

# **Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks**



**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

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Audit of Internal Financial Controls  
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E-mail : [aasb@icai.in](mailto:aasb@icai.in)

Website : [www.icai.org](http://www.icai.org)

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## Foreword

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Assessment of internal financial controls over financial reporting is a vital responsibility of the auditor, cast by Standards on Auditing (SAs). Reporting on internal financial controls by auditor is also not a new requirement in India. The Companies Act, 2013 introduced Section 143(3)(i) which requires statutory auditors of companies (other than exempted class of companies) to report on the internal financial controls of companies. The Auditing and Assurance Standards Board of ICAI issued the “Guidance Note on Audit of Internal Financial Controls Over Financial Reporting” in 2015 to provide guidance to auditors on this reporting requirement. The Reserve Bank of India vide its communication to public sector banks in March 2020 (followed by communication in May 2020) has made reporting on internal financial controls in public sector banks mandatory for statutory auditors from the financial year 2020-21 onwards. Therefore, a need was felt for providing appropriate guidance to auditors on this new reporting requirement in case of public sector banks so that they can discharge their reporting obligation with efficacy.

I am happy that the Auditing and Assurance Standards Board of ICAI has brought out this “Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks” for the benefit of the members. The objective of bringing out this Technical Guide is to provide a supplementary resource to auditors on the “Guidance Note on Audit of Internal Financial Controls Over Financial Reporting” while carrying out audit of internal financial controls in case of public sector banks. The Technical Guide has been written in easy to understand language.

I compliment CA. G. Sekar, Chairman, CA. Shrinivas Y. Joshi, Vice-Chairman and all members of the Auditing and Assurance Standards Board for their efforts in bringing out this Technical Guide for benefit of the members and other stakeholders.

I am sure that the members and other stakeholders would find this Technical Guide immensely useful.

March 12, 2021  
New Delhi

**CA. Nihar N Jambusaria**  
President, ICAI



## Preface

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Section 143(3)(i) of the Companies Act, 2013 requires auditors of companies (other than exempted class of companies) to report in their auditor's report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls. In 2015, the Auditing and Assurance Standards Board (AASB) of ICAI issued the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting" to provide detailed guidance to auditors on this reporting requirement. Such reporting on internal financial controls was not required in case of public sector banks till financial year 2018-19. The RBI has made reporting on internal financial controls mandatory for statutory auditors of public sector banks from financial year 2020-21 (such reporting was recommendatory for financial year 2019-20). AASB undertook the task of developing a specific Technical Guide to provide appropriate guidance to auditors on this new reporting requirement prescribed by RBI.

We feel immense pleasure in placing in hands of the members this "Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks" issued by the Board. The Technical Guide has been developed in easy to understand language and provides additional guidance in relation to certain specific matters that may arise in an audit of internal financial controls in case of public sector banks. We may caution the members that this Technical Guide is not a substitute for the publication "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting" and this Technical Guide should be used in conjunction with the Guidance Note while carrying out audit of internal financial controls in case of public sector banks.

At this juncture, we wish to place on record our sincere gratitude to CA. Aniket Sunil Talati, Central Council member for leading the

study group under his able convenorship. Our deepest gratitude is also due to key resource person CA. V. Balaji and all other members of the study group viz., CA. Shrinivas Y. Joshi, CA. Dayaniwas Sharma, CA. Niranjan Joshi, CA. Gopal Dhakan, CA. Vitesh D Gandhi and CA. Heneel Patel for sparing time out of their other preoccupations to develop this Technical Guide.

We express our sincere thanks to CA. Nihar N Jambusaria, Honourable President, ICAI, CA. (Dr.) Debashis Mitra, Honourable Vice-President, ICAI and CA. Atul Kumar Gupta, Honourable Immediate Past President, ICAI for their guidance and support to the activities of the Board.

We also express our sincere thanks to all the Board members and all the Central Council members for their suggestions, support and guidance in finalising this Technical Guide. We also express our sincere thanks to RBI officials for their valuable suggestions on this Technical Guide. We appreciate the efforts made by CA. Megha Saxena, Secretary, AASB and other staff of AASB in finalizing this Technical Guide.

We are confident that the members would find this Technical Guide immensely useful.

**CA. Shrinivas Y. Joshi**  
Vice Chairman, AASB

**CA. G. Sekar**  
Chairman, AASB

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## 1. Introduction

1.1 Auditor's reporting on internal controls is not a new requirement in India. This requirement was introduced in Manufacturing and Other Companies (Auditor's Report) Order, 1988 (MAOCARO, 1988) which required auditors to report if there was an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of stores, raw materials, including components, plant and machinery, equipment and other assets, and for the sale of goods. The Companies Act, 2013 introduced section 143(3)(i) which required the auditors of companies, other than specified class of companies, to report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

1.2 Since Public Sector Banks ("**PSBs**") are not companies under the Companies Act, 2013, auditor's reporting on internal financial controls with reference to financial statements was hitherto not applicable to PSBs.

1.3 The RBI vide its letter no. DOS. ARG No.6270 /08.91.001/2019-20 dated 17<sup>th</sup> March 2020 has directed the PSBs to advise their Statutory Central Auditors ("**SCAs**") to report in their independent auditor's report, inter alia, whether the Bank has adequate internal financial controls system in place and the operating effectiveness of such controls [Refer paragraphs 108 and 109 and IG 11 and IG 12 of the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting" issued by the ICAI in September 2015 ("**the Guidance Note**") for testing the design of a control and paragraphs 110 and 111 and IG 13 of the Guidance Note for testing operating effectiveness of controls]. Subsequently, the RBI in May 2020 clarified that the reporting on internal financial controls system is with reference to financial statements.

1.4 The aforesaid reporting on internal financial controls with reference to financial statements was recommendatory for the financial year ended March 31, 2020 and is mandatory with effect from the financial year ended March 31, 2021. Extract of the RBI

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advice and the subsequent clarification are given as **Appendix I and II** to this Technical Guide respectively.

1.5 In the case of Banks, including PSBs, the guiding principles on objectives, strategy, scope and coverage of Long Form Audit Report (“**LFAR**”) prescribed by the RBI requires the SCAs and the Statutory Branch Auditors (“**SBAs**”) to consider the Bank’s internal control including the control culture of the bank, structure and complexity of the IT systems, etc. when determining the audit strategy and for reporting on various particulars of the Bank’s operations in the LFAR. As such, reporting on internal controls in the case of Banks is not entirely new under the aforesaid advice of the RBI.

1.6 It may be noted that the principles and guidance stated in the Guidance Note though issued with reference to section 143(3)(i) of the Companies Act, 2013 shall be equally applicable to reporting on internal financial controls with reference to financial statements even in the case of PSBs since the fundamental concepts of internal financial controls and the approach to testing such controls would be similar in an audit of companies and in an audit of PSBs and therefore should be followed wherever applicable.

1.7 This “Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks” has been issued by the Auditing and Assurance Standards Board of ICAI to provide additional guidance in relation to certain specific matters that may arise in an audit of internal financial controls with reference to financial statements of PSBs. It may be noted that this Technical Guide should be used in conjunction with the Guidance Note while carrying out audit of internal financial controls in case of public sector banks. The guidance provided in this Technical Guide can be used in any audit of internal financial controls with reference to financial statements to the extent relevant.

### **Board Responsibility for Internal Controls in a PSB and the SCA Responsibility**

1.8 Preparation of the financial statements of the Bank as a whole (after consolidation of accounts of branches) is the

responsibility of the Bank's management. RBI vide its Circular No DBOD.No.BP.BC.72/ 21.04.018/2001-02 dated February 25, 2003 has issued guidelines to banks on consolidated accounting and other quantitative methods to facilitate consolidated supervision. This responsibility also includes maintenance of adequate accounting records for safeguarding of the assets of the Bank and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Those Board of Directors are also responsible for overseeing the Bank's financial reporting process.

1.9 As per the requirements of the RBI, SCAs are required to report whether the Bank has adequate internal financial controls with reference to financial statements (hereinafter referred as internal financial controls over financial reporting or IFCoFR) and whether such controls were operating effectively as at the Balance Sheet date.

1.10 It appears that the aforesaid reporting on IFCoFR has been mandated only for PSBs. As such reporting on IFCoFR is not applicable for cooperative banks and other banks that are not companies incorporated under the Companies Act, 2013 or the Banks incorporated under the Banking Regulation Act, 1949. This Technical Guide and the Guidance Note, to the extent applicable, will become applicable to such banks when they are notified for reporting on IFCoFR by the RBI.

### **Applicability to SBAs**

1.11 As per RBI requirement, SCAs are required to report on IFCoFR of the Bank. Since the financial statements of the Bank will include the financial information relating to the branches,

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whether in India or outside India, reporting on IFCoFR will be applicable in respect of branches. For this purpose, the branches that are required to be covered for reporting on IFCoFR will be determined and scoped in by the SCAs. It is not necessary that all the branches of the Bank are covered for reporting on IFCoFR since the controls operating at the branches will be common controls (refer paragraph 3 below) that are designed centrally at the Bank and operated at the branches.

1.12 As part of planning the audit for the bank, SCAs are required to scope in the branches for testing and reporting on IFCoFR and send appropriate referral instructions to the SBAs that are so scoped in. At branches, the design of control would not be required to be tested since the controls are expected to be designed centrally, whose design and implementation will be tested centrally by the SCAs. Accordingly, the SBAs would be required to test only the operating effectiveness of IFCoFR at the branches based on sample sizes to be tested at each branch as determined by the SCAs.

### **Reporting on IFCoFR**

1.13 Reporting on IFCoFR by the SCAs has not been directly specified under the Banking Regulation Act, 1949 (hereinafter referred as “**the Act**”). The RBI requirement on reporting on IFCoFR by the SCAs has been issued in the context of “Appointment of Central Statutory Auditors of Public Sector Banks – Reporting obligations for SCAs from FY 2019-20. Since the requirement for such reporting is a regulatory requirement by the RBI, SCAs should include the reporting on IFCoFR as part of reporting under “Report on Other Legal and Regulatory requirements” section of the independent auditor’s report.

### **Applicability of Reporting on IFCoFR in the case of Consolidated Financial Statements (i.e. including Subsidiaries) of a Bank**

1.14 It may be noted that section 129(4) of the Companies Act, 2013 states that “*the provisions of this [Companies] Act applicable to the preparation, adoption and audit of the financial statements*”

*of a holding company shall, mutatis mutandis, apply to the consolidated financial statements*". The RBI requirement is that the SCAs should report if the Bank has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls. Sub-section (2) of Section 30 of the Banking Regulation Act, 1949 ("**the Act**") states that the powers and functions of an auditor of a banking company shall be as provided in Section 227 of the Companies Act, 1956. This sub-section of Section 30 has been made applicable to SBI and Nationalized Banks by its incorporation in Section 51 of the Act. Since the Companies Act, 1956 has already been repealed and re-enacted as the Companies Act, 2013, the corresponding provisions in the Companies Act, 2013 appearing in Section 143 shall be deemed to apply to the banking companies, Nationalized Banks and SBI. As Section 129 of the Companies Act, 2013, is, prima facie, not applicable to PSBs, the reporting requirement as introduced by RBI regarding IFCoFR will apply only to standalone financial statements of PSBs and not to consolidated financial statements of PSBs.

## **2. Joint Auditors Responsibilities**

2.1 The joint auditors of PSBs should comply with the requirements of SA 299(Revised), "Joint Audit of Financial Statements" in an audit of IFCoFR. The following should be considered by the joint auditors in this regard:

- Agree on the scope of coverage of branches for audit of IFCoFR.
- Division of work on the audit, including audit of IFCoFR.
- Plan for coordination with SBAs for the audit including audit of IFCoFR.

2.2 The joint auditors should discuss and document the nature, timing and the extent of the audit procedures including the testing of the IFCoFR for common and specific allotted areas of audit to be performed by each of the joint auditor and the same shall be communicated to those charged with governance of the PSB. The work allocation document should be signed by all the

joint auditors. With all banks on CBS platform and with the level of automation, the division of work is usually done based on various departments at the Head Office (HO), like treasury, central accounts, etc. or geographical areas. However, certain areas of work, owing to their nature or importance may not be divided and may be covered by all the joint auditors.

2.3 Illustrative format of engagement letter by SBAs and SCAs for audit of IFCoFR is given in **Appendix III** and **IV**, respectively to this Technical Guide.

### **3. Common Controls**

3.1 A common control is one that is centrally designed and intended to be performed consistently in accordance with the manner in which it was designed across different components or locations (e.g. the controls over deposits and advances may be the same across branches). The auditor may consider the following questions and characteristics in evaluating the commonality of a relevant control:

- i. Is the control developed centrally and required to be implemented as designed at some or all components or locations?*

Evidence that the auditor may consider in making his assessment about whether the control is considered common across the components or locations where it is implemented includes:

- Whether an appropriately detailed description of the control is maintained centrally and clearly establishes the expectations of what is to be performed at each component or location where the control is implemented, such that the auditor can conclude the control is designed to operate consistently at all such components or locations. The following factors may be considered when making this conclusion:

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- What are the various aspects of the control or the specific activities that the person operating the control should perform?
  - Who should perform the control, including whether different aspects should be performed by different people?
  - What is the specified frequency with which the control should operate?
  - Are thresholds for investigation or further analysis or follow-up specified, and if so, what are they?
  - What reports or other information should be used to operate the control?
  - What documentation or evidence of the operation of the control should be created and maintained?
  - Whether the policies and procedures have been documented in writing and communicated to the control performers.
  - Whether training is provided to the individuals responsible for performing the control, and whether such training is consistent among the different components or locations at which the control is implemented.
  - Whether management at the locations or components where the control is implemented is permitted to make modifications to the design of the control to take into account any specific or unique considerations, such that the operation of the control (and therefore the auditor's testing of the design and operation of the control), would likely need to vary by component or location.
- ii. *Is the control performed and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components or locations where the control is implemented?*

A control performed in multiple components or locations will be performed by different personnel at the various components or locations. In these circumstances, the auditor considers whether the control is performed and, if applicable,

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monitored by person(s) at the components or locations who have similar levels of competence and appropriate levels of authority to support consistent operation of the control across the components or locations where the control is intended to operate, regardless of the title or position of the control performer.

- iii. *If the control is automated, is it configured in the same IT application across the components or locations?*

For an automated control to be considered “common” across the bank, generally the application systems at the components or locations where the automated control operates need to be the same and each instance of the application system needs to be configured in the same way in order to support a conclusion that such an automated control is a common control. When there are different IT applications deployed by the bank across the components or locations, the automated control is typically not a common control.

**For example**, if a bank has five instances of the Core Banking Solutions (CBS) application and all five instances are configured the same way, the auditor can conclude an automated control in the CBS application is a common control. It may be noted that in this case the auditor would perform procedures to confirm that the configuration is the same for the five instances of CBS to evidence the auditor’s conclusion that the automated control is a common control.

Conversely, if a bank runs CBS at one location and JD Edwards at another location, while both systems may have a similar automated control, the automated control would not be common across these two applications and would need to be tested separately for each application. This is because the program code, data, and general IT controls underlying each application are unique, and, as such, a test of one would need to be completed for the automated control separately for each IT application.

- iv. *If a control uses information from IT systems, are the IT systems that generate the information the same across the components or locations?*

Determining whether a control is common will depend on specific consideration of the facts and circumstances, including the similarity of the business activities of the components or locations where the control is implemented. When the processes and risks at the components or locations where the control is implemented are the same or very similar and the controls do not require significant judgment, it is more likely that such controls may be considered common across components or locations. However, when the business activities at the components or locations are less similar, it is also less likely that processes and risks are common, and therefore less likely that the controls may be considered common. In addition, as the extent of judgment involved in operating controls at different components or locations increases, so too does the likelihood that such controls may not be considered common (e.g., controls related to management estimates, controls with a review element that address multiple risks and assertions for multiple account balances).

Generally, controls that operate at various components or locations, but that are supported by and use information from the same IT system(s) are more likely to be considered common controls than controls that are not supported by the same IT systems. When the use of different IT systems results in different processes and inputs (e.g., data) or outputs (e.g., reports) that are used in the operation of the control, the controls over the information will be different and will need to be tested separately. Further, the control procedures that use such inputs and outputs may also be performed differently and therefore may be less likely to be considered common controls.

**For example**, consider a control with a review element over the allowance/provision for Non-performing Advances (NPAs), which relies upon an Aging report. If a bank uses

different loan management system to extract Aging report, the Aging report is a separate report for each application, as it has separate program code, source data, and general IT controls underlying it. In this case, the controls over the Aging report need to be tested separately for each application. The control with a review element that uses this report may be common (i.e., performed the same way for each location, regardless of whether the Aging report is generated from different system). As such, it may be appropriate to consider the control with a review element, a common control across the locations, but the controls that address the completeness and accuracy of the Aging report are tested separately for the Aging Reports from each of the system.

v. *Is the control centrally monitored?*

This consideration relates to whether the control is monitored on a central basis (e.g., at the group or corporate level or at a segment level) and whether exceptions or deviations from the prescribed operation of the control would be discovered timely, thereby enabling remediation in order to maintain standardization of the operation of the control across the components or locations.

**For example**, if the bank has an internal audit function, the auditor may consider what components or locations the internal auditors are planning to visit, what testing procedures they will perform at the components or locations they will visit, how frequently they visit the components or locations, as well as the results of their procedures.

**For example**, a bank's management may monitor the control activities at the component or location level via an ongoing "dashboard of key performance indicators" that provides relevant information, both direct and indirect, about the ongoing operation of controls at the component or location level.

3.2 When a control is common, the evaluation of the design of the control is typically performed centrally (i.e. by the SCA). When the detailed evaluation of design of the control needs to be

performed at the component or location level, this is typically an indicator that the auditor will generally not be able to treat such controls as common. When performing the tests of operating effectiveness of controls at the selected components or locations (including when directing component auditors to perform such testing), the auditor considers whether the evidence obtained supports the conclusion that the control is in fact a common control.

3.3 The objective of the auditor's testing of a common control that operates across multiple components or locations is typically two-fold:

1. To determine whether a control identified as common is in fact implemented consistent with the common design and operating commonly across the components or locations.
2. To obtain sufficient evidence of operating effectiveness of the common control across the components or locations (by testing the common controls as a single population across the components or locations where it is implemented).

3.4 The determination of the auditor's sampling strategy for a common control that operates at different components or locations and the determination of the components or locations to be tested is a matter of professional judgment. The following outlines the auditor's considerations in this regard:

- Auditor should follow the guidance provided in paragraph 99 of the Guidance Note and IG 1 of the Guidance Note on "*Multiple Locations Scoping Decision*".
- Start with the minimum sample size based on the sample size provided in Appendix VI to the Guidance Note based on the assessed risk associated with the control, as well as the number of times the control operates across all locations.
- Consider increasing the overall sample size above the sample sizes suggested in the Guidance Note, due to (1) a potential increased risk of ineffectiveness since the controls operate at each component or location and (2) to allow for the possibility

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of identifying one or more deviations in auditor's testing (allowing for deviations may be appropriate when it may be practically difficult to expand the auditor's testing at a later date if a deviation is identified at one or more of the individual components or locations where the testing was performed) (3) number of components or locations proposed to be covered.

- If the number of components or locations proposed to be covered for testing is significantly higher than the sample size, the auditor may follow one of the two methods given below for the testing:
  - i. Since the control has been assessed as a common control, the population covered by the common control may be assessed as homogenous and the auditor (SCA) may consider the population as one rather than disaggregate them by components or locations. Such homogenous population may be used for sampling from the entire population and the auditor determines the sample size as per the guidance provided in the Guidance Note and informs the component auditors of the locations to which the sample belongs with the details of the samples to be tested. It may be noted that under this alternative, the selection of the specific sample is done centrally by the SCA and informed to the SBA for testing.
  - ii. If it is not possible to determine that the population is homogenous due to variants at the components or locations, the SCA can determine the components or locations to be covered for testing based on the guidance given in IG 1 of the Guidance Note and inform the SBAs of the components or locations so determined for coverage about the need for testing controls. It may be noted that under this alternative only the component or location is selected by the SCA and the SBA determines the sample size as per Appendix VI to the Guidance Note and selects the sample. In this alternative, the overall sample size tested for controls will be significantly higher

than the sample size stated in Appendix VI to the Guidance Note but such higher sample size will be distributed across components or locations and will be tested by different SBAs.

## **4. Centralized Controls**

4.1 Centralized controls are controls that are performed centrally on behalf of the bank's locations or components (e.g., a shared service center). Typically, the processing of transactions and related centralized controls operate the same for all transactions regardless of the component or location (i.e., the processes, risks, and controls for all transactions, regardless of the source of the transaction, are the same). In such cases, it is generally appropriate to consider and test the controls as a single population. However, when controls in a centralized environment are designed to operate differently for certain components or locations, the auditor tests the controls for each component or location as a separate population to address the difference in design of the control for such components and locations.

**For example**, the processing of accounts payable and the related controls are performed centrally for all components or locations at a shared service center and each transaction is processed the same regardless of which location originated the transaction. Accordingly, the auditor may define the population for testing as all the instances that the control operates for all of the relevant locations or components.

4.2 When testing the operating effectiveness of a centralized control, the auditor shall:

1. Define the population subject to the centralized control (i.e., all of the instances of the control designed to operate the same and performed centrally).
2. Determine the sample size.
3. Select the sample, without regard to the component or location.

4. Perform the tests of operating effectiveness of controls.
5. Evaluate the results of the auditor's procedures (e.g., qualitatively and quantitatively evaluate the implications of any exceptions identified across the population as a whole).

## **5. Group Audit Instructions**

5.1 Detailed instructions on testing of the controls need to be given to the SBA of the Branch/ unit selected for testing by the SCA. The instructions should either state the samples to be tested at the branch for operating effectiveness of controls (in case of common controls with homogenous population) or the branch that is scoped in for a full testing of the operating effectiveness of the IFCoFR (where the SBA independently determines the sample to be tested in case of heterogeneous population at the branches). SCA should inform the SBA that the design of the controls has been tested centrally and the results of such testing. The SCA should also share with the respective SBAs, the relevant portions of the Risk Controls Matrix ("RCM") of the PSBs and request the SBA to test the operating effectiveness of the controls based on the risks and controls described in the RCM.

## **6. Typical Business Cycles covered as Part of Audit of IFCoFR of a PSB**

6.1 The following are the typical areas/ cycles covered for testing IFCoFR in a PSB:

- Entity Level Controls
- Financial Closing and Reporting Process
- General Information Technology Controls
- Liquidity Adjustment Facilities
- Repo/ Reverse Repo
- Borrowing and Lending
- Investment in SLR securities
- Investment in Non-SLR securities

- Mutual fund
- Investment in PTCs
- Forward Contracts
- Derivatives
- Wholesale Lending
- Retail Lending
- Credit Cards
- SME lending
- Trade Finance
- Non-Performing Assets/Stress assets Group
- Deposits
- Clearing
- Cash Management Services
- Cash at branch
- Cash at ATM
- Bank Balances
- Debit Cards
- Net Banking
- Para Banking
- Securitisation
- Nostro Account reconciliation
- Fixed Assets
- Operating expenses
- Employee benefits
- Share Capital

6.2 Some illustrative and additional RCM specific to PSBs (which are not included in Appendix IV to the Guidance Note) is given in **Appendix V** to this Technical Guide in respect of the following business cycles of PSBs: (a) Advances (b) Deposits (c) Derivatives (d) Investments (e) Borrowings and (f) Lending.

## **7. Scoping of Branches for Testing IFCoFR**

7.1 The SCA should exercise professional judgement in identifying and scoping branches to be covered for testing IFCoFR. Refer guidance given in paragraphs 99 and 166 and section IG 1 - Multiple Locations Scoping Decisions of the Guidance Note.

7.2 RBI has issued Norms on eligibility, empanelment and appointment of Statutory Branch Auditors in Public Sector Banks from the year 2020-21 and onwards. As per these norms, statutory branch audit of PSBs should be carried out so as to cover 90% of all funded and 90% of all non-funded credit exposures of a bank. The selection of branches for statutory audit shall include a representative cross section of rural/semi-urban/urban and metropolitan branches, predominantly including branches which are not subjected to concurrent audit. Central Processing Units / Loan Processing Units and other centralised hubs, by whatever nomenclature called, would be included for branch audit every year. Further, as regards statutory branch audit to be carried out by SCAs, banks will allot the top 20 branches (to be selected strictly in order of the level of outstanding advances) in such a manner as to cover a minimum of 15% of total gross advances of the bank by SCAs.

7.3 The following guidance can be considered by SCAs to select the branches for testing IFCoFR:

- Branches classified as low/medium risk in previous year but high risk in current year.
- Branches assigned need improvement/unsatisfactory rating in current year.
- High Volume of Current Accounts / Savings Accounts (CASA), term deposits, advances and cash at branches.

- Branches where association of branch head is more than 5 years.
- New branches opened during the year.
- Branches which have material decentralized operations.

## **8. Entity Level Controls (“ELC”)**

8.1 Refer paragraphs 88 to 93, IG 5, IG 19.7 to IG 19.10 and IG 19.15 and IG 19.20 of the Guidance Note for guidance on ELC.

8.2 In addition to the guidance provided in the Guidance Note, SCAs should assess the ELC in respect of the following:

- Compliance with directions, circulars and instructions given by the RBI – controls to identify relevant literature, dissemination of information and controls designed, implemented and operated to ensure that the relevant RBI announcements are complied with.
- SCAs shall review any inspection reports issued by the RBI and assess the adequacy of the steps implemented by the PSB to address the observations made by the RBI. Timing of implementation of remedial steps may be of relevance if there was any control deficiency during the year that was not appropriately and timely mitigated thereby impacting the SCAs opinion on IFCoFR.
- It is common in PSBs to have promotions, transfers, including role changes for key employees. SCAs should understand and test the controls that are designed, implemented and operated by the PSB to familiarise such employees regarding the way in which the controls should be operated by such employees in their new roles such that the controls operate as intended.
- PSBs would have implemented a whistle-blower mechanism. SCAs should assess the design and efficacy of such mechanism in planning and performing the audit. Although an effective whistle-blower mechanism is not a direct and precise control, the efficacy of the same will enable the SCAs to identify relevant risks and plan appropriate audit procedures.

## **9. Segregation of Duties**

9.1 Refer paragraph 113 and IG 6 of the Guidance Note for guidance regarding segregation of duties and audit thereof.

9.2 PSBs usually adopt the following measures amongst other for segregation of duties:

- Work of one staff member is invariably supervised / checked by another staff member, irrespective of the nature of work.
- PSBs have a system of rotation of job amongst staff members, which reduces the possibility of frauds and is also useful in detection of frauds and errors. PSBs may also have a process of giving “block” (mandatory) leave to its staff members wherein the employee stays away from work for at least a continuous period of 2 weeks (it may be noted that different banks may use different timeframe).
- RBI vide its circulars and notifications suggested banks to establish effective segregation in its functions, for example, the master circular on prudential norms for classification, valuation and operation of investment portfolio by banks, clearly advises banks to have functional separation of trading, settlement, monitoring and accounting activities.

9.3 The SCAs should plan and perform procedures to determine if the PSB has appropriate segregation of duties to enable the controls to operate as intended.

## **10. General Information Technology Control (“GITC”) and Scoping of Testing GITC**

### **Overview**

10.1 Over the years, the banking operations have been automated to a large extent and wide range of banking software have been developed for accounting of transactions and core banking operations. Bank software is becoming more sophisticated over the years. As new accounting methods develop and more people undertake banking transactions online, private banking software is being developed to streamline the processes.

10.2 In today's environment, all banks have set up and implemented large scale computerisation projects, which has resulted in changes in the processing and storage of information. Information generated by IT systems are also used for decision making. The importance, extent of use and complexity of a bank's information systems affect the organisation and procedures employed by the bank to achieve adequate internal controls. Moreover, the new systems bring with it an entire new set of risks. Thus, while the overall objective and scope of audit do not change simply because data is maintained on computers, the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls and the nature, timing and extent of his other audit procedures are affected in a CIS environment. The nature of audit evidence and the techniques used to evaluate them have also undergone a significant change.

10.3 With mandates emanating from various regulations and trend of automation in processes and controls by adoption of advanced IT products and services for enabling greater efficiency in operations, internal controls have gained more momentum in India during recent years. This requires an increased focus on effective operation of controls around IT assets and services.

### **Audit of GITC**

10.4 General Information Technology Controls (GITCs) are a critical component of business operations and financial information controls. They provide the foundation for reliance on data, reports, automated controls, and other system functionality underlying business processes. The security, integrity, and reliability of financial information rely on proper access controls, change management, and operational controls. General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:

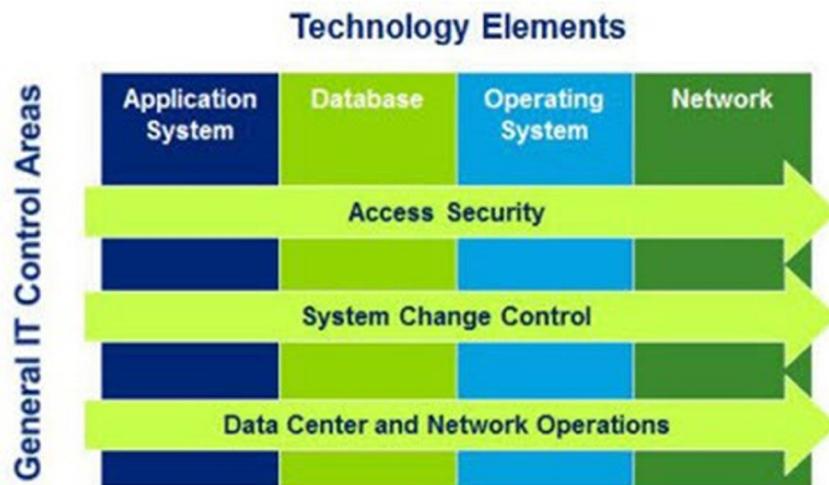
- Data center and network operations.

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- System change.
- Access security.

10.5 GITCs also include controls over each of the relevant technology elements within the bank's IT environment, including the application systems, databases, operating systems, and networks. As depicted in Figure below, GITCs are typically structured such that there are similar controls in place for each of the GITC areas across each of the technology elements.



10.6 From an auditor's standpoint, it is important to identify applications and related IT elements that are relevant to financial reporting and then evaluate the general IT controls for such applications before placing reliance on the automated controls or system generated reports that are relied upon by the auditors. This brings us to an important consideration of "scoping of relevant IT elements".

The auditor should perform an understanding of the relevant flow of transaction or processes that identifies the relevant IT environment related to those flows or processes. This also helps in understanding the effect of IT and the information technology risks on the processes.

10.7 The auditor is expected to inquire and obtain a register of all IT applications including the related infrastructure (operating system and database) used in the bank, both at central/ corporate level and at a branch level. The auditor shall perform an assessment to identify the relevance of each such IT system for the purposes of IFCoFR. The auditor shall also determine the owner of IT assets and understand, whether the maintenance of any application or infrastructure is outsourced to a third party. Where a third party is used for the purpose of managing and maintaining an IT application, the auditor shall refer to the guidance on use of a service organization given in paragraphs 10.29 to 10.32 of this Technical Guide.

10.8 As part of the IT understanding, the following needs to be assessed by the auditor:

- How IT systems are used during transaction initiation, authorization, recording & processing?
- Transfer of transactional data (i.e., interfaces) to the general ledgers and financial statements.
- Participation in electronic commerce.
- Use of emerging technologies.
- Generation of reports and other electronic information.
- Controls surrounding journal entries.
- Any applications which are deployed for specific branches.

The result of the above exercise identifies applications, data warehouse, report writers, software tools and their supporting infrastructure that the bank uses for its processes. The rationale for not scoping certain applications which may be in the nature of utilities, dashboards or monitoring tools shall be arrived at after applying the four factors test of reliance on data, automated controls, system generated reports and substantive procedures to each application.

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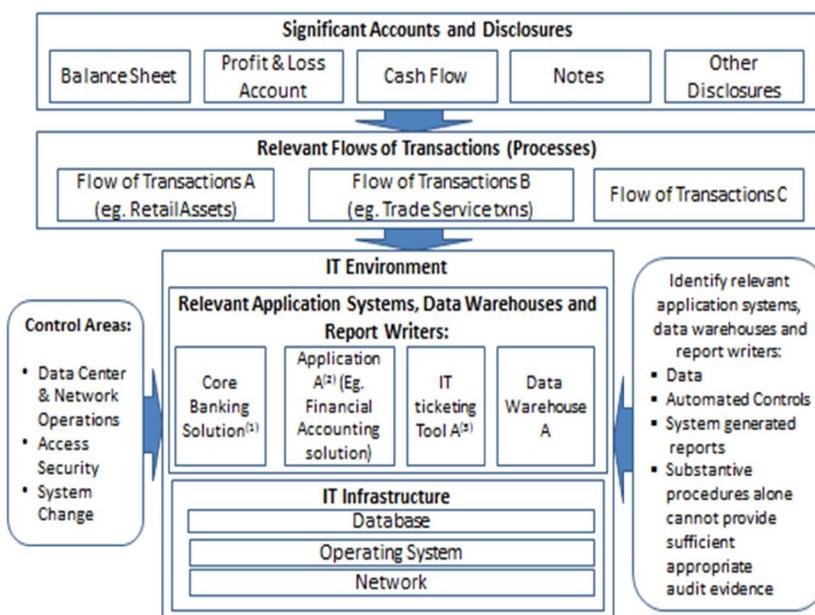
10.9 Scoping is a continuous exercise – the auditor needs to factor any significant changes to the application landscape during the audit period such as major upgrades of the underlying infrastructure, migration to a cloud environment, migration to a new application, implementation of new applications to comply with various regulatory requirements etc.

10.10 The technology function of a bank may also rely on certain workflow / rule-based tools which do not directly support transaction processing but may be of relevance to the auditor for examining in-system approvals / populations etc. While a complete testing may not be warranted for such tools, the auditor needs to evaluate controls over users that have privileged access to make changes to the logs / workflows maintained in the tool, process followed for making such changes and method of accessing such tools. Some examples of IT tools are:

- change ticketing tool is used to document authorization of changes. Changes are implemented in production once they are approved in the tool.
- code migration tool is used to migrate changes into production.
- tool that is used to monitor segregation of duties of end user access to approve user access provisioning and role modification requests.

10.11 The diagram below illustrates that the identification of the relevant aspects of the IT environment follows the auditor's identification of significant accounts and disclosures, further emphasizing that the relevant aspects of the IT environment are identified based on the effect they may have on the PSB's internal controls, and ultimately on the financial statements.

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### Notes:

- 1) Core Banking Solution (CBS) is a centralized system established by a bank allowing customers to conduct banking transactions irrespective of the bank's branch and across various banking products. CBS may be developed in-house in the bank or a commercially available software product customised for the bank's needs. CBS, where used, is fundamental to the banking operations and acts as a primary transaction processing system. Therefore, CBS is relevant to scope as an IT system for IFCoFR purposes. There could be more than one CBS application system in use for different banking products and all such systems are to be considered as relevant to scope for IFCoFR purposes.
- 2) Certain banks may have a separate accounting solution for recording financial entries and will act as source system for trial balance and financial systems. Such application systems are to be considered as relevant for IFCoFR purposes.

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- 3) An IT ticketing tool for IT change management to document authorization of changes to application systems and may be of relevance for the auditor for examining in-system approvals or for change population data. While a complete testing may not be warranted for such tools, the auditor needs to evaluate controls over users that have privileged access to make changes to the logs / workflows maintained in the tool, process followed for making such changes and method of accessing such tools.

10.12 Once the scoping is finalized, the auditor needs to assess the technology risks that impact the completeness, accuracy and validity of the data processed and produced by the applications. Some of the key risks are:

- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (particular risk might arise when multiple users access a common database);
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby breaking down segregation of duties;
- Unauthorized changes to data in master files;
- Unauthorized changes to systems or programs;
- Inappropriate manual intervention;
- Disruption of services due to system failure on account of downtime issues or cyber attacks;
- Potential loss of data or inability to access data as required.

10.13 Auditor shall then conduct walkthroughs with key stakeholders from the IT function to understand the controls implemented by the management to address these risks. The design of the management's controls can also be derived from the approved policies and procedures related to the information technology processes and a technology risk and controls matrix.

Auditor should perform control testing based on the controls implemented by the management, and this should be a preliminary ask of the IT management.

Some of the standard controls that are within purview of technology controls review include:

- Access Security: controls related to user provisioning, role modifications, user termination, access recertification, authentication controls, privileged access, review of SODs.
- Program change: Change classification and related controls for authorization & user acceptance sign offs, segregation of environments to develop and deploy changes and related accesses, access restrictions to make direct changes to tables, programs etc. in production environment.
- Computer operations: Back up, job scheduling, physical security and environment controls and network controls related to segmentation of network infrastructure, restriction over VPN access, incident monitoring, firewalls and other response measures.

10.14 It is also important to evaluate the risks related to cyber security when it comes to integration of channels like mobile applications, digital wallets, internet banking and UPI which transmit huge transaction volumes to the core banking system.

### **10.15 Illustrative Scenarios for Scoping an IT System**

- i. *Transaction processing system for processing trade business related transactions and such system is operational only at a specialized branch where trade transactions are processed. The trade transaction processing system acts as a source system for bank charges and liabilities tracking. Bank charge related information are transmitted and posted to the financial accounting system through an interface. Also, assignment of customer deposits for the purpose of issuing a secured bank guarantee is triggered from the trade transaction processing system.*

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The auditor shall consider the trade transaction processing system as relevant for the purposes of IFCoFR based on the following:

- Directly supports transaction processing.
- Transfer of transactional data to the general ledgers and financial statements.

The auditor may assess the risk of application system as significant considering the impact of key risks identified in paragraph above and cover the following GITC controls for examination:

- Data center and network operations.
- Program change.
- Access security.

- ii. *Mobile banking software used for corporate and retail customer transactions. Customers can access the application using digital authentication mechanisms and initiate and perform transactions available through mobile banking platform. The application data is transmitted to core banking solutions. Data exchange may happen with third party systems through a payment gateway or other similar platforms for certain mobile initiated transactions.*

The auditor shall consider the mobile banking software as relevant for the purposes of IFCoFR based on the following:

- Directly supports transaction processing.
- Transfer of transactional data to the general ledgers and financial statements.

The auditor may assess the risk of application system as significant considering the impact of key risks identified in paragraph above including risk of data loss or system failure due to cyber-attacks and cover the following GITC controls for examination:

- Data center and network operations.

- Program change.
  - Access security.
- iii. *A bar code scanner application is used to scan all loan applications to a document management system connected to a loan origination system. The application is interfaced to a hardware device to image, store and index physical loan application forms. The loan approver validates the information available on the scanned forms in document management system prior to loan sanction. Also, an end of day of control is performed by the scan operator to reconcile the forms received and scanned to the document management system.*

The auditor may not consider scoping the bar code scanning application as the system acts as an input device and there are overriding manual controls prior to transaction approval to address the validity of the transaction.

- iv. *IT Ticketing tool system is used for tracking system changes for all applications and related infrastructure. The tool is a workflow system when all system change requests are recorded, approved and tracked for closure.*

The IT ticketing tool may be of relevance for the auditor for examining in-system approvals or for change population data. While a complete testing may not be warranted for such tools owing to the related risks of this ticketing tool, the auditor shall evaluate controls over users that have privileged access to make changes to the logs / workflows maintained in the tool, process followed for making such changes and method of accessing such tools.

- v. *A report writer is used for compiling and preparing regulatory reports as per requirements and formats prescribed by the Reserve Bank of India. The system extracts information from various application systems including CBS, financial accounting system and other transaction processing systems.*

The auditor may not scope in the above mentioned regulatory reporting software as it does not directly or indirectly relate to financial reporting.

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- vi. *A document management system is used as digital repository for all loan and mortgage related documents. These documents are indexed and tagged to a specific loan account and interfaced with the loan origination/management system. All physical copies of loan documents are secured in a centralized facility.*

The auditor may classify the application system as relevant for GITC scoping considering the information stored in the application system and based on which loan sanctions are provided. However, the risk may be assessed as 'not significant' after considering the impact of key risks identified in paragraph above and that the application is not a primary transaction processing system. The following control areas shall be covered as part of GITC testing:

- Data center and network operations.
- Program change.
- Access security (especially privileged access management).

- vii. *A mirror or clone database is used for financial reporting and management review purposes*

The auditor may classify the database as relevant for the purposes of GITC testing as the information from such database is used in a control. The following control areas shall be covered:

- Data center and network operations.
- Program change.
- Access security (especially privileged access management).

The auditor shall also test the integrity of the information in the clone databases by understanding the frequency of data updation in the clone databases from the primary database and controls around cloning or mirroring activities performed by IT database administration.

## **User Management**

10.16 Access to business application needs to be granted based on roles and responsibilities of users. Provision of access that is not in line with the user's job responsibilities could lead to posting of unauthorised financial transactions. Branch banking makes monitoring access at branch level extremely critical since most of the transactions are decentralized to the branch level whether it be data entry and approvals for certain loans (based on amount).

10.17 Given the use of multiple application systems in a bank IT environment, the auditor shall specifically understand the identity and access management framework as to how user profiles are integrated across multiple application systems. This could be managed using a specific identity management solution, in which case, the relevance of scoping such solution for the purpose of GITC should be considered.

10.18 While access provisioning needs to be controlled, it is equally important to control the access revocation process. When employees are separated from the organisation, their User IDs can be misused for processing of financial transactions. Such transactions would not only be unauthorised, but also lack accountability.

10.19 Furthermore, if an employee gets transferred to another division/ department / branch and the old access provisioned to him does not become obsolete, it leaves a chance to be used later on. Such access also needs to be de-provisioned on the transfer of employee.

## **Change Management**

10.20 Direct change may override an already existing automated application control for a particular financial transaction or certain set of transactions. In the absence of audit logs, such direct changes will remain undetected. Most of the core banking and loan management systems are developed by vendors and access to direct changes is fairly controlled. It however then requires control over the level of access that the vendor is granted to

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develop and deploy changes and whether such changes are periodically subjected to review.

10.21 New application systems could be introduced, or existing systems migrated to new systems. The auditor shall understand the timing of such change and determine the audit tests to be performed in such a scenario. The changes could also include migration of underlying infrastructure (database, services and network devices) and a clear understanding of the timing and nature of such changes should be obtained. Where the changes are performed during the financial audit period, the auditor shall scope in both the legacy system (till the time of migration) and the new system (from the date of migration and go-live) for the purposes of GITC. Where the system migration is brought to the notice of the auditor post migration, the auditor should examine whether adequate logs and traces pertaining to the migration are retained to perform GITC tests. Additionally, accuracy and completeness of data migrated from legacy system to the new system shall be examined by the auditor.

10.22 In cases where two or more banks have merged or amalgamated during the financial year, the auditor shall determine the scope of GITC application systems based on the timing of integration of such systems. Unless the application systems are integrated as one for the new amalgamated bank, the auditor shall evaluate the IT environment of each erstwhile bank that merged as a separate instance and perform GITC tests accordingly. The auditor shall also understand the harmonization of policies, procedures and products across the merged banks to determine the nature and extent of testing to be performed.

### **Common Controls**

10.23 While using a common sampling method to test controls around centralized systems and processes and homogeneous controls, ensures that the audit tests are simplified, it is important to consider the following before a common controls testing strategy is adopted:

1. Is the control developed centrally and required to be implemented as designed at some or all components / locations?
2. Is the control performed / monitored by individuals with similar responsibilities centrally and required to be implemented as designed at some or all components / locations?
3. Is the control automated?
4. If the control uses some information from IT systems, are these systems used across all components / locations?
5. Is the control centrally monitored?

10.24 While the access management is centralized in most banks, specific inquiries need to be made if certain controls are operated at branch level such as access to update masters, manually upgrade / downgrade NPA classification, assign temporary accesses etc. Such controls need to be identified and tested independently as business controls in the respective processes.

10.25 With the current trend of merger of PSBs, applying a common controls strategy for testing the operating effectiveness of controls for the areas such as user access provisioning/ modification and change management has become slightly complicated.

10.26 Similar considerations also need to be applied to the controls pertaining to change management for the banks' in-house and vendor developed custom applications along with the underlying infrastructure. The key considerations for applying a common controls testing strategy need to be thoroughly reviewed considering the complexities of the changing processes so as to ensure that the operating effectiveness of the key controls can be tested over the period of its intended reliance.

### **Segregation of Duties**

10.27 Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may

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change the risk associated with internal control. As the process undergoes transformation and the access rights are aligned as per the version of the common core banking solution in the course of merger. The role re-design and the subsequent access recertification is fundamental to the functioning of the access management process.

10.28 While GITCs would generally cover segregation between developers and implementers, it is essential to assess whether role based segregation of duties is implemented by the banks and there is adequate segregation involved in the loan approval, disbursement, journal entry recording, loan provisioning. This could mean that multiple application systems are used for various purposes viz., loan management, financial accounting, payroll etc. and the auditor shall understand the level of segregation of a user profile across these multiple systems. This could also be managed by the PSB by using a specific tool / solution.

### **Use of Service Organization for IT**

10.29 The auditor's understanding of the flows of transactions includes an understanding of the bank's use of service organizations to perform processes relevant to financial reporting (e.g., payroll processing, processing of insurance or medical claims) and, from an IT perspective, the systems that are being used by the service organizations to perform those processes. The bank may also outsource administration of one or more of its systems to a service organization or use a service organization to "host" its systems. (Refer IG 9 of the Guidance Note on "*Use of service organization*")

10.30 The following are the procedures that the auditor should perform with respect to the relevant services provided by the service organization:

- Obtaining an understanding of the controls at the service organization that are relevant to the bank's internal controls and the controls at the bank over the activities of the service organization.

- Obtaining evidence that the controls that are relevant to the auditor's opinion are operating effectively.
- Understanding the implications if there is a sub-service organization involved and whether the controls at sub-service organization are relevant – if yes, have they been carved in or carved out.
- Evaluation of complimentary user entity controls.
- Evaluation of exceptions identified in the service auditor's report and the disposition of such exceptions.

10.31 Testing the design of the control considering all the above factors is the first step for evaluation of the General IT controls. Some of the key considerations to evaluate the design of the control include:

- Appropriateness of the control to address the risk and related assertion.
- Frequency of operation of the control.
- Competence of personnel performing control.
- Level of precision of control.
- Dependence on other controls.
- Reliance on system generated reports to perform the control.
- Follow up actions required in case the control is in the nature of review / reconciliation.

10.32 Once the assessment of design of the control is performed, the auditor shall proceed to plan the nature, timing and extent of performing the testing of operating effectiveness of the controls and test the same over the period of intended reliance. The approach will depend on criticality of systems scoped in and complexity / volumes of transactions performed. Some factors to be considered would be:

- Nature of the system and number of related account balances.

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- Volume of data.
- Number and complexity of relevant automated controls.
- Interfaces with other applications.
- History of error in automated calculations or automated controls.
- Type of control environment and leadership / staff.
- Number of users with 'update' access to the system.
- Level of customization.
- Number of changes and data conversions.
- Nature of jobs scheduled that affect financial data.
- Type of role-based security.

Another factor would be the risk associated with the controls and probability of failures of controls.

### **Consideration of Cybersecurity and Risks of Material Misstatement**

10.33 Banks today function in an ecosystem where delivery of banking services are largely technology dependent and, in many cases, such technology is controlled by various business partners viz., outsourced technology companies, channel partners and other vendors. It is imperative that the bank assesses the impact of any failure in technology and the resultant cybersecurity risks it may pose.

10.34 PSBs are expected to implement adequate controls for securing financial records maintained in electronic format. With respect to audit of IFCoFR in PSB, the auditor's primary focus is on the controls and systems that deal with or are impacting the application data relevant to the financial statements—that is, systems and applications that house financial statements related data. Cybersecurity risks and controls are within the scope of the auditor's concern only to the extent they could impact financial statements and the PSB's assets to a material extent. The auditor

needs to obtain an understanding of how the PSB uses Information Technology (“IT”) and the impact of IT on the financial statements including but not limited to cyber incidents and cyber frauds.

10.35 The auditor should evaluate the impact of cybersecurity risks over the bank’s internal controls over financial reporting and understand the specific controls identified by the management for mitigating such risks. The following factors may be considered in performing such evaluation:

- Cybersecurity accountability and responsibility.
- Cybersecurity team competency and authority.
- Critical asset identification.
- Cybersecurity risk assessment.
- Cybersecurity strategy and program.
- Cybersecurity policies and procedures.
- Security awareness and end-user training.
- Access management including provisioning, de-provisioning and authentication.
- Technical security controls including perimeter defense, anti-malware protection, encryption, patch management, data loss prevention, secure configuration and intrusion detection.
- Third-party risk management.
- Cybersecurity testing, such as vulnerability and penetration testing.
- Threat intelligence and event monitoring to anticipate and identify attacks.
- Incident response and recovery, including crisis management and escalation.
- Recovery plans, including backups and testing.

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### *Procedures to determine if a cybersecurity breach occurred and related response*

10.36 The auditor may consider performing the following procedures to determine if a cybersecurity breach has occurred and accordingly, perform adequate audit tests to ascertain the impact of the breach:

- Meet with the Chief Information Security Officer or the bank's cybersecurity program leader and inquire to understand the cybersecurity program; how cyber incidents are monitored, tracked, and reported and if any cyber breaches have occurred.
- Observe meeting(s) or inspect minutes of the meeting of cybersecurity incident response team in which cybersecurity results were being discussed and monitored.
- Read drafts of the financial statements to determine if a cyber-breach occurred.
- In addition, inspect the financial statements and the bank's disclosures related to cybersecurity to determine any changes in the current fiscal year.
- Inquire of branch manager, IT and finance management regarding whether a cybersecurity breach occurred at the bank.
- Attend Audit Committee meetings in which IT updates are provided regarding cybersecurity risk and the bank's program or inspect minutes of audit committee meetings.
- Inspect internal auditor reports and communications to the Audit Committee from internal auditor regarding cybersecurity breaches.
- Search via the internet for news articles or other external sources in which a cyber-breach related to the bank was publicly disclosed, where applicable.

10.37 If a cybersecurity breach occurred and is detected during the financial year, the auditor shall evaluate the following matters:

- Internal control implications of the cybersecurity breach - Whether the incident resulted from one or more controls that were not suitably designed or operating effectively.
- Accounting treatment of the effects of the cybersecurity breach - Whether the incident had a material effect on the PSB's financial position or results of operations and required disclosure in a financial statement filing.
- Adequacy of the bank's disclosures related to the breach - Whether the incident resulted in sanctions by any legal or regulatory agency. Whether public disclosure of the incident was required (or is likely to be required) by any laws or regulations.

**Evaluating the effect of GITC Deficiencies on IT Risks and Concluding on Deficiencies**

10.38 The auditor needs to understand the nature and cause of the deficiency in order to determine if the deficiency is regarding the design or operating effectiveness of GITC. The auditor may consider the following three points to address the IT risks:

- Perform mitigating procedures.
- Identify and test alternate GITC.
- Identify and test direct and precise business controls.

10.39 If the IT risk is addressed by one or more of these three options, the auditor can maintain the audit plan to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures. (Refer IG 20 of the Guidance Note on *“Reporting consideration”*)

Refer **Appendix V** of the Guidance Note for more examples of control deficiencies.

## 11. Testing Information Used in Control (“IUC”)

### Overview

11.1 Information (e.g., data, reports, spreadsheets) is used in a variety of ways to prepare the financial statements (e.g., to record account activity or to support judgments, such as estimates), and also in the operation of relevant controls (e.g., controls with a review element like provision for non-performing assets based on the overdue report) to identify misstatements in those activities. It is important to first obtain an appropriately detailed understanding of the IUC, and the process from initiation of the data to the generation of the reports. The auditor begins with a thorough understanding of what the IUC is and how the IUC is generated.

11.2 IUC typically consists of three elements: (1) source data, (2) report logic, and (3) parameters. These three elements are further described as follows:

Element	Description
<p><b>Source Data</b></p>	<p>The information from which the IUC is created. This may include data maintained in the IT system (e.g., within an application system or database) or external to the system (e.g., data maintained in an Excel spreadsheet or manually maintained), which may or may not be subject to general IT controls.</p> <p><b>For example</b>, for a report of all loans greater than Rs. 100,00,00,000, the source data is the database of all outstanding loans.</p>
<p><b>Report Logic</b></p>	<p>Automated report logic, which the auditor views as akin to an automated control, is the computer code, algorithms, or formulas for transforming, extracting, or loading the relevant source data and creating the report. Report logic may include standardized report programs, user-operated tools (e.g., query tools and report writers), or Excel</p>

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	<p>spreadsheets, which may or may not be subject to the general IT controls.</p> <p><b>For example</b>, for the loan aging report, the report logic is typically a program in the loan application that contains the code and algorithms for extracting the data from the loans sub-ledger detail (source data), allocating it to the various aging categories, and calculating the subtotals and totals of the report.</p>
<p><b>Report Parameters</b></p>	<p>Report parameters allow the user to look at only the information that is of interest to them. Common uses of report parameters include defining the report structure, specifying or filtering data used in a report, or connecting related reports (data or output). Depending on the report structure, report parameters may be created manually by the user (i.e., user-entered parameters) or they may be pre-set (i.e., there is significant flexibility in the configuration of parameters, depending on the application system), and they may or may not be subject to the general IT controls.</p> <p><b>For example</b>, for a report of loans over 90 days overdue as at quarter end, the user enters the overdue days&gt;90 and quarter end date parameters to generate the reports.</p>

11.3 The auditor’s objective when performing procedures on IUC is to evaluate whether these three elements, when applicable, produce IUC that is accurate and complete. As IUC is generated in many different forms and through many different methods, the auditor’s evaluation strategy may vary depending on the nature of the IUC (e.g., a standard pre-coded report versus a custom ad-hoc report) and how it is created (e.g., the degree of automation,

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which typically increases reliability when subject to effective general IT controls).

**For example**, Bank A and Bank B both use the same Core Banking system; however, Bank A uses an Loan aging report from the system to determine its NPA provision, and Bank B takes the same loans aging report, downloads it into Excel, and then manually manipulates the report. The downloading and manipulation of Bank B's report likely introduces additional possibilities that the IUC may be inaccurate or incomplete compared to the loan aging report used by Bank A; therefore, it would likely be necessary to perform additional procedures on Bank B's report to determine its accuracy and completeness as compared to Bank A's report.

11.4 Accordingly, for relevant information used in a control, it is important that the auditor obtains an understanding of how the information is generated (i.e., from initiation of the data to the generation of the report) as part of the auditor's overall understanding of the process flows for the relevant process. If the bank makes pervasive use of IT systems and programs to generate information (e.g., reports), the auditor may consider teaming with the auditor's IT specialists to obtain an appropriate understanding of both the IT aspects and the non-IT aspects of generating information.

11.5 Information used in a relevant control is generally derived from:

1. Transactional data captured by the bank's IT systems (e.g., sub-ledgers or general ledgers)

A typical process flow begins with the origination of transactions which are processed through IT systems and captured as *data*, which is compiled into a report, and then used to detect misstatements. Such reports may be:

- System-generated – The report logic is subject to the bank's general IT controls (GITCs).

- Non-system-generated – The report is generated with *manual intervention*, which may include the collection or input of data, inputting parameters or utilizing a user-configured report writer or query script or utilizing an end-user application such as Excel which are not subject to the bank's GITCs.

2. Data from other sources

Banks often also collect data from sources which are relevant to internal control over financial reporting, which is compiled into a report and then used to detect misstatements. Such sources may include:

- Information from processes or systems which were not initially considered to be relevant to internal control over financial reporting (which may or may not be subject to the bank's GITCs).
- Information generated from applications hosted by a service organization.
- Information obtained from external sources (e.g., information available in the public domain or information obtained from specialists or service providers, such as investment security pricing services).

11.6 Accordingly, for relevant information used by a relevant control, it is important that the auditor obtains an understanding of how the information (e.g., reports) is generated as part of the auditor's overall understanding of the process flows for the relevant process. Given the pervasive use of IT systems and programs to generate information (e.g., reports), the auditor typically teams with the auditor's IT specialists to obtain an appropriate understanding of both the IT aspects and the non-IT aspects of generating information. Specific considerations when understanding how a report is generated include the following:

- The auditor seeks to understand both (1) the process for capturing the source data that underlies the report, including any interfaces between applications and (2) how the report

logic is maintained and initiated (e.g., any parameters which the user needs to enter each time the report is run). In some instances, the parameters for system-generated reports are automatically generated by the IT systems, and therefore the user is not required to input any parameters. With today's Core Banking systems, to initiate the report, the user needs to enter basic parameters such as the "as-of date" of the report or the location code(s) desired.

- Data warehouses are often used to enable end-users to access and filter data using report writer or query tools on an as-needed basis, which typically upload the extracted data into an Excel template for further refinement or formatting. An important determination is whether the data warehouse and related queries are subject to the bank's GITCs (i.e., if these elements are not subject to the GITCs, then the auditor needs to understand what the users do to address the accuracy and completeness of the information). There are typically two scenarios:
  1. Standard queries that are subject to GITCs (e.g., access and change controls) (i.e., the user can run the query, but cannot alter it).
  2. User-generated queries that are not subject to GITCs. While the report writer or query software itself may be subject to the bank's GITCs, the query "scripts" (or equivalent) which represent the specific "instructions" of what the user wants the tool to extract, is maintained by the user, and is therefore not subject to the bank's GITCs.

### **System Generated Reports**

11.7 Management review controls using system-generated reports typically rely on the underlying IT systems, and therefore the controls over the generation of the report also need to be identified and tested, including reports obtained from service organizations. Given the volume of transactions processed through IT systems and the lack of transparency to the user as to

how a report is produced, the user of a system-generated report is typically relying on the report; therefore, the purpose of their review activities is not for the specific and direct purpose of determining if the report itself is accurate and complete. While they may be able to identify an error in the report or data, or determine that the amounts appear “reasonable” based on their knowledge, this is generally not sufficient to conclude that the report was generated as intended. Therefore, the control that uses the report is typically designed to operate in combination with:

- Transaction-level controls over the initiation and processing of the data that is included in the report, including relevant automated or interface controls, and
- The automation of the report logic, which is subject to GITCs (1) that prevent unauthorized access to the source data and the report logic (e.g., the programs and algorithms that produce the report) and (2) that make certain that any changes to the applications related to the source data or the report logic are tested prior to being placed into production.

### **Non-system Generated Reports**

11.8 In today’s information age and data rich IT systems, information needed to manage the business, and in particular for internal control over financial reporting, is made accessible to end-users through data warehouses and report writer/queries to enable users to directly access and extract specified data (which may or may not have been initially processed through the IT systems) that can then be further filtered and summarized in end-user applications, such as Excel. The auditor refers to these as “non-system-generated reports.”

11.9 When a non-system generated report is produced by using queries (to extract data from a database) (e.g., the IT system or data warehouse), due to the volume of the data processed and complexity of these queries, a reviewer is typically relying on the proper generation of the report. While the reviewer may be able to identify an error or determine that the amounts appear reasonable based on his knowledge, this is generally not sufficient to

conclude that the report was generated as intended. Therefore, the control that uses the report is typically designed to operate in combination with:

- Transaction-level controls over the initiation and processing of the source data, including relevant automated or interface controls to the point from which the data is extracted (e.g., the data warehouse) and,
- Controls that management implements to check that the report was produced as intended (e.g., controls which "prove" the extraction of data, such as reconciling the report to the data from which it was derived, comparing individual data from the report to the source and vice versa, and controls which check the formulas or macros).

## **12. Financial Closing and Reporting Process (FCRP)**

12.1 It is a common practice that PSBs issue year-end financial closing instructions to branches, based on which branches prepare their balance sheet, profit and loss account and other returns necessary for preparation of the financial statements of the bank as a whole. These instructions issued by the Head Office (“HO”) are generally called ‘Accounts Closing Instructions’ and include the format of the financial statements and other relevant returns, significant accounting policies to be followed, other instructions necessary for the conduct and completion of the audit, timelines of audit completions and consolidations etc. The FCRP controls at the HO and at the branches will need to be identified separately.

12.2 Considering the significance of these instructions, it is necessary that before these instructions are sent to branches, the SCA reviews them to assess whether the instructions are sufficiently comprehensive, clear and adequate to facilitate the compilation of branch financial statements and other relevant data accurately and expeditiously and identifies the controls exercised at the HO level and the branch level.

12.3 The HO will also issue instructions to the central team of the PSB regarding the requirements for the preparation of the financial statements of the PSB.

12.4 The SCA should particularly examine whether the instructions are in consonance with the accounting policies of the bank and are in such compliance so that the SCA is able to obtain evidence that they and the SBAs, as applicable, will be able to perform the audit to enable the appropriate preparation of the financial information at the HO.

### **13. Using the Work of Internal Auditor**

13.1 Refer paragraphs 82 to 85 and IG 18 of the Guidance Note on the use of work of an internal auditor and that of an auditor's expert in an audit of IFCoFR.

### **14. PSBs use of Service Organisations**

14.1 Outsourcing is a worldwide phenomenon, finding presence in every industry, including the banking industry. With a view to ensure that the banks adequately address the risks associated with outsourcing of some of their activities (especially financial services) as also to bring such outsourced activities under the regulatory purview and protect the interests of the customers, the RBI issued circular no. DBOD.BP.40/21.04.158/2006-07 dated November 3, 2006 on "Guidelines on Managing the Risks and Code of Conduct in Outsourcing of Financial Services by Banks" read with circular DBOD.No.BP.97/21.04.158/2008-09 dated December 11, 2008 and circular DBS.CO.PPD.BC.5/ 11.01.005/2008-09 dated April 22, 2009.

14.2 The auditor needs to understand the use of service organisations by the PSB and whether any financial reporting control operates within such service organisation impacting the PSBs financial reporting process. In case the service organisation operates any financial reporting control that is scoped in for testing by the SCA, the SCA should follow the guidance given in paragraphs 90, 105 to 107 and IG 9 of the Guidance Note.

## **15. Timeline for Testing Controls**

15.1 The SCA will need to plan the audit of the IFCoFR in conjunction with the audit of the financial statements. Depending on the materiality and the account balances scoped in, the SCA will need to issue necessary instructions to the SBAs for scoped in process and controls.

15.2 Since an audit of IFCoFR relates to testing controls that operated during the year or are relevant to the financial closing process that may operate after the year-end, some of the controls will need to be tested before the year-end to form an opinion on the design and operating effectiveness of those controls, whilst the other controls may be tested after the year-end. For example, the IT and automated controls will need to be tested before the year-end for expressing an opinion on IFCoFR since those controls may be subject to change after the year-end and therefore may not leave any trail of the operation during the year, whereas manual controls may be tested after the year-end since the evidence of exercise of the control will be available even after the year-end. Further, controls relating to FCRP are normally tested after the year-end since the financial reporting process itself occurs after the year-end.

## **16. Evaluation of Misstatements –Aggregation of Control Deficiencies**

16.1 Refer paragraphs 128 to 136 and IG 20.15, IG 20.16, IG 14.17 of the Guidance Note for guidance on evaluation of misstatements.

16.2 A final step in evaluating the controls would be to evaluate the control deficiencies. A deficiency exists when the related GITC may not be designed or operating effectively.

Deficiency may be classified into one of the following categories based on severity:

- **Material weakness:**

There is a reasonable possibility that a material misstatement of the bank's annual or interim financial statements will not be prevented or detected on a timely basis e.g.: GIRC deficiency identified related to broad business user access to financial reporting transactions without appropriate segregation of duties (SOD).

- **Significant deficiency:**

Significant deficiency is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the bank's financial reporting e.g.: GIRC deficiency identified related to inappropriate access to make application program changes in a revenue application. There were no other controls in place to address the IT risk.

- **Deficiency:**

Design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. It is less severe than a material weakness or significant deficiency.

16.3 Misstatements or possible misstatements identified across account balances should not be netted off but aggregated. The auditor aggregates and evaluates control deficiencies that directly relate to risks of material misstatement by each assertion for each significant class of transaction or account balance. A combination of deficiencies affecting the same assertion or significant class of transactions, account balance or disclosure may increase the likelihood of misstatements to such an extent as to give rise to a higher classification for the control deficiency on a collective basis even though the severity of the deficiency individually may have been assessed as less severe.

**For example**, the materiality for the audit of a PSB is determined at Rs. 100,00,00,000. During the audit of IFCoFR, two control

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deficiencies that may result in potential misstatement of financial statements are identified as follows:

- a) Overstatement of interest income on loans that have become NPAs (Assertion: Accuracy) – potential misstatement Rs. 70,00,00,000.
- b) Overstatement of operating expense (advance rent expensed) (Assertion – Cut-off) Rs, 65,00,00,000.

Net potential impact on financial statements Rs. 5,00,00,000.

In this example, the individual deficiencies may not qualify as a material weakness since their potential impact on the financial statements is less than the materiality. However, the aggregate of these two deficiencies is Rs. 135,00,00,000 which is greater than materiality for the audit of PSB in the instant case and therefore may result in a material weakness on an overall basis requiring a modification in the opinion on the design and / or operating effectiveness of IFCoFR.

16.4 It is common in branches of PSB to record Memorandum of Changes (“**MoC**”) to record / propose accounting entries to be posted centrally in relation to the branch since the books of account at the branch were closed before such MoC were recorded in the books of account at the branch. The MoC so stated may relate to the following categories:

- i. Entries identified as part of FCRP but could not be posted due to closure of the books at the branch.
- ii. Entries identified at the branch by the branch management to rectify errors and omissions in the books of account.
- iii. Audit adjustments included based on audit observations accepted by the branch management.

Entries within the purview of (i) above are as a result of the operation of the PSBs FCRP and do not require further evaluation of design and operating effectiveness of IFCoFR.

Entries within the purview of (ii) above will need to be assessed for existence of a control deficiency during the year, the significance / classification of such deficiency (as deficiency, significant deficiency or material weakness), when the deficiency was remediated to determine the operating effectiveness of the remediated control for sufficient period of time before the year-end, in order to determine if such errors indicated a material weakness in the design and/or operating effectiveness of the controls during the year requiring a modification to the opinion on IFCoFR.

Entries within the purview of (iii) above are clearly deficiencies which need to be assessed for significance (as deficiency, significant deficiency or material weakness). It needs to be noted that what is considered as material at the branch requiring modification of the branch's IFCoFR may not be material at the HO on consolidation of the branches in preparing the financial statement of the PSB.

16.5 Accordingly, the SCA should request the SBA to categorise the entries proposed in the MoC into each of the categories mentioned above to enable the SCA to opine on the IFCoFR for the PSB at the HO at a consolidated level.

## **17. Audit Report on IFCoFR**

17.1 Illustrative formats of audit reports on IFCoFR by SBAs and SCAs are given in **Appendix VI and VII** respectively to this Technical Guide.

## **18. Other Certifications and Reports issued by the SCAs and SBAs**

18.1 It may be noted that auditor's reporting on IFCoFR is a requirement specified in connection with the annual audit of the financial statements of PSBs.

Accordingly, reporting on IFCoFR will not be applicable with respect to interim financial statements, such as quarterly or half-

yearly financial statements or other certifications and reports issued.

18.2 The requirements to report on internal controls covered by the LFAR is an independent requirement and the work performed in testing the IFCoFR may be used to report on the control aspects covered as part of the LFAR. Further, the work performed in audit of IFCoFR may also be used when testing information relating to other certificates issued by the SCAs or SBAs that are based on or included in the audited financial statements if those financial statements were subject to audit of IFCoFR.

## **19. Year One (Year ended on March 31, 2021) Considerations**

19.1 The PSBs will be in various stages of preparedness with their RCMs. Some PSBs may not have prepared any RCM whilst others may range from starting to compile the RCMs to fully complete RCMs that have been reviewed and approved by the Board of Directors of the PSB.

19.2 Considering the nature and volume of transactions and the dominance of IT systems in a PSB, both SCAs and SBAs of PSBs have traditionally tested controls at the PSBs for gaining assurance that the risks have been mitigated rather than relying solely on substantive procedures even before the requirements for reporting on IFCoFR was mandated by the RBI.

19.3 Auditors audit IFCoFR by testing samples of population that come with the purview of each RCM. In case a PSB is not fully ready with the RCMs or has not yet prepared the RCMs, SCAs and SBAs may test the IFCoFR based on the controls they identify to test the mitigation of the risk of material misstatement (“**ROMM**”) in the financial statements identified for the audit. It is essential that the controls being tested by the SCA / SBA for mitigation of the ROMM are formally documented controls by the Management of the PSB, communicated to all relevant personnel in the PSB including orientation of the way how the control is required to operate and not just based on practices followed within the PSB. In addition to testing the controls that mitigate the

ROMMs in the account balances, the SCAs shall also test the following (though they do not directly relate to the account balances):

- Entity Level Controls.
- GITC.
- Controls over FCRP.

19.4 If on testing controls as stated in paragraph 19.3 above, the auditor has not noted any control weakness, the SCA / SBA may issue an unmodified opinion on IFCoFR of the PSB in respect of the year ended on March 31, 2021. In such circumstances, the SCA shall communicate to the SBA through Group Audit Instructions regarding the ROMM and the relevant controls that mitigates the ROMM that is required to be tested by the SBA at the branch.

19.5 The fact that RCMs are not (fully) available should be viewed as a significant deficiency and communicated to the Board of Directors and the Management of the PSB by the SCA for them to remediate the same by March 31, 2022.

19.6 If other control weaknesses are noted by the SCA/ SBA during their audit for the year ended March 31, 2021, such weaknesses individually or in the aggregate are assessed as significant deficiency (Refer paragraphs 128 to 136 and IG 20 of the Guidance Note) and such weakness is attributed to the absence of RCMs, together, they shall be viewed as a material weakness and the audit report on IFCoFR of the PSB by the SCA shall be modified.

**Example:**

The PSB has not compiled its RCM as at March 31, 2021. During the audit, the SCA observes that the whistle blower mechanism has a weakness (the whistle blower mechanism does not provide or identify the alternate person to whom a complaint can be made if the complaint is against the person listed in the whistle blower mechanism as the responsible person to whom complaints may be submitted). This weakness results in the PSBs not identifying

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appropriately the fraud risk and implementing controls to mitigate the same and therefore is assessed as a significant deficiency. This significant deficiency together with the significant deficiency of absence of RCMs will in the overall assessment be viewed as a material weakness requiring a modification (as a qualification) to the audit report on IFCoFR by SCA.

19.7 If the Management of the PSB does not prepare a full compilation of RCMs during the year ended March 31, 2022, the SCA shall issue a disclaimer of opinion on IFCoFR for that year and the subsequent years where such absence of fully complied RCMs exist in the PSB.

## Appendix I

### **Extract of RBI Communication to PSBs on SCAs Reporting Requirements in the Independent Auditor's Report**

2. In this regard, your bank is requested to advise the SCAs of the bank to also report on following items in the 'Independent Auditors' Report' submitted by them for FY 2019-20 and onwards:

- i) Whether the financial statements comply with the applicable accounting standards.
- ii) The observations or comments on financial transactions or matters which have any adverse effect on the functioning of the bank.
- iii) Whether any director is disqualified from being a director of the bank under sub-section (2) of section 164 of the Companies Act, 2013.
- iv) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
- v) **Whether the bank has adequate internal financial controls system in place and the operating effectiveness of such controls.**

## **Appendix II**

### **Extract of RBI Clarification to PSBs on SCAs Reporting Requirements on IFCoFR**

2. In line with substitution of words “Internal Financial Control System” in Section 143(3)(i) of the Companies Act, 2013, by the words “Internal Financial Controls with reference to Financial Statements” as per the clause 43(ii) of Companies Amendment Act, 2017, the reporting requirement at Para 2(v) of the said letter stands modified to ‘Whether the bank has adequate Internal Financial Controls with reference to Financial Statements and the operating effectiveness of such controls’.

3. Further, with respect to the above mentioned reporting requirements at Para 2 above, some of the banks have expressed certain difficulties in implementation for FY 2019-20. Upon examination, it has been decided to make the above mentioned reporting requirement at Para 2 above as optional for FY 2019-20. Those banks which are using this option, are advised to prepare themselves for its implementation during this financial year itself so that reporting in this regard can be made compulsorily from FY 2020-21.

## Appendix III

### **Illustrative Audit Engagement Letter by the SBAs<sup>1</sup> Audit of Internal Financial Controls over Financial Reporting**

(Name of the Branch and Address)

Dear Sirs,

#### **The objective and scope of the audit**

You have requested that we carry out an audit of the operating effectiveness of the internal financial controls over financial reporting of \_\_\_\_\_ Branch (“the Branch”) of \_\_\_\_\_ Bank (the ‘Bank’) as at March 31, 20YY [balance sheet date] in conjunction with our audit of the standalone financial statements of the Branch for the year ended on that date.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of expressing our opinion as required by letter no. DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 on “Appointment of Statutory Central Auditors (SCAs) in Public Sector Banks – Reporting obligations for SCAs from FY 2019-20”, read with subsequent communication dated May 19, 2020 issued by the RBI (the “RBI communication”), on the adequacy of internal financial controls over financial reporting and the operating effectiveness of such controls as at March 31, 20YY based on the internal control criteria established by you.

Our audit of internal financial controls over financial reporting will not include an evaluation of the adequacy of design and implementation of such internal financial controls over financial reporting since those aspects are audited by the Statutory Central Auditors of the Bank.

#### **Audit of internal financial controls over financial reporting**

We will conduct our audit of the internal financial controls over financial reporting in accordance with the instructions provided by the Statutory Central Auditors of the Bank and in accordance with

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<sup>1</sup> Readers may note that this Appendix will be required only when a branch is scoped in for audit of IFCoFR.

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the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (“the Guidance Note”) issued by the Institute of Chartered Accountants of India (the “ICAI”) and the Standards on Auditing (SAs) issued by the ICAI, to the extent applicable to an audit of internal financial controls over financial reporting. The Guidance Note and Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about the operating effectiveness of the internal financial controls over financial reporting as at the balance sheet date.

An audit of the operating effectiveness of internal financial controls over financial reporting involves performing procedures to obtain audit evidence about the operating effectiveness of the internal financial controls over financial reporting.

The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

### **Inherent limitations in an audit of internal financial controls over financial reporting**

Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper Management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are subject to the risk that the internal financial controls over financial reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Management’s responsibility**

Our audit will be conducted on the basis that Management and those charged with governance (Audit Committee / Board) acknowledge and understand that they have responsibility:

- (a) For establishing and maintaining adequate and effective internal financial controls based on the [state criteria] [for example, “the internal controls over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note

on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”] for ensuring the orderly and efficient conduct of its business, including adherence to Bank’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Banking Regulation Act, 1949.

- (b) To provide us, *inter alia*, with:
- (i) Management’s evaluation and assessment of the adequacy and effectiveness of the Bank’s internal financial controls, based on the control criteria [mention the control criteria] and all deficiencies, significant deficiencies and material weaknesses in the design or operations of internal financial controls identified as part of Management’s evaluation;
  - (ii) Access, at all times, to all information, including the books, account, vouchers and other records and documentation, of the Bank, whether kept at the head office of the Bank or elsewhere, of which Management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - (iii) All information, such as records and documentation, and other matters that are relevant to our assessment of internal financial controls;
  - (iv) Additional information that we may request from Management for the purpose of the audit;
  - (v) Unrestricted access to persons within the Bank from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the Bank such information and explanations as we may think necessary for the performance of our duties as auditor;

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- (vi) Any communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices;
  - (vii) Management's conclusion over the Bank's internal financial controls based on the control criteria set above as at the balance sheet date [insert date];
  - (viii) Informing us of significant changes in the design or operation of the Bank's internal financial controls that occurred during or subsequent to the date being reported on, including proposed changes being considered; and
  - (ix) All the required support to discharge our duties as the statutory auditors as stipulated under the Banking Regulation Act, 1949 / ICAI auditing standards and guidance.
- (c) As part of our audit process, we will request from Management and those charged with governance, written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' / 'quality review' under the Chartered Accountants Act, 1949 and in accordance with our Firm's policies to be conducted by independent reviewer(s). The reviewer(s) may inspect, examine or take abstract of our working papers during the course of the peer review/quality review.

We also wish to invite your attention to the fact that the above mentioned processes are subject to inspection by National Financial Reporting Authority (NFRA) under the Companies Act, 2013 to be conducted by independent reviewer(s). The reviewer(s) may inspect, examine or take abstract of our working papers during the course of the inspection.

### **Reporting**

Our reports will be issued pursuant to the requirements of the RBI communication. The form and content of our reports may need to be amended in the light of our audit findings.

**Our Fees**

- Our fees for the audits of the internal financial controls over financial reporting as at [state Balance Sheet date] have been fixed by the RBI at Rs. \_\_\_\_\_, plus out-of-pocket expenses and indirect taxes.

We will bill as the work progresses. We will notify you promptly of any circumstances we encounter that could significantly affect our estimate of fees and discuss with you any additional fees, as necessary.

This letter should be read in conjunction with our letter dated \_\_\_\_ for the audit of financial statements of the Branch and the terms and conditions specified in the said letter will extend to this letter.

We look forward to full cooperation from your staff during our audit.

Please sign and return the attached copy of this letter after placing the same with the Audit Committee or the Board of Directors together with your acknowledgement of, and agreement with, the arrangements for our audit of the internal financial controls over financial reporting including our respective responsibilities.

Yours faithfully,

For \_\_\_\_\_  
Chartered Accountants  
(Firm Registration No. \_\_\_\_\_)

Xxxxxx  
Partner

Place:

Date:

Copy to: Chairman, Audit Committee

Acknowledged on behalf of <<Name of the Branch>>

Name and Designation: \_\_\_\_\_

Date: \_\_\_\_\_

## **Appendix IV**

### **Illustrative Audit Engagement Letter by the SCAs Audit of Internal Financial Controls over Financial Reporting**

(Name of the Bank and Address)

Dear Sirs,

#### **The objective and scope of the audit**

You have requested that we carry out an audit of the internal financial controls over financial reporting of \_\_\_\_\_ Bank (the 'Bank') as at March 31, 20YY [balance sheet date] in conjunction with our audit of the standalone financial statements of the Bank for the year ended on that date.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of expressing our opinion as required by letter no. DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 on "Appointment of Statutory Central Auditors (SCAs) in Public Sector Banks – Reporting obligations for SCAs from FY 2019-20", read with subsequent communication dated May 19, 2020 issued by the RBI (the "RBI communication"), on the adequacy of internal financial controls over financial reporting and the operating effectiveness of such controls as at March 31, 20YY based on the internal control criteria established by you. In forming our opinion on the internal financial controls over financial reporting, we will rely on the work of branch auditors appointed by the Bank and our report would expressly state the fact of such reliance.

#### **Audit of internal financial controls over financial reporting**

We will conduct our audit of the internal financial controls over financial reporting in accordance with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting ("the Guidance Note") issued by the Institute of Chartered Accountants of India (the "ICAI") and the Standards on Auditing (SAs) issued by the ICAI, to the extent applicable to an audit of internal financial controls over financial reporting. The Guidance Note and Standards require that we comply with ethical requirements and

plan and perform the audit to obtain reasonable assurance about the adequacy of the internal financial controls over financial reporting and their operating effectiveness as at the balance sheet date.

An audit of internal financial controls over financial reporting involves performing procedures to obtain audit evidence about the adequacy of the internal financial controls over financial reporting and their operating effectiveness.

The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

**Inherent limitations in an audit of internal financial controls over financial reporting**

Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper Management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are subject to the risk that the internal financial controls over financial reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**Management's responsibility**

Our audit will be conducted on the basis that Management and those charged with governance (Audit Committee / Board) acknowledge and understand that they have responsibility:

- (a) For establishing and maintaining adequate and effective internal financial controls based on the [state criteria] [for example, "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India"] for ensuring the orderly and efficient conduct of its business, including adherence to Bank's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the

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accounting records, and the timely preparation of reliable financial information, as required under the Banking Regulation Act, 1949.

- (b) To provide us, *inter alia*, with:
- (i) Management's evaluation and assessment of the adequacy and effectiveness of the Bank's internal financial controls, based on the control criteria [mention the control criteria] and all deficiencies, significant deficiencies and material weaknesses in the design or operations of internal financial controls identified as part of Management's evaluation;
  - (ii) Access, at all times, to all information, including the books, account, vouchers and other records and documentation, of the Bank, whether kept at the head office of the Bank or elsewhere, of which Management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - (iii) All information, such as records and documentation, and other matters that are relevant to our assessment of internal financial controls;
  - (iv) Additional information that we may request from Management for the purpose of the audit;
  - (v) Unrestricted access to persons within the Bank from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the Bank such information and explanations as we may think necessary for the performance of our duties as auditor;
  - (vi) Any communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices;
  - (vii) Management's conclusion over the Bank's internal financial controls based on the control criteria set above as at the balance sheet date [insert date];

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- (viii) Informing us of significant changes in the design or operation of the Bank's internal financial controls that occurred during or subsequent to the date being reported on, including proposed changes being considered;
  - (ix) All the required support to discharge our duties as the statutory auditors as stipulated under the Banking Regulation Act, 1949 / ICAI auditing standards and guidance.
  - (x) Providing us with the auditor's report on internal financial controls over financial reporting of the Statutory Branch Auditors.
- (c) As part of our audit process, we will request from Management and those charged with governance, written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' / 'quality review' under the Chartered Accountants Act, 1949 and in accordance with our Firm's policies to be conducted by independent reviewer(s). The reviewer(s) may inspect, examine or take abstract of our working papers during the course of the peer review/quality review.

We also wish to invite your attention to the fact that the above mentioned processes are subject to inspection by National Financial Reporting Authority (NFRA) under the Companies Act, 2013 to be conducted by independent reviewer(s). The reviewer(s) may inspect, examine or take abstract of our working papers during the course of the inspection.

### **Reporting**

Our reports will be issued pursuant to the requirements of the RBI communication. The form and content of our reports may need to be amended in the light of our audit findings.

### **Our Fees**

- Our fees for the audits of the internal financial controls over financial reporting as at [state Balance Sheet date] have been fixed by the RBI at Rs. \_\_\_\_\_ , plus out-of-pocket expenses and indirect taxes.

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We will bill as the work progresses. We will notify you promptly of any circumstances we encounter that could significantly affect our estimate of fees and discuss with you any additional fees, as necessary.

This letter should be read in conjunction with our letter dated \_\_\_\_ for the audit of financial statements of the Bank and the terms and conditions specified in the said letter will extend to this letter.

We look forward to full cooperation from your staff during our audit.

Please sign and return the attached copy of this letter after placing the same with the Audit Committee or the Board of Directors together with your acknowledgement of, and agreement with, the arrangements for our audit of the internal financial controls over financial reporting including our respective responsibilities.

Yours faithfully,

For \_\_\_\_\_  
Chartered Accountants  
(Firm Registration No. \_\_\_\_\_)

Xxxxxx  
Partner

Place:

Date:

Copy to: Chairman, Audit Committee

Acknowledged on behalf of <<Name of the Bank>>

Name and Designation: \_\_\_\_\_

Date: \_\_\_\_\_

## Appendix V

### Illustrative Risk - Control Matrices

Advances

Deposits

Derivatives

Investments

Borrowings

Lending

#### **Advances**

Sr. No.	Risk	Control	Audit Procedure
1	Risk that the Loans may not be sanctioned by the appropriate authority.	The Credit Risk and Business team members review the credit appraisal memo and approve the facility within their delegated powers.	Auditor shall ensure that the Credit Appraisal Memo is approved by appropriate authority as per the approval matrix after performing all the review steps.
		System based maker checker control exists for Loan approval in Loan management System (LMS).	Auditor shall verify the system based maker checker control as part of automated control testing.

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2	Risk that the customer wise documents / security adequacy may not be maintained correctly as per the Credit Approval Memorandum.	The concerned department [e.g. Credit Administration Department (CAD)] ensures completion of all facility, KYC and security documents prior to any disbursement of funds under a maker - checker control, without which the sanction limits cannot be activated.	Auditor shall obtain and review the documentation checklist prepared by the CAD preparer and reviewed by the checker to ensure that all the documents are collected prior to the sanction of loan.
3	Risk that the Loans may not be accounted appropriately as data may not be entered appropriately as per the underlying signed documents.	The operation team based on the sanction documents, Limit Setup Memo (LSM) etc., records the opening of the loan account in the respective system under a maker checker control.	Auditor shall verify that the limit set up is as per the LSM and reviewed by the checker.  Auditor shall verify that the checker has reviewed and authorised details of the borrower, the amount to be disbursed, period of the loan, repayment details etc. with the underlying documents.
		There exists a control in the system which does not permit disbursement amount to be more	Auditor shall test the System based control as part of automated control testing.

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		than the sanction amount as per the LMS.	
4	Risk that all the loans disbursements and repayments may not be recorded in the correct accounting period.	Reconciliations are performed for various disbursement/ repayment control accounts under maker checker control to ensure that the entries are recorded in correct accounting period.	Auditor shall verify that the reconciliation of control accounts is prepared and verified by the checker.
		There exists an automated control for appropriation of receipts between interest and principal amounts.	Auditor shall test the System based control as part of automated control testing.
5	Risk that the Standard Asset Provisions may not be accounted appropriately as Bank may not have calculated it correctly as per the RBI guidelines/ Bank's internal policy.	At the period end, the working of provision on Standard Assets is prepared, reviewed and approved by the Reviewer as per the authority matrix.	Auditor shall verify that the provisions are reviewed by the appropriate authority.
6	Risk of NPAs may not be appropriately identified and provided for as per the RBI	There exists an automated control for computing the overdue cases and for identification/ flagging of NPAs.	Auditor shall test the System based control as part of automated control testing.

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	regulations and the Bank's internal policy.		
		Chief Risk Officer (CRO)/ Risk committee reviews and approves the provision of NPAs.	Auditor shall verify that the CRO / Risk committee reviews the NPAs and adequacy of provision there on.
7	Loan sanctioned without product being offered or for discontinued product.	Application for loan accepted only during validity of loan product as per the Bank's circular.	Auditor shall verify that there exists a system based control that once the product is discontinued it cannot be logged into the system and hence could not be offered.
8	Loan product released without approvals of all the designated departments.	Circular notifying release of loan product is approved by all the designated departments before launch of the product.	Auditor shall verify that the Product is approved by the appropriate authorities.
9	Loan product specifications are not as per RBI guidelines.	Approval of compliance department to the Loan Product.	Auditor shall verify that the Product is approved by the compliance Department.

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10	Loan product specifications are not configured in the system application.	Creation of loan product master before releasing the new product and Sign off from IT Department on Product master creation.	Auditor shall verify that the IT department has approved the Product master.
11	Risk that the Fees and other charges may not be collected or levied as per the approved product charges master created.	The operation team at the time of disbursement under maker checker control ensures that the Fees as per the product master is collected.	The Auditor shall verify that there exists a maker checker control.
12	Interest income on loans is computed on a loan that does not exist or does not accrue interest or Interest income is incomplete.	Interest on advances calculated automatically in System	Auditor shall test the System based control as part of automated control testing.
		Interest in suspense- on identification as an NPA, all accrued interest till NPA date as well as interest accrued going forward is not recognised as income by the system but parked in interest in suspense.	Auditor shall test the System based control as part of automated control testing.

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13	All loan modifications and/or changes to loan terms, such as interest rate or maturity dates, are not authorized, recorded, and reflected in the interest calculation.	Change in Interest rate is updated in the system interest rate chart basis the approvals and the rates are updated.	Auditor shall verify the system based control to ensure that the rate change is affected based on the approval for all the applicable cases.
14	Disclosures related to Advances are omitted, incomplete, or inaccurate.	The disclosures are prepared by the Financial reporting department maker and reviewed by the checker for the completeness of the disclosures.  Based on the various reports generated from the system the disclosures are compiled.	The Auditor shall verify that there exists a maker checker control.  Auditor shall test the report logic for the completeness and accuracy of the report used as part of IPE testing.
15	Risk that periodic operational data such as Stock/ book debt statements, Financial Statements etc. are not	The operation team obtains and verifies the data on regular interval.	Auditor shall obtain and review the documentation checklist prepared by the CAD preparer and reviewed by the checker to

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	obtained regularly from the borrower and not scrutinized properly		ensure that all the documents are collected and scrutinized.
16	Risk that valuation reports from approved valuer for NPA accounts is not obtained in respect of the securities charged to bank, once in three years.	The operation team obtains and verifies the data on regular interval.	Auditor shall ensure that all the documents are collected and scrutinized.
17	Risk that the NPA accounts, Provision may not be accounted appropriately as Bank may not have calculated it correctly as per the RBI guidelines/ Bank's internal policy.	At the period end, the working of provision on NPA is prepared, reviewed and approved by the Reviewer as per the authority matrix.	Auditor shall verify that the provisions are reviewed by the appropriate authority.

**Deposits**

Sr. No.	Risk	Control	Audit Procedure
1	Risk that Bank may not adhere to the KYC guidelines.	Completeness of Account Opening Form along with supporting documents is validated with the checklist which covers all the requirement of the bank's internal policy and RBI policy.	Auditor shall verify that the account opening form has been approved by the Compliance and product departments.
		Maker Checker control is in place for the verification of data recorded in system at the time of account opening.	Auditor shall verify that the maker checker control exist at the time of opening of account.
2	Risk that multiple Customer ID's are created for the same customer.	Dedupe check - system check is performed to identify existing customer from customer master while processing application for new account/ facility.	Auditor shall test the System based control as part of automated control testing.
3	Risk that the Customer with negative profile are validated in	Each account opening request is validated against list of personnel/	The auditor shall test the system based control for validation of the

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	KYC process.	organisations published by RBI as part of AML guidelines, Enforcement Directorate and other Government Authorities.	name.
4	Interest expense on deposits and TDS thereon may not be correctly calculated and accrued for the period.	Interest Expense and TDS is calculated automatically by the system based on principal, tenure and interest rate. For TDS calculation system also considers additional details fed in system like age, residential status, threshold etc.	The auditor shall test the system based control for validation of the name.
5	Interest rate on deposits may not be appropriate based on the applicable rate card.	Rate card is received from the Balance Sheet Management Group. There are special rates for deposits amount more than Rs 1 crore. The rate is entered in the system by Product Development	The auditor shall test the system based control. The auditor shall verify that the rate card is updated in the system under maker checker control.

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		Group under the maker checker control and which is applied for the entire loan by the IT team.	
6	Settlement/ Renewal including interest on maturity or preclosure of Term Deposits may not be calculated correctly by the system or may not be done on the due date.	In case of preclosures, interest rate is offered for the actual retained tenure rather than the agreed tenure. The calculations are done automatically by the system based on the preclosure/renewal instructions.	The auditor shall test the system based control: <ul style="list-style-type: none"> <li>• to verify whether the interest is calculated correctly by the system.</li> <li>• to verify whether the maturity amount is transferred to the predefined account on the maturity date.</li> <li>• to verify whether the maturity amount is transferred to the customer's accounts on the maturity date.</li> </ul>

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7	<p>Details of deposit creation like start date, interest rate, tenure, amount, scheme etc. may not be correctly recorded in the system based on the application form.</p>	<p>The deposit is created based on the deposit application form submitted.</p> <p>The operation team under maker checker control verifies the details of the customer, signature verification and evidence of the same is put on the form.</p> <p>The data entry into the system is subject to maker checker.</p>	<p>Auditor shall verify that the Operation team verifies the details entered in the system are as per the Application form and the supportings under maker checker control.</p> <p>Auditor shall also verify that the Data verification checklist is prepared by the maker and verified by the checker.</p>
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### Derivatives

Sr. No.	Risk	Control	Audit Procedure
1	<p>Derivative and Forex deals may not be correctly recorded in the books of account as:</p> <ul style="list-style-type: none"> <li>• All deals booked in the front end system</li> </ul>	<p>The count of deals booked as per front end system and the count of deals validated as per back end system is reconciled daily by Treasury Back office. Exceptions are reported to</p>	<p>Auditor shall verify whether daily deal count reconciliation is performed by Treasury Back Office and discrepancies in reconciliation, if any, are raised and resolved in a timely manner.</p>

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	may not flow to back end system.	Treasury Front Office.	
2	<p>Derivative and Forex deals may not be correctly recorded in the books of account as:</p> <ul style="list-style-type: none"> <li>- Erroneous deal parameters entered in system by Treasury Front Office (TFO) and validated by Treasury Back Office (TBO)</li> </ul>	<p>All deals are entered by the Treasury Front office (TFO) being the maker in the front end system, which then flows automatically to the back end system where Treasury Back Office (TBO) validates the deal after verifying the deal parameters with the external party confirmations in the back end system.</p>	<p>Auditor shall verify that the TBO has validated all the deals parameters in the back end system for samples selected.</p>
3	<p>Accounting entries may not be passed for all the deals entered into the front end system and risk that the transactions are not recorded in the period in which they occurred.</p>	<p>Once the journal entries are posted in back end system, no modification is allowed by the system.</p>	<p>Auditor shall verify the system based control that whether the entries can be modified post posting.</p>

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4	<p>Underlying document not received from the customer within a maximum period of 15 days from the trade date for non inter bank deals.</p>	<p>Treasury Back Office personnel tracks the receipt of underlying documents status in the excel tracker. If the underlying documents are not received on the trade date, the same is communicated to the stakeholder on daily basis through email.</p>	<p>Auditor shall verify that the Treasury Back Office sends the email for overdue status of underlying documents on a daily basis.</p>
5	<p>Settlement of Derivative and Forex deals may not be recorded correctly as:</p> <ul style="list-style-type: none"> <li>- Erroneous settlement is processed by TBO;</li> <li>- Settlement entries for deals struck with Banks and merchant missed to be recorded.</li> </ul>	<p>Single validation is carried out for receipts and dual validation is done for payments at the time of processing settlements on the due date by TBO. CCIL net settlement amount as per back end system is tallied with IRIS/UBS Report.</p> <p>Settlement is carried out for Trade finance as per the terms of the contract under Maker Checker controls.</p>	<p>Auditor shall verify that settlement is processed under maker checker controls.</p>

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		<p>Reconciliation Team prepares daily reconciliation for Treasury wash and Nostro accounts and sends the unreconciled entries/ exception entries to the Treasury Back office for resolution. TBO resolves the same, if it pertains to treasury and send it back to the reconciliation team for further action.</p>	<p>Auditor shall verify that the Reconciliation team prepares the Nostro/Wash Reconciliation and emails the exception, if any, to the TBO for resolution.</p>
6	<p>Realised profit/ loss on all cancellation/ settlement of Derivative/ Forex deals may not be accounted appropriately as settlement value may not be correctly determined.</p>	<p>Single validation is carried out for receipts and dual validation is done for payments at the time of processing settlements on the due date by TBO. CCIL net settlement amount as per back end system is tallied with IRIS/UBS Report.</p> <p>Settlement is carried out for Trade finance as per the terms of</p>	<p>Auditor shall verify that cancellation deal can only be made in the system by exchanging cash flows which is the result of validation of deals in the system, which is done under maker checker controls by the TBO.</p>

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		the contract under Maker Checker controls.	
7	<p>Interest on derivative may not be recorded correctly as:</p> <ul style="list-style-type: none"> <li>• Incorrect rates may be applied.</li> <li>• Interest may not be calculated as per the economic parameters feed in the system.</li> </ul>	<p>The rate feeds in the back end system are automatically picked up from the RIC's defined in the front end system which are mapped to the Market data systems.</p>	<p>Auditor's IT Team shall verify whether rate feeds from Market data system flow to the back end system automatically for fixing rates for the samples selected.</p>
		<p>Treasury front end and back end system automatically calculates the interest for all the deals based on the parameters entered in the front end system.</p>	<p>Auditor's IT Team shall verify that the interest is calculated correctly as per the market feeds and other economic parameters of the deal for the sample deals selected.</p>
8	<p>All Derivatives and Forex outstanding deals may not be valued</p>	<p>Treasury middle office system calculates the MTM which is posted in OGL on daily basis</p>	<p>Auditor's IT Team shall verify for a sample trade whether the middle office system has calculated the MTM</p>

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	<p>appropriately as</p> <p>1. Valuation methodology may not be as per the Accounting standard/ Regulation/ Valuation policy.</p> <p>2. The rate considered may not be correct.</p>	<p>accurately for every deal.</p>	<p>which is posted in OGL. Auditor shall re-calculate the MTM of Derivative for each product based on the market data used by Bank and verify if the correct valuation methodology has been adopted.</p>
9	<p>Overdue deals not monitored and which may lead to non - identification of NPA.</p>	<p>Treasury Back office personnel circulates MIS containing deals with pending utilisations on a daily basis. Relationship Manager does rollover action in the system if the client is not going to utilise the contract on due date. Such rollover deals flow from middle office system to the back end system through the front end system and the same are</p>	<p>Auditor shall verify that the overdue deal MIS is shared with all Treasury Heads and RMs on a daily basis.</p>

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		<p>validated by TBO. After three days, the deal is cancelled if not utilised and if there is gain the same is not transferred to the counterparty and if there is a loss then it is debited to the customer account.</p>	
10	<p>Derivative transaction is done with a counterparty where ISDA agreement is not signed or exchanged.</p>	<p>TBO tracks all the deals done under LFCC along with details of date of expiry of LFCC. TFO is informed of the expiry date of LFCC 90 days before the expiry date and follow up is done on as needed basis. Further extension of timeline requires approval from authorized persons.</p>	<p>Auditor shall verify whether TBO tracks all the deals done under LFCC along with details of date of expiry of LFCC, and if information to TFO 90 days before the expiry date and follow up with TFO on a daily basis is done.</p> <p>Auditor shall verify whether in case of further extension of timelines, approval has been taken from authorized persons.</p>

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11	Unamortised premium/hedge cost for all the outstanding foreign exchange hedge contracts may not be calculated correctly as per the economic parameters captured in the front end system.	The unamortised premium/hedge cost is automatically calculated by the back end system for all the outstanding foreign exchange hedge contract.	Auditor's IT Team shall verify for the sample deal that the hedge cost/unamortised premium is calculated automatically in the back end system based on the parameters from the front end system and accounting entries are passed correctly.
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## Investments

Sr. No.	Risk	Control	Audit Procedure
1	Investment may not be accounted appropriately as incorrect deal parameters are entered/ updated.	Treasury Front office (TFO) being the maker enters the deals in System which automatically flow to accounting System. Treasury Back Office(TBO) being the checker validates the deal after verifying the deal parameters with the external party confirmation in System.	Auditor shall verify that the Deal is validated by the TBO checker with the external party confirmations.

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2	Transactions for Investment missed to be recorded in system leading to under reporting in the financial statements.	There is an automatic interface between the dealing platform (NDS OM, etc.) to Treasury System on real-time basis.	Auditor shall verify that the deal auto flows from the Dealing system to treasury system.
3	Investment may not be accounted appropriately as Purchase/ sale/ redemption of all the Investments may not be recorded in the correct accounting period.	TBO prepares the stock position which is reconciled on a daily basis with External Party Confirmation.	Auditor shall verify that TBO prepares the Stock reconciliation on the daily basis and reconcile with the counterparty confirmation.
4	Investment may not be accounted appropriately as all investments outstanding may not exist as on the balance sheet date.	TBO prepares the stock position which is reconciled on a daily basis with External Party Confirmation.	Auditor shall verify that TBO prepares the Stock reconciliation on the daily basis and reconcile with the counterparty confirmation.
5	Investment may not be accounted appropriately as	<u>Purchase:</u> Dual validation is done at the time of payment to	Auditor shall enquire that authorised TBO personnel has

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	Cash/securities may not be received against securities sold/purchased.	counterparty. TBO validates delivery only after sighting a credit in demat account. TBO alerts TFO and Compliance for non- receipt of stock and holds the delivery validation. <u>Sale/ Maturity:</u> Auto validation is done at the time of delivery of Investment. TBO tracks receipt of funds and alerts TFO and Compliance for non- receipt of funds.	validated based on sighting the credit in the bank statement. Auditor shall verify the payment/Receipt of fund in bank statement.
		In System all the receipts have single validation whereas all the payments have dual validation before processing the payment.	Auditor shall verify the system based Validation control.
6	All investments may not be valued appropriately as 1. Valuation methodology may not be	Treasury Mid Office personnel being the Maker performs the valuation of investment as per RBI Guidelines and then TMO	Auditor shall verify that there exists a maker checker control for the Valuation.

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	<p>as per the Accounting standard/ Regulation/ Valuation policy.</p> <p>2. The price considered may not be correct.</p> <p>3. Corporate action relating to Bonus, Split, consolidation etc. are not accounted appropriately.</p>	<p>Personnel being the checker reviews the same by checking valuation, rate used, RBI Guidelines and source date.</p>	
7	<p>Interest/ Discount income on investment may not be appropriate as Income may not be calculated and accrued on all the investment for the correct accounting period.</p>	<p>The System automatically calculates the interest income. The calculation is as per deal parameters entered in the system.</p>	<p>Auditor shall verify the system based Control.</p>
8	<p>Profit or loss on sale of Investment may not be computed accurately as</p>	<p>The profit/loss is automatically calculated by K+tp system on FIFO/ Weighted average basis.</p>	<p>Auditor shall verify the system based Control.</p>

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	Cost may not be correctly allocated and may not be calculated in correct accounting period.		
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### Borrowings

Sr. No.	Risk	Control	Audit Procedure
1	Borrowing deals missed to be recorded in system leading to under reporting in the financial statements.	<p>Call/Notice/CBLO/ REPO –</p> <p>There is an automatic interface between the dealing platform (NDS OM, etc.) to Treasury System on real-time basis.</p> <p>Deals are entered in the system by Treasury Front Office (TFO) which auto flows for Treasury Back Office (TBO) validation. TBO verifies the trade details entered in the system with the confirmation / deal slips.</p>	<p>Auditor shall verify that the deal auto flows from the Dealing system to treasury system.</p> <p>Auditor shall verify that the Deal is validated by the TBO checker with the external party confirmations/ deal slips.</p>

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2	Borrowings may not be accounted appropriately as incorrect deal parameters are entered/ updated.	Deals are entered in the system by Treasury Front Office (TFO) which auto flows for Treasury Back Office (TBO) validation. TBO verifies the trade details entered in the system with the confirmation / deal slips.	Auditor shall verify that the Deal is validated by the TBO checker with the external party confirmations/ deal slips.
3	Settlement on borrowing or maturity/prepayment of borrowings may not be calculated correctly by the system or may not be done on the due date.	On the date of borrowing, receipt entry is validated by TBO only after sighting credit in account. In case of non-receipt of funds from lender, TBO alerts TFO.  On maturity date, the borrowing repayments queue up in the system for which the TBO has to process payments. All repayments are made to counterparty post dual validation of payments in system. Post dual validation, the payment is	Auditor shall obtain the control sheet for payment which has been approved by TBO which is reconciled with the R&T agent Report.

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		<p>processed.</p> <p>Beneficiary Position Report (BenPos) is received from R&amp;T agent on record date (15 days prior to interest payment date). The maturity /buyback /interest amount is calculated by TBO as per holding statement received from R&amp;T Agent and the same is reconciled with the amount as per K+TP system post which the payment is processed.</p>	
4	<p>Borrowings may not be accounted appropriately as all borrowings outstanding may not exist as on the balance sheet date.</p>	<p>The Treasury Back Office obtains balance confirmation and tallies the outstanding amount as per books with the Closing Statements/ Balance confirmations received from external parties.</p>	<p>Auditor shall obtain the balance confirmations/outstanding statements from the Treasury Back office received by them and verify whether the balance tallies with the books.</p>

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5	The Interest expense on borrowings may not have been calculated properly by the system due to incorrect rates.	The System automatically calculates the interest expenses. The calculation is as per deal parameters entered in the system.	Auditor shall verify the system based Control.
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### Lending

Sr. No.	Risk	Control	Audit procedure
1	Lending deals missed to be recorded in system leading to under reporting in the financial statements.	Call/CBLO/ Reverse Repo –  There is an automatic interface between the dealing platform (NDS OM, etc.) to Treasury System on real-time basis.  Deals are entered in the system by Treasury Front Office (TFO) which auto flows for Treasury Back Office (TBO) validation. TBO verifies the trade details entered in the system with the confirmation / deal slips.	Auditor shall verify that the deal auto flows from the Dealing system to treasury system  Auditor shall verify that the Deal is validated by the TBO checker with the external party confirmations/ deal slips.

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2	Lending may not be accounted appropriately as incorrect deal parameters are entered/ updated.	Deals are entered in the system by Treasury Front Office (TFO) which auto flows for Treasury Back Office (TBO) validation. TBO verifies the trade details entered in the system with the confirmation / deal slips.	Auditor shall verify that the Deal is validated by the TBO checker with the external party confirmations/ deal slips.
3	Settlement on Lending or maturity of Lending may not be calculated correctly by the system or may not be done on the due date.	In system all the receipts have single validation whereas all the payments have dual validation before processing the payment.	Auditor shall obtain the control sheet for receipt which has been approved by TBO.
4	Lending may not be accounted appropriately as all lending outstanding may not exist as on the balance sheet date.	The Treasury Back Office obtains balance confirmation and tallies the outstanding amount as per books with the Closing Statements/Balance confirmations received from external parties.	Auditor shall obtain the balance confirmations/out standing statements from the Treasury Back office received by them and verify whether the balance tallies with the books.

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5	The Interest income on Lending may not have been calculated properly by the system due to incorrect rates.	The System automatically calculates the interest income. The calculation is as per deal parameters entered in the system.	Auditor shall verify the system based Control.
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## **Appendix VI**

### **Illustrative Audit Report on IFCoFR by SBAs**

#### **A. Illustrative Audit Report by the SBA when a branch is not scoped in for audit of IFCoFR**

##### **In the main Audit Report of the Branch by the SBA**

##### **Under the Section “Auditor’s Responsibilities for the Audit of Standalone Financial Statements of the Branch”**

1. Our objectives are to obtain reasonable assurance about whether the Standalone Financial Statements of the Branch as a whole are free from material misstatement whether due to fraud or error and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material, if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Standalone Financial Statements of the Branch.
2. As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:
  - Identify and assess the risks of material misstatement of the Standalone Financial Statements of the Branch, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- ***Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Branch's internal control.***
  - Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
  - Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Standalone Financial Statements of the Branch or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
  - Evaluate the overall presentation, structure and content of the Standalone Financial Statements of the Branch, including the disclosures and whether the Standalone Financial Statements of the Branch represent the underlying transactions and events in a manner that achieves fair presentation.
3. We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
  4. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and to communicate

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with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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**B. Illustrative Audit Report by the SBA when a branch is scoped in for audit of IFCoFR**

**In the main Audit Report of the Branch by the SBA**

**Under the section “Auditor’s Responsibilities for the Audit of Standalone Financial Statements of the Branch”**

1. Our objectives are to obtain reasonable assurance about whether the Standalone Financial Statements of the Branch as a whole are free from material misstatement whether due to fraud or error and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material, if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Standalone Financial Statements of the Branch.
2. As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:
  - Identify and assess the risks of material misstatement of the Standalone Financial Statements of the Branch, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- **Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.**
  - Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
  - Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Standalone Financial Statements of the Branch or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
  - Evaluate the overall presentation, structure and content of the Standalone Financial Statements of the Branch, including the disclosures and whether the Standalone Financial Statements of the Branch represent the underlying transactions and events in a manner that achieves fair presentation.
3. We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
  4. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and to communicate with them all relationships and other matters that may

reasonably be thought to bear on our independence, and where applicable, related safeguards.

**Under the section “Report on Other Legal and Regulatory Requirements”**

“Our audit report on the operating effectiveness of the Branch’s internal financial controls over financial reporting as required by the RBI Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) is given in Annexure A to this report. Our report expresses an unmodified opinion / qualified / adverse opinion<sup>2</sup> on the operating effectiveness of internal financial controls over financial reporting of the Branch as at \_\_\_\_\_ (balance sheet date).”

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**ANNEXURE “A” TO THE INDEPENDENT AUDITOR’S REPORT**

(Referred to in paragraph \_\_\_ under ‘Report on Other Legal and Regulatory Requirements’ section of our report of even date)

**Report on the Operating Effectiveness of Internal Financial Controls Over Financial Reporting as required by the Reserve Bank of India (the “RBI”) Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) . (the “RBI communication”)**

We have audited the operating effectiveness of the internal financial controls over financial reporting of \_\_\_ Branch (“the Branch”) of \_\_\_ Bank (“the Bank”) as of March 31, 20XX in conjunction with our audit of the standalone financial statements of the Branch for the year ended on that date.

**Management’s Responsibility for Internal Financial Controls**

The Bank’s management is responsible for establishing and maintaining internal financial controls based on \_\_\_\_\_ [for example, “the internal control over financial reporting criteria

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<sup>2</sup> Delete whichever is not applicable.

established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”.] These responsibilities include the design, implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the orderly and efficient conduct of its business, including adherence to Bank’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India.

#### **Auditor’s Responsibility**

Our responsibility is to express an opinion on the operating effectiveness of internal financial controls over financial reporting of the Branch based on our audit. Our audit of internal financial controls over financial reporting did not include an evaluation of the adequacy of the design and implementation of such internal financial controls over financial reporting since those aspects are audited by the Statutory Central Auditors of the Bank.

We conducted our audit based on the instructions provided by the Statutory Central Auditors of the Bank and in accordance with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (the “Guidance Note”) issued by the Institute of Chartered Accountants of India (the “ICAI”) and the Standards on Auditing (SAs) issued by the ICAI, to the extent applicable to an audit of internal financial controls. Those Standards and the Guidance Note require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether internal financial controls over financial reporting operated effectively in all material respects.

Our audit involves performing procedures to obtain audit evidence about the operating effectiveness of the internal financial controls over financial reporting of the Branch. The procedures selected depend on the auditor’s judgement, including the assessment of

the risks of material misstatement of the financial statements, whether due to fraud or error.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion / qualified / adverse opinion<sup>3</sup> on the operating effectiveness of the Branch's internal financial controls over financial reporting.

### **Meaning of Internal Financial Controls Over Financial Reporting**

A Bank's internal financial controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A Bank's internal financial controls over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Bank are being made only in accordance with authorisations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

### **Inherent Limitations of Internal Financial Controls Over Financial Reporting**

Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are

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<sup>3</sup> Delete whichever is not applicable.

subject to the risk that the internal financial controls over financial reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Opinion**

In our opinion, and to the best of our information and according to the explanations given to us, the Branch has, in all material respects, internal financial controls over financial reporting that were operating effectively as at March 31, 20XX, based on \_\_\_\_\_ [for example, “the criteria for internal control over financial reporting established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”].

**OR**

### **Scenario 1 - Qualified Opinion on operating effectiveness of Internal Financial Controls Over Financial Reporting**

#### **Basis for Qualified opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the operating effectiveness of the Branch’s internal financial controls over financial reporting as at March 31, 20XX:

- a) The Branch’s internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, were not operating effectively which could potentially result in the branch recognising revenue without establishing reasonable certainty of ultimate collection.
- b) [list other material weaknesses identified]

A ‘material weakness’ is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material

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misstatement of the branch's annual or interim financial statements will not be prevented or detected on a timely basis.

### **Qualified Opinion**

In our opinion, and to the best of our information and according to the explanations given to us, except for the effects/possible effects of the material weakness/es described in Basis for Qualified Opinion paragraph above on the achievement of the objectives of the control criteria, the Branch's internal financial controls over financial reporting were operating effectively as of March 31, 20XX based on \_\_\_\_\_ [for example, "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India"]

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Branch for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Branch.

### **Scenario 2 - Adverse Opinion on operating effectiveness of Internal Financial Controls Over Financial Reporting**

#### **Basis for Adverse opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the operating effectiveness of the Branch's internal financial controls over financial reporting as at March 31, 20XX:

- a) The Branch's internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, were not operating effectively which could potentially result in the Branch recognising revenue without establishing reasonable certainty of ultimate collection.

- b) The Branch's internal controls over period end adjustments including related presentation and disclosure requirements as mandated by the Accounting Standards, the provisions of the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India were not operating effectively which could potentially result in material misstatements in the Branch's financial statements.
- c) [list other material weaknesses identified]

A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Branch's annual or interim financial statements will not be prevented or detected on a timely basis.

**Adverse Opinion**

In our opinion, and to the best of our information and according to the explanations given to us, because of the effects/possible effects of the material weakness/es described in Basis for Adverse Opinion paragraph above on the achievement of the objectives of the control criteria, the Branch's internal financial controls over financial reporting were not operating effectively as of March 31, 20XX based on \_\_\_\_\_ [for example, "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India"].

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Branch for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Branch.

For XYZ & Co  
Chartered Accountants  
(Firm's Registration No.)

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Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>4</sup> )  
(Membership No.)  
UDIN

Place of Signature:  
Date:

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<sup>4</sup> Partner or Proprietor, as the case may be.

## Appendix VII

### A. Illustrative Audit Report on Internal Financial Controls Over Financial Reporting – Unmodified Opinion by SCAs

#### In the main Audit Report on the standalone financial statements

#### **Under the section “Auditor’s Responsibilities for the Audit of Standalone Financial Statements of the Bank”**

1. Our objectives are to obtain reasonable assurance about whether the Standalone Financial Statements of the Bank as a whole are free from material misstatement whether due to fraud or error and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material, if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Standalone Financial Statements.
2. As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:
  - Identify and assess the risks of material misstatement of the Standalone Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
  - **Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.**

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- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
  - Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Standalone Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
  - Evaluate the overall presentation, structure and content of the Standalone Financial Statements, including the disclosures and whether the Standalone Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.
3. We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
  4. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
  5. From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the Standalone Financial Statements of the current period and are therefore the Key Audit Matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we

determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

**Under the section “Report on Other Legal and Regulatory Requirements”**

“Our audit report on the adequacy and operating effectiveness of the Bank’s internal financial controls over financial reporting as required by the RBI Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) is given in Annexure A to this report. Our report expresses an unmodified opinion on the Bank’s internal financial controls over financial reporting as at \_\_\_\_\_ (balance sheet date).”

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**ANNEXURE “A” TO THE INDEPENDENT AUDITOR’S REPORT**

**(Referred to in paragraph \_\_\_ under ‘Report on Other Legal and Regulatory Requirements’ section of our report of even date)**

**Report on the Internal Financial Controls Over Financial Reporting as required by the Reserve Bank of India (the “RBI”) Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) (the “RBI communication”)**

We have audited the internal financial controls over financial reporting of \_\_\_ Bank (“the Bank”) as of March 31, 20XX in conjunction with our audit of the standalone financial statements of the Bank for the year ended on that date which includes internal financial controls over financial reporting of the Bank’s branches.

**Management’s Responsibility for Internal Financial Controls**

The Bank’s management is responsible for establishing and maintaining internal financial controls based on \_\_\_\_\_ [for example, “the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”.] These responsibilities include the design, implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the

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orderly and efficient conduct of its business, including adherence to the Bank's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on the Bank's internal financial controls over financial reporting based on our audit. We conducted our audit in accordance with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (the "Guidance Note") issued by the Institute of Chartered Accountants of India (the "ICAI") and the Standards on Auditing (SAs) issued by the ICAI, to the extent applicable to an audit of internal financial controls. Those Standards and the Guidance Note require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether adequate internal financial controls over financial reporting were established and maintained and if such controls operated effectively in all material respects.

Our audit involves performing procedures to obtain audit evidence about the adequacy of the internal financial controls over financial reporting and their operating effectiveness. Our audit of internal financial controls over financial reporting included obtaining an understanding of internal financial controls over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal financial controls based on the assessed risk. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

We believe that the audit evidence we have obtained and the audit evidence obtained by the branch auditors, in terms of their reports referred to in the Other Matters paragraph below, is sufficient and appropriate to provide a basis for our audit opinion on the Bank's internal financial controls over financial reporting.

### **Meaning of Internal Financial Controls Over Financial Reporting**

A Bank's internal financial controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A Bank's internal financial controls over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Bank are being made only in accordance with authorisations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

### **Inherent Limitations of Internal Financial Controls Over Financial Reporting**

Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are subject to the risk that the internal financial controls over financial reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Opinion**

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, the Bank has, in all material respects, adequate internal financial controls over financial reporting and such internal financial controls over financial reporting were operating

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effectively as at March 31, 20XX, based on \_\_\_\_\_ [for example, “the criteria for internal control over financial reporting established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”].

### Other Matters

Our aforesaid report insofar as it relates to the operating effectiveness of internal financial controls over financial reporting of \_\_\_ (number, specify scoped in / IFCoFR reporting branches) branches is based on the corresponding reports of the respective branch auditors of those branches.

Our opinion is not modified in respect of this matter.

For XYZ & Co  
Chartered Accountants  
(Firm’s Registration No.)

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>5</sup>)  
(Membership No.)  
UDIN

Place of Signature:

Date:

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<sup>5</sup> Partner or Proprietor, as the case may be.

## **B. Illustrative Report on Internal Financial Controls Over Financial Reporting – Modified Opinion by the SCAs**

### **In the main Audit Report on the standalone financial statements**

#### **Under the section “Auditor’s Responsibilities for the Audit of Standalone Financial Statements of the Bank”**

1. Our objectives are to obtain reasonable assurance about whether the Standalone Financial Statements of the Bank as a whole are free from material misstatement whether due to fraud or error and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material, if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Standalone Financial Statements.
2. As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:
  - Identify and assess the risks of material misstatement of the Standalone Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
  - **Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.**
  - Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Standalone Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
  - Evaluate the overall presentation, structure and content of the Standalone Financial Statements, including the disclosures and whether the Standalone Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.
3. We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
  4. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
  5. From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the Standalone Financial Statements of the current period and are therefore the Key Audit Matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would

reasonably be expected to outweigh the public interest benefits of such communication.

**Under the section “Report on Other Legal and Regulatory Requirements”**

“Our audit report on the adequacy and operating effectiveness of the Bank’s internal financial controls over financial reporting as required by the RBI Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) is given in Annexure A to this report. Our report expresses a qualified / adverse opinion<sup>6</sup> on the Bank’s internal financial controls over financial reporting as at \_\_\_\_\_ (balance sheet date).”

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**ANNEXURE “A” TO THE INDEPENDENT AUDITOR’S REPORT**

(Referred to in paragraph \_\_\_ under ‘Report on Other Legal and Regulatory Requirements’ section of our report of even date)

**Report on the Internal Financial Controls Over Financial Reporting as required by the Reserve Bank of India (the “RBI”) Letter DOS.ARG.No.6270/08.91.001/2019-20 dated March 17, 2020 (as amended) (the “RBI communication”)**

We have audited the internal financial controls over financial reporting of \_\_ Bank (“the Bank”) as of March 31, 20XX in conjunction with our audit of the standalone financial statements of the Bank for the year ended on that date which includes internal financial controls over financial reporting of the Bank’s branches.

**Management’s Responsibility for Internal Financial Controls**

The Bank’s management is responsible for establishing and maintaining internal financial controls based on \_\_\_\_\_ [for example, “the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal

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<sup>6</sup> Delete whichever is not applicable.

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Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”.] These responsibilities include the design, implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the orderly and efficient conduct of its business, including adherence to the Bank’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India.

### **Auditor’s Responsibility**

Our responsibility is to express an opinion on the Bank's internal financial controls over financial reporting based on our audit. We conducted our audit in accordance with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (the “Guidance Note”) issued by the Institute of Chartered Accountants of India (the “ICAI”) and the Standards on Auditing (SAs) issued by the ICAI, to the extent applicable to an audit of internal financial controls. Those Standards and the Guidance Note require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether adequate internal financial controls over financial reporting were established and maintained and if such controls operated effectively in all material respects.

Our audit involves performing procedures to obtain audit evidence about the adequacy of the internal financial controls over financial reporting and their operating effectiveness. Our audit of internal financial controls over financial reporting included obtaining an understanding of internal financial controls over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal financial controls based on the assessed risk. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

We believe that the audit evidence we have obtained and the audit evidence obtained by the branch auditors, in terms of their reports referred to in the Other Matters paragraph below, is sufficient and appropriate to provide a basis for our qualified / adverse audit opinion<sup>7</sup> on the Bank's internal financial controls over financial reporting.

**Meaning of Internal Financial Controls Over Financial Reporting**

A Bank's internal financial controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A Bank's internal financial controls over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Bank are being made only in accordance with authorisations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

**Inherent Limitations of Internal Financial Controls Over Financial Reporting**

Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are subject to the risk that the internal financial controls over financial

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<sup>7</sup> Delete whichever is not applicable.

reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**Scenario 1 - Qualified Opinion on adequacy (and therefore operating effectiveness) of Internal Financial Controls Over Financial Reporting**

**Basis for Qualified opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the Bank's internal financial controls over financial reporting as at March 31, 20XX:

- a) The Bank did not have an appropriate internal control system for customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, which could potentially result in the Bank recognising revenue without establishing reasonable certainty of ultimate collection.
- b) [list other material weaknesses identified]

A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Bank's annual or interim financial statements will not be prevented or detected on a timely basis.

**Qualified Opinion**

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, except for the effects/possible effects of the material weakness/es described in Basis for Qualified Opinion paragraph above on the achievement of the objectives of the control criteria, the Bank has maintained, in all material respects, adequate internal financial controls over financial reporting and such internal financial controls over financial reporting were operating effectively as of March 31, 20XX, based on \_\_\_\_\_ [for example "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal

Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”].

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Bank for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Bank.

**Scenario 2 - Adverse Opinion on adequacy (and therefore operating effectiveness) of Internal Financial Controls Over Financial Reporting**

**Basis for Adverse opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the Bank’s internal financial controls over financial reporting as at March 31, 20XX:

- a) The Bank did not have an appropriate internal control system for customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, which could potentially result in the Bank recognising revenue without establishing reasonable certainty of ultimate collection.
- b) The Bank did not have adequate internal controls over period end adjustments including related presentation and disclosure requirements as mandated by the Accounting Standards, the provisions of the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India, in its standalone financial statements which could potentially result in material misstatements in the Bank’s financial statements.
- c) [list other material weaknesses identified]

A ‘material weakness’ is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Bank’s annual or interim financial statements will not be prevented or detected on a timely basis.

### **Adverse Opinion**

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, because of the effects/possible effects of the material weakness/es described in Basis for Adverse Opinion paragraph above on the achievement of the objectives of the control criteria, the Bank has not maintained adequate internal financial controls over financial reporting and such internal financial controls over financial reporting were not operating effectively as of March 31, 20XX, based on \_\_\_\_\_ [for example “the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”].

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Bank for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Bank.

### **Scenario 3 - Qualified Opinion on operating effectiveness of Internal Financial Controls Over Financial Reporting and unmodified opinion on adequacy of such Controls**

#### **Basis for Qualified opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the operating effectiveness of the Bank’s internal financial controls over financial reporting as at March 31, 20XX:

- a) The Bank’s internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, were not operating effectively which could potentially result in the Bank recognising revenue without establishing reasonable certainty of ultimate collection.
- b) [list other material weaknesses identified]

A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Bank's annual or interim financial statements will not be prevented or detected on a timely basis.

### **Qualified Opinion**

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, the Bank has, in all material respects, maintained adequate internal financial controls over financial reporting as of March 31, 20XX, based on \_\_\_\_\_ [for example, "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India"], and except for the effects/possible effects of the material weakness/es described in Basis for Qualified Opinion paragraph above on the achievement of the objectives of the control criteria, the Bank's internal financial controls over financial reporting were operating effectively as of March 31, 20XX.

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Bank for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Bank.

### **Scenario 4 - Adverse Opinion on operating effectiveness of Internal Financial Controls Over Financial Reporting and unmodified opinion on adequacy of such Controls**

#### **Basis for Adverse opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the operating effectiveness of the Bank's internal financial controls over financial reporting as at March 31, 20XX:

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- a) The Bank's internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for loans and advances, were not operating effectively which could potentially result in the Bank recognising revenue without establishing reasonable certainty of ultimate collection.
- b) The Bank's internal controls over period end adjustments including related presentation and disclosure requirements as mandated by the Accounting Standards, the provisions of the Banking Regulation Act, 1949 and the circulars and guidelines issued by the Reserve Bank of India were not operating effectively which could potentially result in material misstatements in the Bank's financial statements.
- c) [list other material weaknesses identified]

A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Bank's annual or interim financial statements will not be prevented or detected on a timely basis.

### Adverse Opinion

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, the Bank has, in all material respects, maintained adequate internal financial controls over financial reporting as of March 31, 20XX, based on \_\_\_\_\_ [for example, "the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India"], and because of the effects/possible effects of the material weakness/es described in Basis for Adverse Opinion paragraph above on the achievement of the objectives of the control criteria, the Bank's internal financial controls over financial reporting were not operating effectively as of March 31, 20XX.

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Bank for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Bank.

**Scenario 5 - Adverse Opinion on Internal Financial Controls Over Financial Reporting – essential components of internal controls not adequately considered in the internal financial controls established by the Bank**

**Basis for Adverse opinion**

According to the information and explanations given to us and based on our audit, the following material weakness/es has / have been identified in the Bank's internal financial controls over financial reporting as at March 31, 20XX:

- a) The Bank did not have appropriate internal financial controls over financial reporting since the internal controls adopted by the Bank did not adequately consider risk assessment, which is one of the essential components of internal control, with regard to the potential for fraud when performing risk assessment.
- b) [list other material weaknesses identified]

A 'material weakness' is a deficiency, or a combination of deficiencies, in internal financial control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Bank's annual or interim financial statements will not be prevented or detected on a timely basis.

**Adverse opinion**

In our opinion, and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the branch auditors referred to in the Other Matters paragraph below, because of the effects/possible effects of the material weakness/es described in Basis for Adverse Opinion paragraph above on the achievement of the objectives of the control criteria, the Bank has not maintained adequate and effective internal financial controls over financial reporting as of

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March 31, 20XX, based on \_\_\_\_\_ [for example, “the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India”].

We have considered the material weakness/es identified and reported above in determining the nature, timing, and extent of audit tests applied in our audit of the standalone financial statements of the Bank for the year ended March 31, 20XX, and the / these material weakness/es does not / do not affect our opinion on the said standalone financial statements of the Bank.

### Other Matters

Our aforesaid report insofar as it relates to the operating effectiveness of internal financial controls over financial reporting of \_\_ (number, specify scoped in / IFCoFR reporting branches) branches is based on the corresponding reports of the respective branch auditors of those branches.

Our opinion is not modified in respect of this matter.

For XYZ & Co  
Chartered Accountants  
(Firm's Registration No.)

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>8</sup>)  
(Membership No.)  
UDIN

Place of Signature:

Date:

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<sup>8</sup> Partner or Proprietor, as the case may be.