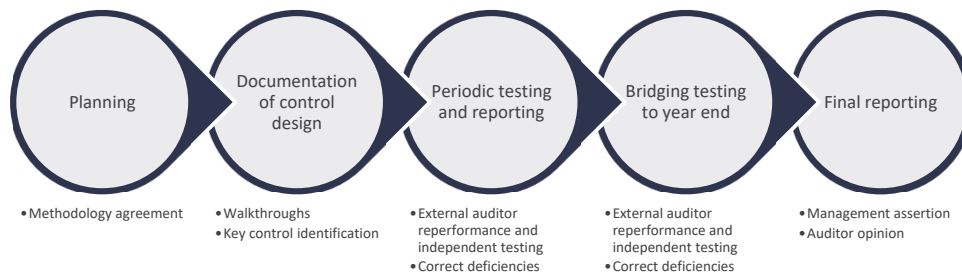
Crossing \$1 Billion Requirements

- Management Reports
 - A statement expressing management's conclusion as to whether the institution's internal control over financial reporting is effective as of the end of its fiscal year
 - Management must disclose all material weaknesses in internal control over financial reporting, if any, that it has identified that have not been remediated prior to the insured depository institution's fiscal year-end.



\$1 Billion Implementation Plan

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Conclusion

- Banks continue to grow at a rapid pace as consolidation continues
- Complying with the regulatory requirements can be a manageable process if appropriately and timely addressed
- It is never too early to get started when anticipating crossing one of the asset threshold levels

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Additional Resources

- You may find the following information helpful for members of the Bank as you plan for implementation:
 - [FDICIA Rule 363](#)
 - [Article: What to Expect When Your Bank Reaches \\$1 Billion](#)
 - [ICBA and CLA Community Banker University](#)



Thank You!
Any Questions?

Joshua Juergensen, CPA
Joshua.Juergensen@CLAconnect.com
612.201.3456

Erica Kottabi, CPA
Erica.Kottabi@CLAconnect.com
309.495.6909

David Heneke, CPA, CISA
David.Heneke@CLAconnect.com
320.203.5621

Mackenzie Rooney, CIA
Mackenzie.Rooney@CLAconnect.com
320.282.7915



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FDICIA Planning, Scoping and Materiality

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FDICIA TEAM

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Oversight Committee

- Define roles and responsibilities
 - Internally and externally
- Include key stakeholders
- Establish communication protocols to ensure the most respectful and efficient working relationship
 - Mitigating as much disruption to the bank's day-to-day operations
- Set the tone at the top
- Identify resources to be utilized and logistical arrangements



FDICIA Plan/Timeline



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Estimated Implementation Timeline

Stage	Anticipated Duration
Phase 1: Planning and Data Gathering	4-6 weeks
Phase 2: Documentation of Design	6-8 weeks
Phase 2: Documentation of Design – Remediation Period	2-4 weeks
Phase 3: Execute Effectiveness Testing	6-8 weeks
Phase 3: Execute Effectiveness Testing – Remediation Period	6-8 weeks
Phase 4: Deliver Results and Insights	2-4 weeks
Revisit remediation efforts for compliance	2-4 weeks

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Internal Control Framework

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Internal Control Framework

- Identification of the internal control framework
 - FDICIA requires management's written assessment of the effectiveness of internal controls to include a statement identifying the internal control framework used by management to evaluate the effectiveness of the institution's internal controls over financial reporting
 - This framework must be a suitable, recognized control framework established by a body of experts that followed due-process procedures, and widely available to users of management's report
 - The most widely used framework is Internal Control – Integrated Framework, sponsored by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).



What is COSO?

- Committee of Sponsoring Organizations of the Treadway Commission
 - American Accounting Association
 - AICPA – Financial Executives International
 - Institute of Management Accountants
 - The Institute of Internal Auditors
- Released first internal control framework in 1992
- Updated framework in 2013
- This framework includes 17 principles supporting 5 components
 - Each of the 5 components and the 17 relevant principles need to be present and functioning



Why is There COSO?

- Formed in 1985 and funded by the AICPA, American Accounting Association, Financial Executives International, the IIA and the Institute of Management Accountants, COSO was formed to review and recommend practices to reign in fraudulent corporate financial reporting.
- The savings and loan scandals in the 1980s brought a sense of need for an internal control framework to prevent major financial reporting frauds.



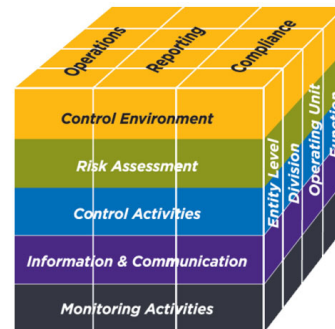
COSO Defined Internal Controls As:

- A process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives as it relates to the effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.



Components of the COSO Integrated Framework

- Controls Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring Activities



Control Environment

- Integrity and ethical values
- Commitment to competence
- Board of Directors or Audit Committee participation
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices



Risk Assessment

- Dynamic, iterative process for identifying and assessing risks to the achievement of objectives
- *Identify and assess changes that could significantly impact the system of internal control:*
 - Changes in the institution's operating environment
 - New personnel
 - New or revised information systems
 - Rapid growth within the institution
 - New technology
 - New lines, products or activities
 - Restructuring within the institution
 - Foreign activities
 - New accounting pronouncements
 - Fraud risks



Control Activities

- Actions established through policies and procedures that help ensure management's directives to mitigate risks to the achievement of objectives are carried out
- Remembering our overview of what internal controls are from earlier:
 - An inherent process performed designed to accomplish management's objectives
 - Accuracy of financial and nonfinancial reporting, compliance with laws and regulations
 - Effectiveness and efficiency of operations



Information and Communication

- Information necessary to support the achievement of objectives.
- Information must be relevant and accurate from both internal and external sources.
- Communication is continuous, disseminated throughout the organization.
- Enables a clear message from senior management that control responsibilities must be taken seriously.



Monitoring Activities

- Ongoing, separate evaluations, or some combination of the two are used to ascertain whether each of the five components is present and functioning.
- The results of the evaluation are evaluated against established criteria and communicated to management and the board, as appropriate.
- The criteria can come from regulators, recognized standard-setting bodies or management and the board of directors.





Materiality

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Calculating Materiality

- Consistent methodology
- Typically seen as a percentage of assets or net income
- Discuss with your internal auditor

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Calculating Materiality

\$1 Billion		\$2 Billion	
Total Assets	1,000,000	Total Assets	2,000,000
Applied %	0.50%	Applied %	0.50%
Benchmark Materiality	5,000	Benchmark Materiality	10,000
Factor Applied	75.00%	Factor Applied	75.00%
Performance Materiality	3,750	Performance Materiality	7,500
Performance Materiality	3,750	Performance Materiality	7,500
1/3 Threshold	1,875	1/3 Threshold	3,750
20% Threshold	750	20% Threshold	1,500
1/6 Threshold	625	1/6 Threshold	1,250
10% Threshold	375	10% Threshold	750

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Risk Assessment



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Risk Assessment

- Perform a risk assessment using qualitative and quantitative criteria
- Include both the balance sheet and income statement
- Risk assessment factors can include
 - Volume of transactions
 - Complexity of Transactions
 - Account Volatility
 - Judgment Estimates
 - Fraud



Polling

- Is your bank using a software for risk assessments? If so, please provide any positives or negatives, or any feedback.



Risk Assessment

Financial Reporting Classification	12/31/20 Balance	Overall Significance	\$ Materiality	Volume of Transactions	Complexity of Transactions	Account Volatility	Judgement Estimates	Fraud	Qualitative Risk
Balance Sheet									
Cash and Due from Banks	\$ 75,583	High	High	High	Low	High	Low	High	Medium
Interest Bearing Deposits in Other Banks	8,594	High	High	High	Low	High	Low	High	Medium
Securities	196,476	Medium	High	Low	Low	Low	Medium	Low	Low
Loans and Leases, Net of Allowance for Loan and Lease Losses	660,796	High	High	High	Medium	High	High	Medium	High
Interest Receivable	4,173	Medium	High	High	Low	Low	Low	Low	Low
Premises and Equipment, Net	31,255	Medium	High	Medium	Low	Low	Low	Low	Low
Foreclosed Assets	2,325	Medium	Medium	Low	High	Low	High	Low	Medium
Bank Owned Life Insurance	10,727	Medium	High	Low	Low	Low	Low	Low	Low
Goodwill	677	Low	Low	High	High	High	High	High	High
Intangible Assets	667	Low	Low	High	High	High	High	High	High
Other Assets	2,451	Medium	Medium	High	Medium	Medium	Low	Low	Medium
Total Assets	\$ 983,724								
Deposits - Interest Bearing	\$ 695,371	High	High	High	Low	High	Low	Medium	Medium
Deposits - Non-Interest Bearing	195,665	High	High	High	Low	High	Low	Medium	Medium
Short and Long Term Borrowings	14,022	Medium	High	Low	Low	Low	Low	Low	Low
Accrued Interest Payable	1,710	Low	Medium	High	Low	Low	Low	Low	Low
Other Liabilities	5,506	High	High	High	Medium	Medium	High	Medium	Medium
Common Stock	1,305	Low	Medium	Low	Low	Low	Low	Low	Low
Additional Paid-In Capital	23,553	Medium	High	Low	Low	Low	Low	Low	Low
Retained Earnings	45,489	Medium	High	Low	Low	Low	Low	Low	Low
Accumulated Other Comprehensive Income	1,103	Low	Medium	Low	Low	Low	High	Low	Low
Total Liabilities and Stockholders' Equity	\$ 983,724								

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Risk Assessment

Income Statement									
Interest Income - Loans and Leases, Including Fees	\$ 32,285	Medium	High	High	Low	Low	Low	Low	Low
Interest Income - Investment Securities	4,083	Medium	High	Medium	Low	Low	Low	Low	Low
Interest Income - Federal Funds Sold and Other Interest Income	1,106	Low	Medium	High	Low	Low	Low	Low	Low
Interest Expense - Checking and Savings Deposits	(1,992)	Low	Medium	High	Low	Low	Low	Low	Low
Interest Expense - Certificates of Deposit	(3,406)	Low	Medium	High	Low	Low	Low	Low	Low
Interest Expense - Notes Payable and Other Borrowings	(684)	Low	Low	Medium	Low	Low	Low	Low	Low
Provision for Credit Losses	(653)	Low	Low	Low	Low	Low	High	Medium	Medium
Service Charges, Commissions, and Fees	2,082	Low	Medium	High	Low	Low	Low	Low	Low
Derivative Income	2,124	Low	Medium	Low	High	Low	Low	Low	Low
Gain on Sales of Loans and Leases	-	Low	Low	Low	Medium	Low	Medium	Low	Low
Gain on Sales of Available-for-Sale Securities	241	Low	Low	Low	Low	Low	Low	Low	Low
Debit and Credit Card Fees	958	Low	Medium	Low	Low	Low	Low	Low	Low
Other Income	1,081	Low	Medium	Low	Low	Low	Low	Low	Low
Compensation and Employee Benefits	(16,339)	High	High	Low	Low	Low	High	High	Medium
Occupancy and Equipment	(2,650)	Low	Medium	Low	Low	Low	Low	Low	Low
FDIC Insurance	(252)	Low	Low	Low	Low	Low	Low	Low	Low
Goodwill Impairment and Intangible Amortization	(572)	Low	Low	Low	Low	Low	Medium	Low	Low
Data Processing	(1,849)	Low	Medium	Low	Low	Low	Low	Low	Low
Loss on Sale of Foreclosed Assets	(12)	Low	Low	Low	Medium	Low	Low	Low	Low
Loss on Sale of Premise and Equipment	(141)	Low	Low	Low	Medium	Low	Low	Low	Low
Derivative Expense	(1,260)	Low	Medium	Low	High	Low	Low	Low	Low
Other Expenses	(4,680)	Medium	High	Low	Low	Low	Low	Low	Low
Net Income	10,270								

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Scoping

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Determining Key Process Areas

- Utilize the materiality calculation, balance sheet and income statement data, and qualitative criteria to identify key processes, business units, locations, and applications/systems to be considered in scope
- Incorporate key general ledger accounts in the key process areas as well as critical processes that support the process

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Determining Key Process Areas

- Key areas from example risk assessment:
 - Cash and Due from Banks
 - Interest Bearing Deposits in Other Banks
 - Securities and Interest Income
 - Loans and Interest Income
 - Interest Receivable
 - Premises and equipment, Net
 - Bank Owned Life Insurance
 - Deposits
 - Short- and Long-Term Borrowings
 - Other Liabilities
 - Equity
 - Compensation and Employee Benefits



Determining Key Process Areas

- Additional key areas:
 - Information technology
 - Identify significant applications
 - Excel and significant spreadsheets
 - Vendor management
 - Access
 - SOC reports
 - Cloud services
 - Entity level
 - Related parties
 - Acquisitions
 - COSO required elements



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Implementation – Documentation of Design

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Overall Methodology



Responsibilities and objectives



Control framework



Control assessment process

Top-down approach
Risk assessment
Documentation
Narratives & matrices



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Overall Methodology



Testing

Timing – interim / year end / roll forward
Sample sizes – comply with auditing standards



Evaluation of findings

Individually
Aggregate



Remediation



Reporting

Internally
External audit



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Key Controls

- Key controls respond to threats of misstatement as identified through evaluating the financial statement assertions
- Only key controls over financial reporting need to be considering (this excludes regulatory and operational controls)
- Test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant financial statement assertion
- There might be more than one control that addresses the assessed risk of misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of misstatement to more than one relevant assertion
- The decision as to whether a control should be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of misstatement to a given relevant assertion



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Determining Key Controls

- Consider “telling a story” of how the process functions from start to finish
 - Who?
 - What ?
 - Where?
 - Why?
 - How?
 - By what means?



Types of Controls

- Key controls, regardless of the level at which they operate vary in how they work
 - Fully manual
 - Fully automated
 - Partly automated
 - automated
- Whether the control is
 - Preventative
 - Detective
- Whether the control works in combination with other controls or relies on the operation of other controls



COSO and Entity Level Controls



KEY CONTROL IDENTIFICATION



INSTITUTION MUST TEST KEY
CONTROLS



COSO MAPPING TO
COMPONENTS AND
PRINCIPLES



Walkthroughs - AICPA

Testing Controls

Evaluating Design Effectiveness

.57 The auditor should evaluate the design effectiveness of controls by determining whether the entity's controls, if they are applied as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the entity's control objectives, and can effectively prevent, or detect and correct misstatements caused by errors or fraud that could result in material misstatements in the financial statements.

.58 A smaller, less complex entity might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex entity might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the entity to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.

.59 Procedures performed to evaluate design effectiveness may include a mix of inquiry of appropriate personnel, observation of the entity's operations,

AT §501.53

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Examination of an Entity's Internal Control

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and inspection of relevant documentation. Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.



Walkthroughs - PCAOB

Understanding Likely Sources of Misstatement

.34 To further understand the likely sources of potential misstatements, and as a part of selecting the controls to test, the auditor should achieve the following objectives -

- Understand the flow of transactions related to the relevant assertions, including how these transactions are initiated, authorized, processed, and recorded;
- Verify that the auditor has identified the points within the company's processes at which a misstatement—including a misstatement due to fraud—could arise that, individually or in combination with other misstatements, would be material;
- Identify the controls that management has implemented to address these potential misstatements; and
- Identify the controls that management has implemented over the prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could result in a material misstatement of the financial statements.



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Walkthroughs - PCAOB

.37 *Performing Walkthroughs.* Performing walkthroughs will frequently be the most effective way of achieving the objectives in paragraph .34. In performing a walkthrough, the auditor follows a transaction from origination through the company's processes, including information systems, until it is reflected in the company's financial records, using the same documents and information technology that company personnel use. Walkthrough procedures usually include a combination of inquiry, observation, inspection of relevant documentation, and re-performance of controls.

.38 In performing a walkthrough, at the points at which important processing procedures occur, the auditor questions the company's personnel about their understanding of what is required by the company's prescribed procedures and controls. These probing questions, combined with the other walkthrough procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walkthrough allow the auditor to gain an understanding of the different types of significant transactions handled by the process.



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Walkthroughs

- A control test of one is not a walkthrough
- A control test of one is not a walkthrough
- A control test of one is not a walkthrough
- A control test of one is not a walkthrough
- A control test of one is not a walkthrough
- A control test of one is not a walkthrough



Walkthroughs

Scenario:

Management requests process owners to describe in a narrative how each control operates, and provide example documentation.

What was missed:

This is not a sufficient procedure to obtain or validate management's understanding of the entity's business processes. Walkthrough procedures should focus on more than just the controls. They should follow transactions through the entire process, from the initiation of the transaction to the recording of the transaction in the general ledger.

The purpose of the walkthrough is to gain an understanding of the process that will enable management and external auditors to identify relevant financial reporting risks and related controls. When walking through the controls instead of the process, there is a risk of not identifying sources of misstatement (i.e., WCGWs) for which controls are needed. ■



Walkthroughs

- Ask management:
 - To describe their understanding of previous and successive steps in the process or control activities;
 - To demonstrate how they perform the activity or control;
 - To describe what they are looking for to determine if there is an error (rather than simply asking them if they perform listed procedures and controls);
 - To explain what they do when they find an error;
 - To explain what kinds of errors they have found, what happened as a result of finding the errors, and how the errors were resolved;
 - To describe whether they have ever been asked to override the activity or controls and, if so, to describe the situation; and
 - To explain whether the transaction and the related process being discussed are typical of all transactions that flow through the process or whether other transactions follow a different process.

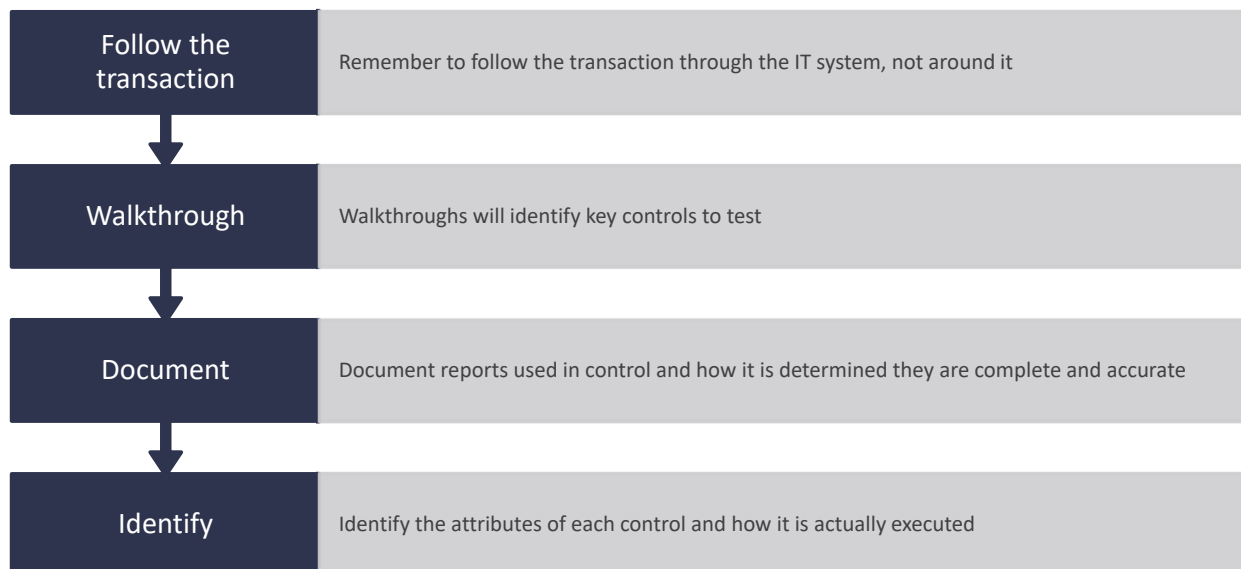


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Walkthroughs



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Conclusion

- Take the time to ensure the controls are thoroughly described
- Ensure all components and principles of COSO are addressed
- Focus on key controls over financial reporting, do not over test
- Make sure samples are statistically relevant and in accordance with auditing standards



Resources

- [AIPCA Internal Control Toolkit](#)



Thank You!
Any Questions?



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Engaging Employees, Management and Governance and the Utilization of IT Resources

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Setting the Tone

Obtain buy in from all stakeholders

- Kick-off meeting to discuss requirements and process
- CEO, CFO, etc. should set the tone for the project and explain the importance of the financial reporting integrity

Timely communication and planning

- Recurring meetings to assess
 - The state of the project
 - Milestone achievement
 - Issues or concerns
- Open communication
 - Internally and externally
- Determine if additional staffing requirements are needed

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Education



Good practice starts with educating all stakeholders including individual control operational owners all the way to the Board



In most cases, controls may exist, but minor enhancements might be involved in the process as well as documentation of the actual control for testing purposes

Understanding the documentation requirements for key controls

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Utilizing IT Resources

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Utilizing IT Resources

- Resources need to make sense to those stakeholders utilizing as well be simple enough for those involved to make updates and
- Consider the cross utilization of your resources with other functions of the Bank
 - Internal audit

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Ways to Screw Up

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Common Pitfalls

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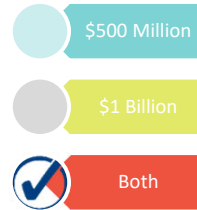
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Lack of Consistent Methodology

- Determine a clear methodology related to the:
 - Risk assessment
 - Sample sizes
 - Frequency of testing
 - Responsibility of testing
 - Documentation
 - Evaluation of control deficiencies, remediation
 - Communication with governance and external audit firm
- Clearly documented and agreed upon annually with any outsourced parties or firms



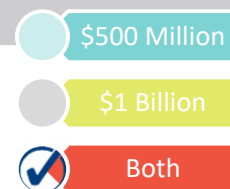
Assuming the Existing Internal Audit Function is Already FDICIA Compliant



Annual enterprise risk assessment to determine significant lines of business and support functions

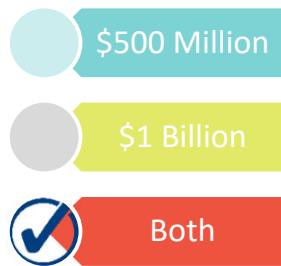


Evaluate time and resources to determine if independent individuals testing and reporting on FDICIA controls, have sufficient skills, training, and availability



Testing Too Many Controls

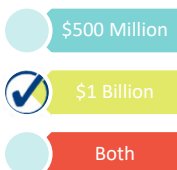
- Key controls are those that, if they fail, could lead to a material misstatement on your financial statements or regulatory reports



Not Sufficiently Testing Controls



ATTENTION SHOULD BE GIVEN TO THE DESIGN AND OPERATING EFFECTIVENESS OF KEY CONTROLS.

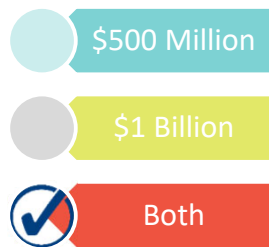


INCLUDE ATTRIBUTES SUCH AS VERIFYING COMPLETENESS AND ACCURACY OF THE UNDERLYING DATA, INQUIRY, OR OBSERVATION OF THE CONTROL OPERATOR, AND RE-PERFORMANCE OF THE STEPS WITHIN THE CONTROL IN ORDER TO DETERMINE THAT THE CONTROL CAN BE RELIED UPON.



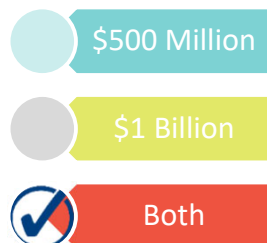
Lack of Precision in Review

- In many instances, sighting evidence of the reviewer's initials on a reconciliation is not sufficient to conclude that the control is designed and operating effectively.



Testing the Process Instead of the Control

- Spend time and resources focused on ICOFRs instead of operational processes instead of ICOFRs



Internal Audit is Acting as the Control



Watch for instances in which the internal audit function (or outsourced internal audit) is actually the control operator



If not independent of the control, your institution cannot assert on your own work



\$500 Million



\$1 Billion



Both



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Waiting Too Long to Start Testing

- Waiting until near the end of the year to perform testing, any control deficiencies noted may have to be reported because management no longer has enough instances of the control to remediate and test to conclude otherwise



\$500 Million



\$1 Billion



Both



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Ignoring Portions of the Year



RECOMMEND TESTING A PORTION OF YOUR SAMPLE SIZE AS OF OR NEAR YEAR-END

- ☐ \$500 Million
- ☒ \$1 Billion
- ☐ Both



SAMPLES SELECTED FROM A PRIOR YEAR'S ANNUAL REPORTING PERIOD DO NOT PROVIDE EVIDENCE OF CONTROL DESIGN AND OPERATION FOR THE CURRENT YEAR'S ATTESTATION AND OPINION



Lack of Audit Trail

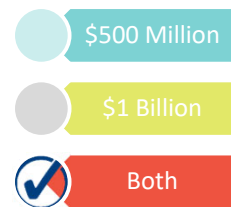
- Document
- Document
- Document

- ☐ \$500 Million
- ☐ \$1 Billion
- ☒ Both



Lack of Reporting

- Increases the potential of the external auditor reporting a significant deficiency or material weakness that might have otherwise been avoided
- Quarterly presentations to management, governance are recommended
- Annual presentations to the external auditor is recommended



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Any Questions?

Joshua Juergensen, CPA
Joshua.Juergensen@CLAconnect.com
612.201.3456

Erica Kottabi, CPA
Erica.Kottabi@CLAconnect.com
309.495.6909

David Heneke, CPA, CISA
David.Heneke@CLAconnect.com
320.203.5621

Liz Rider, CPA, MBA
Elizabeth.Rider@CLAconnect.com
515.222.4400

Mackenzie Rooney, CIA
Mackenzie.Rooney@CLAconnect.com
320.282.7915



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Implementation – Execute Effectiveness Testing

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Control Testing

- Must be linked to relevant assertion
 - There may be more than 1 key control linked to a relevant assertion,
 - BUT if there is no relevant assertion, it is likely not a key control
 - Control must be auditable, with specific attributes and documentation



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Control Testing

- 4 ways to testing internal control
 - Inquiry (not the best)
 - Inspection
 - Observation
 - Reperformance
 - If you did not perform the above, you did not test the control



Control Testing

- Inquiry
 - Discussing the controls with management
 - Least reliable form of testing
 - Should not be relied upon to determine if a control is operating effectively



Control Testing

- Inspection
 - Reviewing documentation supporting the control was executed
 - Ensure actual documents used in the control are reviewed



Control Testing

- Observation
 - Viewing the control being performed
 - Document observation dates and who you viewed execute the control



Control Testing

- Reperformance
 - Reperforming the control executed by an employee
 - Ensure you reperform the control the exact same way the employee executes it, use the same reports, perform the same procedure, etc.



Control Testing

- Management review reliant controls
 - Document the precision of review for controls where the primary activity is management review
 - Management needs to define the review procedures with specifics, in order to ensure it is auditable



Reporting and Remediation

- Required written reporting

AT 501 - The auditor also should communicate to management, in writing, all deficiencies (those deficiencies that are not material weaknesses or significant deficiencies) identified during the integrated audit on a timely basis, but no later than 60 days following the report release date, and inform those charged with governance when such a communication was made. In making the written communication referred to in this paragraph, the auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, whether those communications were made by the auditor, internal auditors, or others within the organization.

AS 2201 - The auditor also should communicate to management, in writing, all deficiencies in internal control over financial reporting (*i.e.*, those deficiencies in internal control over financial reporting that are of a lesser magnitude than material weaknesses) identified during the audit and inform the audit committee when such a communication has been made. The auditor should communicate this information to the audit committee in a timely manner and prior to the issuance of the auditor's report on internal control over financial reporting. When making this communication, it is not necessary for the auditor to repeat information about such deficiencies that has been included in previously issued written communications, whether those communications were made by the auditor, internal auditors, or others within the organization.



Reporting and Remediation

- Evaluation of control deficiencies 8010.00

Communicating ICFR-Related Matters

.59 The auditor should communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the integrated audit, including those that were remediated during the integrated audit and those that were previously communicated but have not yet been remediated. (Ref: par. .A105—.A107)

governance when such a communication was or is expected to be made. In making the written communication referred to in this paragraph, the auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, regardless of whether those communications were made by the auditor, internal auditors, or others within the organization. (Ref: par. .A110—.A112)



Reporting and Remediation

- Remediation – case specific
 - Consider
 - management’s root cause analysis
 - timing, portion of year, significance
 - if management changed a control and then tested without exception
 - If not remediated, have to report if consider a deficiency of a key control



IT Controls

- Internal Control over Financial Reporting (ICFR)
 - Evaluate and test key controls related to information technology (IT)
 - Consideration should be given to systems that are significant to the institution
 - Many institutions undergo an annual “IT general controls review” – helpful, but not sufficient
 - May need more extensive testing of certain key elements to satisfy management’s attestation and the external auditor’s opinion



IT Controls

- Generally expected control testing
 - Decommissioned Users
 - User Access Rights
 - SOC User Controls
 - Password sufficiency
 - SOC reviews
 - Disaster recovery and backup
 - Significant system software updates are authorized and tested in accordance with a formal change management process.



IT Controls

- Generally expected control testing
 - Core system configuration changes User Access Rights
 - Elevated User Access
 - Physical access
 - Interest income – loans, deposits, investments



Integration with External Audit

- If executed correctly, testing and documentation can be leveraged to reduce substantive testing
- The level of substantive testing should be directly related to overall of risk of the audit area and the identified effectiveness of internal control



Integration with External Audit



Planning is critical, institutions and audit teams should use a holistic planning approach for both control and substantive testing



Identify the more efficient test, i.e. control vs process



Resources

- [AIPCA Internal Control Toolkit](#)

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