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Owner: Sarah Collins: Chief Auditor
Section: Administrative
References:

1080.10 Internal Controls Procedure

PROCEDURE STATEMENT

These procedures accompany and implement certain aspects of the Internal Controls Policy.

PROCEDURE

Qualifications Of Internal Auditors and Reviewers

The person or persons engaged to perform the internal audit and review procedures designed to monitor compliance with the system of internal controls shall:

- Have adequate technical training and proficiency to perform the tasks to which he/she is assigned;
- Maintain an appropriate degree of independence in mental attitude and objectivity; and
- Exercise due professional care in the performance of his/her assigned tasks.

Standards for the training required to initiate the audit/review programs:

Internal Audit

- Attend annual national Review, Audit, Appraisal WorkGroup (RAAW) conference.
- Attend annual AgFirst Compliance Conference.
- Attend meetings of local chapter Institute of Internal Auditors (IIA).
- Seek certification as Certified Internal Auditor or Certified Financial Services Auditor.
- Complete at least 20 hours Continuing Education every year to maintain certification.

Internal Credit Review

- Attend annual national Review, Audit, Appraisal WorkGroup (RAAW) conference.
- Attend annual AgFirst Compliance Conference.

Internal Appraisal Review

- Certified General Appraiser licensure in good standing with the State where the work being reviewed is located.
- Successful completion of state appraisal board approved continuing education courses amounting to at least 28 hours every 2 years.
- Experience reviewing evaluations.

LOAN AND ASSET REVIEW AND ASSET QUALITY CLASSIFICATION (AICR)

Credit Administration

The Ag First Credit, Appraisal and Review Standards will be the basis for rating performance on individual loan actions and the performance of AgSouth overall. The CEO has established two committees to provide further internal controls: the Asset/Liability Management Committee (ALCO) and the Loan Committee.

An annual branch risk assessment will be completed, which will determine the frequency of branch reviews, along with the extent of testing. Minimum reporting criteria will include the following:

1. Accrual Loan Portfolio
 - Any risk rated 10-11 loan > \$300,000
 - Any loan > \$1,000,000 in exposure with risk rating of 9 and lower (i.e. 10-13)
 - Any Fair or Unsatisfactory graded loan
 - Any delinquent > 60 days
 - Any loan action which, in the reviewer's judgment, adds material risk to the portfolio
 - Director, employee, and related-party loans – summary level data (no financial information) will be included
2. Specials Asset Management (SAM)
 - Any loan with specific reserve
 - New transfers into/out of nonaccrual
 - New loans taken into acquired property

Special Assets Management

The sample for the SAM center will be included in the total sample. The nonaccrual review will include no less than 10% of the portfolio by number. This selection will be given to accounts with larger net balances and accounts not included in recent, previous reviews. The intent will be to review all significant nonaccrual accounts (> \$100k) on a revolving basis. Accounts will also be selected from each of the following categories but the relevance of accounts will be the overriding criteria for selection: (1) resolved accounts, (2) unresolved accounts and (3) accounts in litigation (bankruptcy or foreclosure).

The Other Property Owned sample will be stratified to include the following, if available: (1) acquisitions during the review period; (2) sales during the review period and accounts in inventory more than 3 months. 100% of new OPO acquired and sold will be reviewed during the quarter.

Credit Classification Testing

Credit classification will be tested on each account included in the credit administration review. Emphasis will be placed on the accuracy and timeliness of classification assignments.

Specific reserves will be tested in the same manner as credit classifications.

Other Areas

In addition to the credit review the following areas will be tested for propriety and compliance with regulations: perfection of liens on collateral, consumer lending regulations, disclosure of effective interest rates on loans not subject to truth in lending, collateral insurance, and borrowers' rights (proper notice of adverse action,

distressed borrowers' right to restructure, and previous owners' right to first refusal on acquired property). The review will include a select sample, if available, in each compliance area from each office.

The CEO will be provided an Executive Summary and a detailed report of findings following each quarterly review. Minimum reporting requirements and loan comments have been identified in the Internal Audit and Credit Review Plan.

APPRAISAL REVIEW

AgSouth will rely on the procedure for Appraisal Reviews as defined by the AgFirst District Credit Manual.

CONTRACTED APPRAISAL REVIEW

The Audit Committee will approve the sample size, focus, and the grading system for the contracted outside review. The grading system will be A, B or C for outside appraisal reviews. Appraisals graded C are unsatisfactory, seriously inaccurate, misleading or do not comply with the institution's policies, law, or federal regulation. These inadequacies may or may not lead to an inaccurate appraised value. All others are considered satisfactory.

The Audit Committee has the responsibility to ensure that the scope of the review provides feedback as to the performance of its appraisal function. With each appraisal reviewed, the appraisal reviewer should evaluate the compliance with recognized techniques and the reliability of the appraised value.

The Audit Committee will be provided a written report of the findings which addresses the scope of the review, the areas of significant concern and weaknesses, and an overall summary. The Contracted Reviewer will report findings to the Audit Committee. The Chief Appraiser will receive a report which provides detailed comments on each appraisal reviewed.

ADMINISTRATIVE APPRAISAL REVIEW

The Asset/Liability Committee (ALCO) will approve the review plan for an annual administrative appraisal review. The ALCO has the responsibility to ensure that the scope of the review provides feedback as to the performance and training of qualified evaluators and the quality of their work to help mitigate credit risk.

Loan Officers will maintain an Appraisal Log on all Personal Property Appraisals/Valuation completed. This log should be kept current and submitted to the Chief Appraiser or his designee upon request in order to conduct the Administrative Review.

The Chief Appraiser, or his designee, will complete a review sheet on each appraisal reviewed, complete a brief review summary, and maintain in a file. The grading system for appraisals reviewed will be A, B, or C. The ALCO will be provided a written report of the findings which addresses the scope of the review, the areas of significant concern and weaknesses, and an overall summary. The review details are available to Senior Management upon request. The Reviewer will report findings to the ALCO, and subsequently, the Risk Manager will report the findings of the review to the Risk Management Committee. Following reporting by the Risk Manager to the Risk Management Committee, if the Risk Management Committee determines any additional appraisal reviews are necessary, the Risk Management Committee will refer the audit to the Audit Committee for further consideration.

FINANCIAL AND OPERATIONS REVIEW

The F&O audit program will focus on achieving the following objectives:

- a. Evaluate the adequacy and effectiveness of the Association's internal controls;
- b. Determine the degree of compliance with policies and procedures, applicable regulations, and contracts;

- c. Determine the reliability and integrity of financial and operational information; and
- d. Assess the adequacy, effectiveness and efficiency of the Association's operating policies and procedures.

An evaluation of internal controls is conducted to provide reasonable assurance that:

1. Transactions are executed in accordance with management's authorization.
2. Transactions are recorded as necessary to permit preparation of financial statements in accordance with Generally Accepted Accounting Principals and maintain accountability for assets.
3. Access to assets is permitted only in accordance with management's authorizations.
4. The recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Schedule

Internal Audits will be conducted in office locations and Administrative office locations or remotely, as technology permits. The rotation schedule will be completed by the auditor and the Chief Financial Officer during the internal audit planning phase. Senior Management can elect to have specific office locations audited if deemed necessary.

Scope

An annual risk assessment will be completed on each audit component, which will assist in identifying allocation of resources, guiding the frequency of audits, and will be a factor in determining appropriate audit coverage.

A system of Transaction and Compliance Testing will be utilized with audit results documented in work papers. Additional work papers will be added as needed to ensure thorough and complete audits.

- Compliance testing will be conducted to ensure compliance with policies and procedures established by management, and if not, a reasonable basis for any differences is well-documented.
- Transaction testing will be conducted to ensure the system of internal controls is adequate and functioning properly, and that operations are carried out in accordance with prescribed policy and procedures. This is to ensure that transactions are properly classified, authorized, and posted accurately and timely.

RELATED POLICY

[1080 Internal Controls Policy](#)

Attachments:

No Attachments

Approval Signatures

Approver	Date
Ashleigh Barefield: Executive Admin Assistant	04/2017
Sarah Collins: Chief Auditor	04/2017