OCC Directors Handbook

October 2003

G. Audits and Internal Control

Well-planned, properly structured, and effective audit and internal controls are essential to manage risk properly and to maintain a safe and sound bank. The board of directors must establish and maintain effective audit functions. An effective internal auditing process meets statutory and regulatory requirements as well as other audit-related supervisory guidelines and standards. Directors cannot delegate their responsibility for oversight of the auditing function. However, they may delegate the design, implementation, and monitoring of specific internal controls to management and the testing and assessment of internal controls to others.

The internal control system should, with reasonable assurance, help prevent or detect inaccurate, incomplete, or unauthorized transactions; deficiencies in the safeguarding of assets; unreliable financial and regulatory reporting; violations of laws or regulations; and deviations from the institution's own policies and procedures. Both internal and external auditors should monitor and evaluate the effectiveness of internal controls. The board of directors should determine how intensive auditing must be to test and monitor internal controls effectively and to ensure the reliability of the bank's financial statements and reporting.

The board of directors should consider whether the bank's control systems and auditing methods, records, and procedures are proper in relation to the bank's:

- Size.
- Organization and ownership characteristics.
- Business activities and product lines.
- Operational diversity and complexity.
- Risk profile.
- Methods of processing data.
- Applicable legal and regulatory requirements. (continued)

H. Consumer Compliance

Compliance with consumer laws and regulations is an integral part of a bank's business strategy. Violations and noncompliance can significantly impair a bank's reputation, value, earning ability, and business opportunity. To effectively monitor compliance with consumer laws and regulations, the board must receive timely and accurate reports on compliance matters. To ensure that directors learn immediately about significant violations and noncompliance, the designated compliance officer should have direct access to the board. The board should periodically receive formal reports on compliance matters. The complexity and extent of reporting will vary with the complexity and extent of the bank's operations, products, services, customers, and geographies served.

Consumer Compliance Red Flags:

- Lack of periodic reports to the board on compliance matters.
- The compliance officer reporting to someone other than the board of directors or a committee of the board.
- Significant deficiencies identified in compliance reviews that have not been corrected in a timely manner.
- Significant turnover, including the compliance officer, or a reduction in the staff responsible for ensuring compliance with laws or specific consumer products.
- Lack of evidence that compliance was adequately considered when new products and delivery systems were developed and introduced, or when new marketing materials were designed.