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Emerging Strong: A Fresh Look at Internal Controls

Kara Bowen, Managing Director | DHG Financial Services
Lindsay Schuster, Senior Manager | DHG Financial Services
Payal Shah, Manager | DHG Financial Services
Tayler Harvey, Manager | DHG IT Advisory

In this new normal, can we look at our environment, work-flow structure and economic impacts to claim business as usual? In this second half of 2020, it is pertinent for financial institutions to reassess the control environment and business processes to confirm changes are appropriately captured.

The timeliness of this key controls reassessment, related primarily to internal controls over financial reporting, compliance or operational risks, is imperative to catching any control gaps and deficiencies that may need remediation. Emerging strong for financial institutions is critical; therefore, the following are some considerations for financial institutions as they undertake their evaluation process.

New Controls

- **Paycheck Protection Program (PPP) Loan Originations Controls –** For loans originated as part of the PPP, consider whether they were originated in a similar manner to other Small Business Administration (SBA) loans taking place at the financial institution. If SBA loan originations is a new process, make sure that an understanding of the process is documented to aid in the identification of controls that may differ from other loan origination processes. Further, for any differences that may have been identified, consider evaluating whether any controls would be deemed key controls over financial reporting, such as new approvals needed, new systems utilized and new control owners.
- **PPP Loan Forgiveness Controls –** Financial institutions should develop the process for loan forgiveness. Once the process has been determined, management should identify the key financial reporting controls. These controls may consist of approval controls, forgiveness application review controls prior to submission to the SBA and segregation of duties between cash handling, transaction processing and monitoring.
- **Accounting for PPP Fees/Costs –** Management should consider whether any new controls were developed in accounting for PPP loans, such as whether any new accounts would require additional reconciliation procedures, and controls regarding the review of the accounting of the related fees and costs to ensure they are appropriate and in compliance with GAAP reporting. Consideration of whether these fees are accounted through an existing system or a spreadsheet should be made to determine whether there are sufficient change management controls in place.

- **Delay of Current Expected Credit Loss (CECL) Standard Adoption –** The Coronavirus Aid, Relief, and Economic Security (CARES) Act allowed public companies to delay the effective date of adoption for CECL to the earlier of the date when the COVID-19 national emergency is terminated or Dec. 31, 2020. Financial institutions that took advantage of this delay should continue to prepare for adoption of this standard during this year, confirming that they have sufficient control documentation to evidence this new process. Evidence of effective challenge of expected credit losses and other review controls will be crucial in light of the economic uncertainty related to COVID-19. Additionally, financial institutions that adopted CECL during the first quarter of the year should continue to reassess the impact of the pandemic on their models, especially the impact on key economic forecast variables, such as GDP and unemployment.
- **Remote access to networks and applications –** Management should consider which additional safeguards are necessary to support the remote work environment. The increase in employees and vendors accessing systems from outside of the office opens more avenues for attackers. Additional preventative and detective controls for remote access should be implemented. These controls may consist of logging and monitoring all remote access connections, restricting remote access during specific times, limiting the applications available for remote access, adding robust authentication methods for access and encrypting secure communications.

Modification of Existing Controls

- **Changes in Control Documentation –** As financial institution associates continue to perform duties virtually or in a remote environment, financial institutions should consider what type of documentation will be maintained. Process and control documentation may be performed electronically, and evidence of preparer and reviewer signoffs may look different. For example, journal entries that may have historically been printed and manually signed to show evidence of the preparer and who reviewed the entry may now be replaced with another method of signoff, such as a stamped signature. It is important to consider controls around access to spreadsheets and electronic files to prevent file manipulation and control evidence. If signoffs now occur within a Microsoft Excel workbook, control measures should be in place to ensure further modifications are tracked and signatures are authentic.
- **Troubled Debt Restructurings (TDRs) –** The CARES Act included provisions that allow financial institutions temporary relief in the accounting and financial reporting requirements for loans that would normally be considered TDRs. If this election is made, added or modified, controls may be warranted regarding updated and approved policy and procedural documents, review of modified loans not deemed TDRs and changes in information used to support or populate disclosure requirements.
- **Processing of Transactions and Reconciliation Performance –** Due to the current operating environment, processes such as transaction processing and reconciliations may now be performed later than usual. Financial institutions should consider reviewing when these processes are completed, and if there is a change, should assess if the process is still occurring timely. This may require determination and documentation to note the acceptable timeframe for these processes. Further, financial institutions should consider evaluating whether the level of supporting documentation has changed and check that the support retained remains sufficient for the process at hand.
- **Changes in Control Owners –** As employees are impacted by the pandemic, there may be an increase in the number of employees absent from work or taking leaves of absence, resulting in tasks assigned to fewer associates. Financial institutions should confirm that all control owners have identified back-up team members who have the appropriate level of competency to perform the required duties. Additionally, financial institutions should consider any potential segregation of duties issues that may arise with fewer employees or that could result from performing tasks virtually.
- **Changes in Access Reviews –** Management may decide to increase the frequency of access reviews to reduce the likelihood of terminated users retaining system access. Access reviews may also be enhanced to evaluate the actions performed by administrator accounts on key systems.
- **Enhancing Patch Management –** A centralized patch management solution may not promptly reach all laptops or telework computers. Management, with the help of the information technology (IT) department, should consider configuring all mobile devices to automatically contact vendor's online services to check for downloads and install necessary updates.

New Emphasis on Existing Controls

- Due to disruptions from the COVID-19 pandemic on the U.S. and global economies, there are several financial reporting items that may be applicable for the first time or since the last economic recession, present more complexity or be deemed higher risk in the current year. These include the accounting for estimates, especially ones with fair value assumptions, goodwill and other intangible impairment analyses and enhanced financial statement disclosures. The control procedures performed in developing these items will be crucial to validate that appropriate documentation is maintained to support management's rationale and conclusions.

- In order to comply with the Gramm-Leach-Bliley Act (GLBA) and the Federal Trade Commission's (FTC) Safeguard rule, financial institutions must prove that customer information is appropriately protected and secured. This may require financial institutions to enhance IT and human resources (HR) policies and procedures. Enhancements might include best practices for handling customer information when outside of the office and acceptable use of technology and VPN connections. It may also be necessary to re-train employees on how to handle sensitive information and to further educate employees regarding the risks when customer data is accessed from their home or other offsite locations.

As you work through this process of reevaluating your control environment, it is important to verify that any changes to controls and processes are captured appropriately within your risk assessment and communicated timely with your regulators, internal and external auditors.

DHG Contacts

Kara Bowen, CPA
Managing Director, DHG Financial Services

Lindsay Schuster, CPA
Senior Manager, DHG Financial Services

Payal Shah, CPA
Manager, DHG Financial Services

Tayler Harvey, CISM, CISA
Manager, DHG IT Advisory

benchstrength@dhg.com

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DHG Financial Services professionals provide you with in-depth industry knowledge and a wide range of advisory, assurance and tax services to address issues facing your industry in today's challenging environment.