

Risk Based Internal Audit (RBIA) Framework

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In news

Reserve bank asks banks to align the internal audit function like those issued by the Basel Committee on Banking Supervision (BCBS) and the Institute of Internal Auditors (IIA).

Background

According to a 2002 guidance note of RBI, banks are required to put in place a risk based internal audit (RBIA) system as part of their internal control framework that relies on a well-defined policy for internal audit, functional independence with sufficient standing and authority within the bank, effective channels of communication, adequate audit resources with sufficient professional competence, among others.

While the aforesaid Guidance Note(2002) lays out the basic approach for risk based internal audit functions, banks are expected to re-orient their approach, in line with the evolving best practices, as a part of their overall Governance and Internal Control framework. Banks are encouraged to adopt the International Internal Audit standards, like those issued by the Basel Committee on Banking Supervision (BCBS) and the Institute of Internal Auditors (IIA).

The RBI's advisories to banks

To bring uniformity in approach followed by the banks, as also to align the expectations on Internal Audit Function with the best practices, banks are advised as under:

Authority, Stature and Independence:

- As per RBI circular, the **internal audit function must have sufficient authority, stature, independence and resources within the bank**, thereby enabling internal auditors to carry out their assignments with objectivity.
- Accordingly, the **Head of Internal Audit (HIA) shall be a senior executive of the bank** who shall have the ability to exercise independent judgement.
- The HIA as well as the internal audit function shall have the authority to communicate with any staff member and have access to all records or files that are necessary to carry out the entrusted responsibilities.

Competence:

- Requisite professional competence, knowledge and experience of each internal auditor is essential for the effectiveness of the bank's internal audit function.
- The desired areas of knowledge and experience may include banking operations, accounting, information technology, data analytics and forensic investigation, among others.
- Banks should ensure that internal audit function has the requisite skills to audit all areas of the bank.

Staff Rotation:

- Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the **Board should prescribe a minimum period of service for staff in the Internal Audit function.**
- The Board may also examine the feasibility of prescribing at least one stint of service in the internal audit function for those staff possessing specialized knowledge useful for the audit function, but who are posted in other departments, so as to have adequate skills for the staff in the Internal Audit

function.

Tenor for appointment of Head of Internal Audit:

- Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the **HIA shall be appointed for a reasonably long period, preferably for a minimum of three years.**

Reporting Line:

- **The HIA shall directly report to either the Audit Committee of the Board (ACB) / MD & CEO or Whole Time Director (WTD).**
- Should the Board of Directors decide to allow the MD & CEO or a WTD to be the 'reporting authority' of the HIA, then the 'reviewing authority' shall be with the ACB and the 'accepting authority' shall be with the Board in matters of performance appraisal of the HIA.
- Further, in such cases, the ACB shall meet the HIA at least once in a quarter, without the presence of the senior management, including the MD & CEO/WTD.
- **The HIA shall not have any reporting relationship with the business verticals of the bank** and shall not be given any business targets.
- **In foreign banks operating in India as branches, the HIA shall report to the internal audit function** in the controlling office / head office.

Remuneration:

- The independence and objectivity of the internal audit function could be undermined if the remuneration of internal audit staff is linked to the financial performance of the business lines for which they exercise audit responsibilities.
- Thus, the **remuneration policies should be structured in a way that it avoids creating conflict of interest and**

compromising audit's independence and objectivity.

Other conditions

- The **internal audit function shall not be outsourced.**
- However, where required, experts, including former employees, could be hired on contractual basis subject to the ACB being assured that such expertise does not exist within the audit function of the bank.
- Any conflict of interest in such matters shall be recognised and effectively addressed.
- **Ownership of audit reports in all cases shall rest with regular functionaries of the internal audit function.**
- **Banks must ensure and demonstrate through proper documentation** that their risk-based internal audit framework captures all the significant criteria / principles suited for their organisational structure, the business model and the risks.
- According to RBI, the instructions contained in this circular shall come into effect immediately from the date of this circular

Basel Committee on Banking Supervision (BCBS)

- The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters.
- Its 45 members comprise central banks and bank supervisors from 28 jurisdictions.
- The Basel Committee, initially named the Committee on Banking Regulations and Supervisory Practices
- It was established by the central bank Governors of the Group of Ten countries at the end of 1974 in the aftermath of serious disturbances in international

currency and banking markets

- The Committee, headquartered at the Bank for International Settlements in Basel, was established to enhance financial stability by improving the quality of banking supervision worldwide, and to serve as a forum for regular cooperation between its member countries on banking supervisory matters.
- The Committee's first meeting took place in February 1975, and meetings have been held regularly three or four times a year since.
- Since its inception, the Basel Committee has expanded its membership from the G10 to 45 institutions from 28 jurisdictions.
- Starting with the Basel Concordat, first issued in 1975 and revised several times since, the Committee has established a series of international standards for bank regulation, most notably its landmark publications of the accords on capital adequacy which are commonly known as **Basel I, Basel II and, most recently, Basel III.**

Institute of Internal Auditors (IIA)

Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with global headquarters in Lake Mary, Florida, USA. The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.