

Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

January 31, 2013

To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, Savings and Loan Holding Companies,
and Foreign Banking Offices
in the Twelfth Federal Reserve District

SR/CA 13-1: Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing

Applicability to Community Banking Organizations: This guidance does not apply to community banking organizations, defined as institutions supervised by the Federal Reserve with total consolidated assets of \$10 billion or less.¹

The Federal Reserve is issuing the attached policy statement, *Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing*, to provide institutions² with additional guidance related to interagency guidance that was issued in 2003 and remains in effect.³ Building upon the 2003 interagency guidance, the attached supplemental guidance addresses characteristics, governance, and operational effectiveness of an institution's internal audit function.

Further, this supplemental guidance explains changes over the past several years in banking regulations related to auditor independence and limitations placed on the external auditor. In summary, the supplemental guidance addresses:

- **Enhanced Internal Audit Procedures** – discusses the enhancements that an institution should incorporate into its internal audit function to address lessons learned from the recent financial crisis.
- **Internal Audit Function** – addresses the characteristics, governance, and operational effectiveness of an institution's internal audit function.
- **Internal Audit Outsourcing Arrangements** – covers the responsibilities of an institution's board of directors and senior management to provide appropriate oversight of internal audit outsourcing arrangements.
- **Independence Guidance for the Independent Public Accountant** – addresses certain changes to Section 36 of the FDI Act⁴ enacted since the issuance of the 2003 interagency guidance. Further, the supplemental guidance discusses the restrictions on the services of an institution's internal auditor.
- **Examination Guidance** – discusses the supervisory assessment of an institution's internal audit function and the ability of examiners to rely on work performed by internal audit.

¹ Section 4 of the attached policy statement, however, clarifies certain changes to the Federal Deposit Insurance Corporation regulation (12 CFR part 363) on independence standards for independent public accounts at insured depository institutions with total assets of \$500 million or more, which were adopted pursuant to 2009 amendments to Section 36 of the Federal Deposit Insurance Act (FDI Act).

² For purposes of this guidance, "institutions" refer to state member banks, domestic bank and savings and loan holding companies, and U.S. operations of foreign banking organizations with total consolidated assets of \$10 billion or more.

³ Refer to SR letter 03-5, "Amended Interagency Guidance on the Internal Audit Function and Its Outsourcing."

⁴ See 12 CFR part 363.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's website, at <http://www.frbsf.org/banking/letters>.

For additional information, please contact:

Federal Reserve Bank of San Francisco
Banking Supervision and Regulation
(415) 974-3100

Attachment:

[*Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing*](#)

Cross References:

[SR letter 12-7 / CA letter 12-4](#), "Consolidated Supervision Framework for Large Financial Institutions"
[SR letter 03-5](#), "Amended Interagency Guidance on the Internal Audit Function and its Outsourcing"