



**BOARD OF GOVERNORS**  
OF THE  
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DIVISION OF BANKING  
SUPERVISION AND REGULATION

BASEL COORDINATION COMMITTEE  
(BCC) BULLETIN

**BCC 13-6**

**May 2, 2013**

**SUBJECT: Guidance for Internal Audit under the Advanced Approaches Rule**

### **Background**

Under section 22(j)(5) of the Federal Reserve Board’s advanced approaches risk-based capital rule (rule),<sup>1</sup> a bank or a bank holding company (referred to hereafter as a “banking organization”) “must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the [bank]’s advanced systems and reports its findings to the [bank]’s board of directors (or a committee thereof).”

The “Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing,” issued in January 2013, addresses the characteristics, governance, and operational effectiveness of a banking organization’s internal audit function.<sup>2</sup> Building on the policy statement, the guidance below discusses the role of the independent audit function in assessing the effectiveness of internal controls supporting a banking organization’s advanced systems.

### **General Implementation Guidance**

In order to assess the effectiveness of controls supporting a banking organization’s advanced systems, the banking organization’s internal audit function should have a working knowledge of all rule requirements and an in-depth knowledge of the banking organization’s advanced systems used to achieve compliance. Specifically, internal audit should have a comprehensive understanding of the control environment supporting the advanced approaches framework, including associated policies and procedures that document how the banking organization achieves initial and ongoing compliance with the qualification requirements of the rule.

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<sup>1</sup> 12 CFR part 208, appendix F (state member banks), and 12 CFR part 225, appendix G (bank holding companies).

<sup>2</sup> See SR letter 13-1/CA letter 13-1, “Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing.” (<http://www.federalreserve.gov/bankinfo/srletters/sr1301.htm>).

Internal audit should have a documented plan describing its strategy to develop and deliver an assessment of the controls supporting the banking organization's advanced systems. Such a strategy should include a process to determine whether sufficient work was completed to make the assessment, consolidate audit results, identify the test work of other parties (if any), and arrive at a conclusion on the effectiveness of the controls. Internal audit should have effective processes in place to track, monitor, and follow-up on any open or resolved audit issues.

To achieve a comprehensive understanding of the controls supporting the banking organization's advanced systems, internal audit may choose to adopt a risk-focused audit approach. A risk-focused approach does not require all controls in every advanced system to be tested annually; however, each advanced system should be audited annually. Regardless of approach, the audit plan should ensure that the internal audit function's annual assessment of controls is based on appropriate data and the review conclusions are well founded. Internal audit should ensure that the depth and comprehensiveness of its evaluation fully supports the assessment of the controls supporting the banking organization's advanced systems.

Consistent with section 22(j)(5) of the rule, internal audit must document and report findings to the board of directors or designated committee thereof. Internal audit should deliver an assessment with respect to the effectiveness of controls supporting each of the banking organization's advanced systems and all advanced systems collectively. Such a statement should include an explicit conclusion regarding the effectiveness of controls supporting each of the advanced systems and the entirety of the advanced approaches framework. This assessment should be adequately supported by evidence from the relevant audit(s). The report should incorporate a discussion around the scope of internal audit's reviews such that the board of directors has a clear understanding of the controls that have been assessed and those that require additional evaluation. Internal audit's report to the board of directors should be sufficiently specific and informative so that the board may take appropriate actions to help ensure the effectiveness of controls and compliance of the banking organization's advanced systems with the rule.

Internal audit must comply with section 22(j)(5) of the rule during a banking organization's parallel run and as part of the process to ensure ongoing compliance with the rule's qualification requirements. Internal audit should have proper incentives, stature within the organization, skills, and adequate training in the rule's requirements to assess the controls of the advanced systems. Internal audit also should have a process to promptly report identified issues and escalate critical issues for senior management and board attention, as appropriate.