

Technical Guide on Internal Audit of Mutual Fund

(Revised 2021 Edition)



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

Technical Guide on Internal Audit of Mutual Fund

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Internal Audit Standards Board
The Institute of Chartered Accountants of India
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Foreword

The Indian mutual fund industry is one of the fastest growing and most competitive segments of the financial sector. Laws, regulations and governance, supply side factors, demand side factors and technological issues could all affect the size of mutual industry. It places a growing responsibility on the Trustees to ensure that the operations of the funds are managed to the full benefit of the unit holders as well as also focus on the opportunities to ensure growth. In this regard, Mark Cuban Quote: "Creating opportunities means looking where others are not."

Considering the unique nature of this industry, internal auditors can play an important role to establish effective operational goals, develop and implement control procedures and achieve anticipated results. Internal audit determines whether such objectives and goals are being achieved as per management plans.

It is heartening to note that the Internal Audit Standards Board, ICAI has brought out the revised Technical Guide on Internal Audit of Mutual Fund amply reflecting several significant regulatory changes that impact operating environment within which the Mutual Fund functions and enhanced governance procedures implemented by the mutual fund to facilitate transparent reporting to Trustees, Board of Asset Management Company and the Management. I congratulate CA. Charanjot Singh Nanda, Chairman and CA. Anil Satyanarayan Bhandari, Vice Chairman, Internal Audit Standards Board and other members of the Board on issuance of this Technical Guide.

I am sure that the Technical Guide will assist the members and others in efficiently discharging of their responsibilities.

June 29, 2021
New Delhi

CA. Nihar N Jambusaria
President, ICAI

Preface

India's mutual fund (MF) industry is currently experiencing a state of mutability; while ample opportunities are knocking at the door, it's equally concerned with the numerous challenges. As the number of players in the market increases, competition may force fund houses to comply not only with the laid down regulations and concentrate more on growth but endeavour in creating excellence in governance as well.

In this challenging environment, the debate of growth versus governance is surely set to assume greater significance and stakeholders have additional expectation from internal audit that in ever changing global, business, regulatory and economic scenario to find the best resources to meet those challenges. Internal audit will increasingly play a more meaningful role in the broader value delivery agenda of this industry. For this, the internal auditor must possess knowledge of the technical, commercial and other aspects of the operations of the enterprise concerned.

The Institute had in 2011 issued Technical Guide on Internal audit of Mutual Fund Industry. During the past decade, the Mutual Fund Industry operations have undergone several changes impacting the way operations are carried out. In updating the Technical Guide, the key factors that had been considered while revising this Guide, includes, Introduction of several significant regulatory changes that impact operating environment within which the MF industry functions, Increase in the offerings and complexity of existing products including systematic transactions, changes in the manner in which client on-boarding and KYC/AML practices are conducted, increase in the level of outsourcing of key MF related operations, extensive use of information technology to replace legacy/ manual methods of conducting operations, the resultant emergence of new information and cyber security risks and the regulatory/ industry response in mitigating these risks, introduction of new channels and points of sale, introduction of sophisticated digital technology platforms, enhanced controls implemented by the MF industry, enhanced governance procedures implemented by the Industry to facilitate transparent reporting to Trustees, Board of Asset Management Company and the Management, usage of data analytics techniques, incorporation of key guidance provided by Association of Mutual Funds in India (AMFI) to the MF industry for implementing critical regulatory changes and investor initiatives.

The individual chapters has been reviewed and revised considering the above factors. There are significant changes introduced, specially, in Registrar and Transfer Agent (RTA), Fund Accounting & Back Office and Investment & Mid Office operations. In addition, new chapters on Banking Operations and Reconciliation and Information Technology have been introduced.

Members are advised to keep track of all relevant directions/circulars issued by the Securities and Exchange Board of India, Association of Mutual Fund Industry and other regulatory directives and circulars that may have a bearing on the internal audit of mutual funds. The members conducting internal audit of mutual funds keep themselves abreast of all the developments in the mutual fund industry.

My immense thanks are due to CA. Vishal Dhanesha and his study group members viz., CA. Srinivasan Iyer, CA. Sutlej Teredesai, CA. Sudhir Nair, CA. Nippun Gupta and, CA. Mikit Sheth for sharing their experience and knowledge with us and preparing the draft of this Technical Guide. CA. Shrinivas Yeshwant Joshi, Member of the Internal Audit Standards Board, ICAI deserves special mention for their invaluable support and contribution.

I would like to thank to CA. Nihar N Jambusaria, President, ICAI and CA. (Dr.) Debashis Mitra, Vice President, ICAI and CA. Anil S Bhandari, Vice Chairman, IASB for their continuous support and encouragement to the initiatives of the Board.

I must also thank my colleagues from the Council at the Internal Audit Standards Board, viz., CA. Tarun J Ghia, CA. Nandkishore C Hegde, CA. Chandrashekhar V Chitale, CA. Shrinivas Y Joshi, CA. Aniket S Talati, CA. Dayaniwas Sharma, CA. G Sekar, CA. M P Vijay Kumar, CA. Ranjeet Kumar Agarwal, CA. Pramod Kumar Boob, CA. Manu Agrawal, CA. Prakash Sharma, CA. Kemisha Soni, CA. Satish Kumar Gupta, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, Shri Gyaneshwar Kumar Singh, Mrs. Ritika Bhatia, Shri Chandra Wadhwa, Co-opted members CA. Manoj Kumar Jain, CA. Rakesh Agarwal, CA. Manish Baxi, CA. Kamlesh Amlani, CA. Huzeifa Unwala, CA. Bhavin Shah, CA. Parvinder Singh, CA. Nitin Alshi, Special Invitees CA. Sanjay Agarwal, CA. Pradeep Tyagi and CA. Gavish Uberoi for their vision and support and their invaluable guidance and also their dedication and support to the various initiatives of the Board. I also wish to

express my sincere appreciation for CA. Arti Bansal, Secretary, Internal Audit Standards Board, ICAI for her efforts in giving final shape to this Technical Guide.

I am sure that readers, especially members of the Institute, working as internal audit of mutual fund industry would find this technical guide immensely useful.

May, ___ 2021
New Delhi

CA. Charanjot Singh Nanda
Chairman, Internal Audit Standards Board, ICAI

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Abbreviations

AD	Active Directory
AI	Artificial Intelligence
AGM	Annual General Meeting
AIF	Alternate Investment Fund
AMC	Asset Management Company
AMFI	Association of Mutual Funds in India
AML	Anti-Money Laundering
ARMFA	AMFI Registered Mutual Fund Advisor
ARN	AMFI Registration Number
ASBA	Applications Supported by Blocked Amount
AUM	Assets Under Management
BCP	Business Continuity Plan
BOT	Banking Operations Team
CAAT	Computer Aided Audit Techniques
CAS	Consolidated Account Statement
CBLO	Collateralised Borrowing & Lending Obligations
CCM	Court Convened Meeting
CD	Compact Disc
CD	Certificate of Deposit
CFT	Combatting the Financing of Terrorism
CIB	Corporate Internet Banking
CIO	Chief Investment Officer
CISO	Chief Information Security Officer
CKYC	Centralised Know Your Customer
CMS	Cash Management Services
CP	Commercial Paper

CP	Controlling Person
CRA	Credit Rating Agency
CRM	Customer Relationship Management
CRS	Common Reporting Standards
CTR	Compliance Test Report
CTR	Cash Transaction Report
DC	Direct Credit
DIP	Delivery Instructions for Purchase
DIS	Delivery Instructions for Sale
DRP	Disaster Recovery Plan
DTR	Daily Transaction report
DTSM	Date and Time Stamping Machine
ECS	Electronic Clearing Service
EGM	Extra-Ordinary General Meeting
ETF	Exchange Traded Fund
EUIN	Employee Unique Identification Number
FA	Fund Accountant
FATF	Financial Action Task Force
FATCA	Foreign Account Tax Compliance Act
FD	Fixed Deposit
FDOA	Financial Delegation of Authority
FI	Financial Institution
FII	Foreign Institutional Investor
FIMMDA	Fixed Income Money Market and Derivatives Association of India
FIU	Financial Intelligence Unit
FMP	Fixed Maturity Plan
FOF	Fund of Fund

FPO	Follow on Public Offer
FT	Financial Transactions
GDP	Gross Domestic Product
GL	General Ledger
GST	Goods and Services Tax
HNI	High Net worth Individual
HUF	Hindu Undivided Family
IAP	Investor Awareness Program
IDS	Intrusion Detection System
IPS	Intrusion Prevention System
IFA	Independent Financial Advisor
IPO	Initial Public Offering
IPS	Intrusion Prevention System
IPV	In-person Verification
ISC	Investor Service Centre
ISIN	International Securities Identification Number
IT	Information Technology
KIM	Key Information Memorandum
KYC	Know Your Customer
KYD	Know Your Distributor
KRA	KYC Registration Agency
MCR	Monthly Compliance Report
MERS	Middle East Respiratory Syndrome
MF	Mutual Fund
MFU	Mutual Fund Unit
MIS	Management Information System
ML	Money Laundering
ML	Machine Language

NAV	Net Asset Value
NBFC	Non-Banking Finance Company
NCD	Non-Convertible Debentures
NEFT	National Electronic Fund Transfer
NFO	New Fund Offer
NFT	Non-Financial Transactions
NIGO	Not in Good Order
NISM	National Institute of Securities Market
NPA	Non-Performing Asset
PAN	Permanent Account Number
PDC	Post-dated Cheques
PEKRN	PAN Exempt KYC Registration Number
PEP	Politically Exposed Person
PII	Personally Identifiable Information
PHI	Protected Health Information
PMLA	Prevention of Money Laundering Act
PMS	Portfolio Management Services
PO	Principal Officer
POA	Power of Attorney/ Points of Acceptance
PSU	Public Sector Undertaking
RBI	Reserve Bank of India
RIA	Registered Investment Advisers
RPA	Robotic Process Automation
RTA	Registrars and Transfer Agents
RTGS	Real Time Gross Settlement
RUD	Returned Undelivered
SAI	Statement of Additional Information
SARS	Severe Acute Respiratory Syndrome

SEBI	Securities and Exchange Board of India
SCORES	SEBI Complaint Redressal System
SFTP	Secured File Transfer Protocol
SID	Scheme Information Document
SIP	Systematic Investment Plan
SLA	Service Level Agreement
SOC	Securities Operations Centre
SOP	Standard Operating Procedures
STP	Systematic Transfer Plan
STP	Straight Through Processing
STR	Suspicious Transaction Report
STT	Securities Transaction Tax
SWIFT	Society for Worldwide Interbank Financial Telecommunication
SWP	Systematic Withdrawal Plan
TAT	Turnaround Time
TDS	Tax Deducted at Source
TER	Total Expense Ratio
TF	Terrorist Financing
UAPA	Unlawful Activities (Prevention) Act
UAT	User Acceptance Test
UBO	Ultimate Beneficial Owner
UIDAI	Unique Identification Authority of India
USB	Universal Serial Bus
UNSC	United Nations Security Council
VAPT	Vulnerability and Penetration Testing

Glossary

Net Asset Value (NAV)	Net Asset Value is the market value of the assets of the scheme minus its liabilities. NAV is the net asset value of the scheme divided by the number of units outstanding on the Valuation Date.
Asset Under Management (AUM)	Asset Under Management means the total sum of investors which the AMC is controlling. It is the total size of assets which these AMCs manage for their client. An AUM of an AMC is the sum of total assets held less its liabilities. AUM keeps fluctuating due to fresh investments and redemptions done on a daily basis.
Qualified Foreign Investor (QFI)	A person resident in a country that is compliant with Financial Action Task Force (FATF) standards and that is a signatory to International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding.
Redemption Price	It is the price at which close-ended schemes redeem their units on maturity. Such prices are NAV related.
Repurchase/ Exit Load	It is a charge collected by a scheme when it buys back the units from the unitholders. Also called 'Back-end' or 'Exit' load
Repurchase Price	It is the price at which units under open-ended schemes are repurchased by the Mutual Fund. Such prices are NAV related.
Sales/ Entry Load	It is a charge collected by a scheme when it sells the units. Also called, 'Front-end' or 'Entry' load. Schemes that do not charge a load are called 'No Load' schemes.
Sale Price	It is the price you pay when you invest in a

scheme. Also called Offer Price. It may include a sales/entry load.

New Fund Offer (NFO) New Fund Offer is similar to an IPO of any company. It is an offering made to public to raise capital for a particular scheme. The offer is open for a stipulated time at unit price of usually Rs.10. After the offer is closed, anyone who intends to opt for the fund can only do so at the NAV. Whenever a new scheme is launched by an AMC it is done through NFO route to raise capital from public to buy equities, bonds, etc.

Yield to Maturity (YTM) The Yield to Maturity or the YTM is the rate of return anticipated on a bond if held until maturity.

Chapter 1

Introduction

1.1 India has a strong and a rapidly growing mutual fund industry over the recent years. Since the 1990s when the mutual fund business was thrown open to the private sector, the industry has traversed a long path, adapting itself continuously to the regulatory changes, technology changes, introduction of new products and changes in investor preferences. The industry has grown from a single entity in 1963 to 45 mutual funds in 2020. The Mutual Fund Industry's AUM has grown from 12.63 trillion as on February 29, 2016 to 31.64 trillion as on February 28, 2021, about 2.5 fold increase in a span of 5 years.* The industry AUM stood at Rs. 21.64 lakh crore (Rs. 31.64 trillion) as on February 28, 2021. The Average AUM of the Indian mutual fund industry for the month of February, 2021 stood at Rs. 32.30 lakh crore (Rs. 32.30 trillion). The growth in the mutual fund industry is a result of educating investors, growing economy, new product introductions (tax saving schemes, fund of fund schemes, gold funds, international funds, systematic investment plans, systematic withdrawal plans, systematic transfer plans, etc.), capital gains for certain classes of funds and a wider distribution of fund shares. The rising disposal income amongst retail investors and higher corporate earnings seem to have contributed to the overall growth of the Indian economy in recent years though the industry penetration levels are still low.

1.2 The Mutual Fund Industry's AUM as a percentage of Gross Domestic Product (GDP) remains considerably low in India when compared to developed economies, such as, the United States and the United Kingdom, and even developing economies like Brazil. The ratio of mutual fund AUM as percentage of GDP and net mobilisation by mutual funds as a percentage of Gross Domestic Savings is as under:

Year	MF AUM % of GDP	Net Mobilisation by MFs as % of Gross Savings
2011-12	6.7	-0.7

* Source: Association of Mutual Fund in India

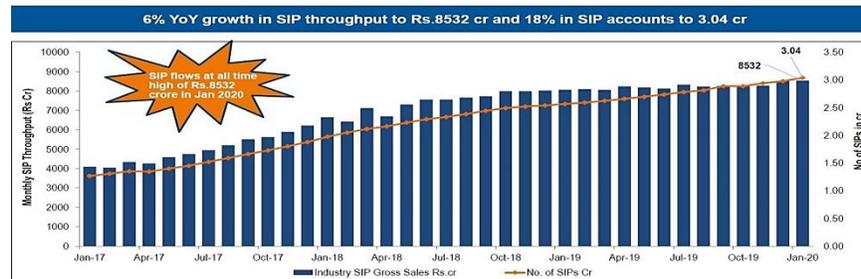
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2012-13	7.1	2.3
2013-14	7.3	1.5
2014-15	8.7	2.6
2015-16	9.0	3.1
2016-17	11.5	7.5
2017-18	11	-

Source: Ministry of Statistics and Programme Implementation (MOSPI) and AMFI

While the United States has its Mutual Fund AUM more than the country's GDP at 103 per cent, it is only 11 per cent in India. The world average is 55 per cent.

1.3 The trend of rising personal income has been witnessed not only amongst the young population, but also amongst the high net worth individual (HNI) segment, which have sizeable funds to invest. India has a very strong middle class and by 2030, India will move from being an economy led by the bottom of the pyramid, to one led by the middle class. This has attracted global fund houses and asset management businesses to focus their attention on India in the segment of household savings and investments. In today's volatile market environment, mutual funds are looked upon as a transparent and low cost investment vehicle, which attracts a fair share of investor attention helping spur the growth of the industry. Over time, inclusive growth across the financial sector seems to have taken centre-stage, re-designing all business strategies around this sole objective. The mutual fund industry being no exception, various measures are being taken by fund houses and distributors to spread access and reach to the semi-urban and rural segments. This is also clearly evident from the SIP growth as depicted in following graph:



Introduction

1.4 The SIP accounts continued to rise sequentially to 3.33 crores in September 2020 and 3.37 crores in October 2020. The SIP AUMs as on October 31, 2020 stood at Rs.3.42 lakh crores (Rs.3.35 lakh crores as at September 30, 2020). The Indian mutual fund industry has high ownership from corporates, banks and institutions comprising over 46% of the total AUM and the number of retail investor accounts pegged at 8.40 crore offers opportunities for higher penetration. The unit holding pattern of mutual fund industry as at September 2020 was as under:

Investor Classification	AUM (Rs. in crore)	% to Total	No. of Folios	% to Total
Corporates	11,94,040.09	44.45	7,79,331	0.84
Banks/FIs	43,410.02	1.62	5,132	0.01
FIIIs	4,747.44	0.18	573	0.00
High Net worth Individuals*	8,82,959.45	32.87	84,28,165	9.03
Retail	5,60,824.90	20.88	8,40,94,279	90.13
Total	26,85,981.90	100.00	9,33,07,480	100.00

Source: AMFI

* Defined as individuals investing Rs. 2 lakh and above

Note: Account refers to a folio. An investor may have multiple accounts in a single fund or across funds. This is, therefore, not a count of number of investors, but number of accounts.

The investor-wise categories across scheme types as at the end of November 2020 is given below:

Investor Categorisation	Debt Oriented Schemes	Equity Oriented Schemes	Liquid/ Money Market Schemes	ETFs/ FOFs
Institutional	61%	12%	84%	91%
Individual	39%	88%	16%	9%
Total	100%	100%	100%	100%

Source: AMFI

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Note:

- Institutions include domestic and foreign institutions and banks.
- Equity oriented schemes include equity schemes and balanced funds.

1.5 The deployment of debt funds by all mutual funds in various asset types as on November 30, 2020 is as under:

Asset type	Sector	Amount (Rs.in crore)	Percentage
Government Securities		2,71,524.65	16.21%
Commercial Paper	Real Estate	305.29	0.02%
	NBFC	60,923.62	3.64%
	Others	2,05,034.61	12.24%
Certificates of Deposit		59,950.86	3.58%
Treasury Bills		2,21,096.04	13.20%
CBLO		1,62,031.93	9.67%
Other Money Market Investments		34,500.47	2.06%
Corporate Debt including floating rate bonds, CDs and others)	Real Estate	5,186.06	0.31%
	NBFC	88,441.57	5.28%
	Others	2,77,306.31	16.55%
PSU Bonds/ Debt		2,47,611.54	14.78%
Asset Backed Securities		7,335.16	0.44%
Single sell downs/ single loan	Real Estate	-	0.00%
	NBFC	-	0.00%
	Others	371.41	0.02%
Bank Fixed Deposit		4883.25	0.29%
Others		28,872.66	1.72%
Total		1675375.4	100.00%

Source: SEBI

1.6 The landscape of the financial sector in India is continuously evolving, accredited to regulatory changes being undertaken, which makes leading market participants like, the Asset Management Companies (AMCs) and distributors to restructure their strategies and adopt business models, which

will yield sustainable benefits. The road ahead for the mutual fund industry will be paved by the performance of the capital markets. It is in the backdrop of some of these encouraging statistics that the Indian mutual fund industry has fostered itself.

Regulatory Framework

Securities and Exchange Board of India (SEBI)

1.7 Securities and Exchange Board of India (SEBI) formed in 1992, regulates and supervises the mutual fund industry in India for establishment of sound and stable financial system, protection of mutual fund unit holders, market efficiency, privatization and opening of markets, etc. The Securities and Exchange Board of India (Mutual Fund) Regulations, 1996 ('MF regulations') govern, *inter-alia*, the establishment and operation of mutual funds in India. The provisions of the MF Regulations are administered by the SEBI. Mutual funds in India are constituted in the form of a trust under the Indian Trusts Act, 1882. All AMCs which manage mutual funds must be approved by SEBI for managing the investments.

Association of Mutual Funds in India (AMFI)

1.8 Association of Mutual Funds in India (AMFI) has been formed for developing the Indian mutual fund industry on professional, healthy and ethical lines and to maintain and enhance the standards in all areas with a view to protect and promote the interests of mutual funds and their unit holders. AMFI, the association of all the Asset Management Companies of SEBI registered mutual funds in India, was incorporated on August 22, 1995, as a non-profit organisation.

As of now, 43 Asset Management Companies are registered with SEBI as members. (Sources: AMFI)

AMFI's objectives are as follows:

- To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
- To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.

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- To interact with SEBI and to represent to SEBI on all matters concerning the mutual fund industry
- To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the mutual fund industry.
- To undertake nationwide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds
- To disseminate information on mutual fund industry and to undertake studies and research directly and/or in association with other bodies.
- To take regulate conduct of distributors including disciplinary actions (cancellation of ARN) for violations of Code of Conduct.
- To protect the interest of investors/unit holders.

Objective and Scope of Technical Guide

1.9 As the industry grows, with multiple products being launched across asset classes, it becomes imperative that the mutual fund sector in India, introduces robust systems and processes that should not only address the problems related to internal control, financial transparency and equity but also bring effective governance so as to serve the interests of the management, unit holders, investors and the society, at large. This Technical Guide is an attempt to disseminate knowledge on internal audit of mutual funds and provides relevant guidance on related issues. Internal audit is an independent examination of processes and transactions, to provide assurance on the reliability of internal controls. Expectations from internal auditors are expanding. As a result, the traditional role of internal auditor is transforming to include activities that go beyond verification of compliance with policy norms and operating procedures to taking primary responsibility in assessing the effectiveness of the risk management processes in a business.

1.10 The emerging role of the internal auditor requires that there is proactive participation by internal audit team in the process of improving an organization's operations through a combination of assurance and consulting work. The real value derived from the efforts of the internal auditor can only be measured when the audit efforts are aligned to the strategic direction of the organization and operate at a level that improves organizational

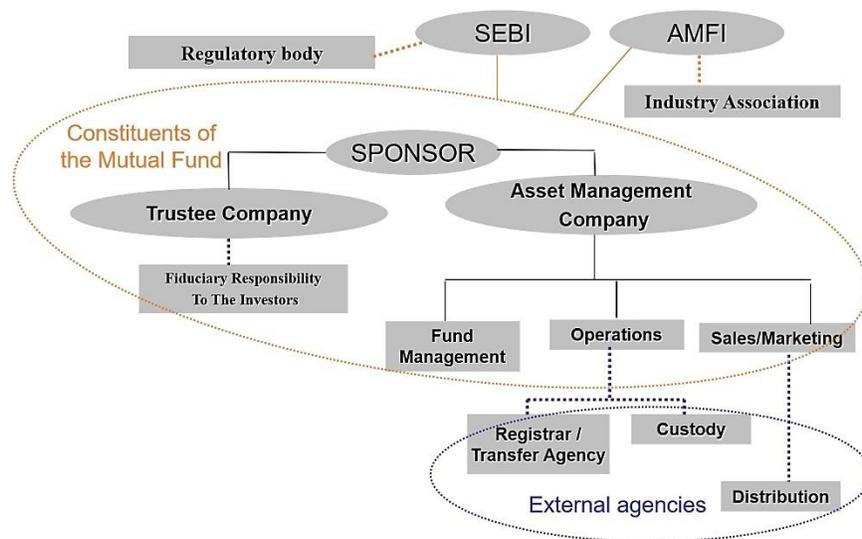
Introduction

performance and ultimately delivers better returns to shareholders. This is possible when the internal auditor develops sector specific skills and competencies. This Technical Guide has been updated with the objective of augmenting the efforts of internal auditors in honing skills and competencies for internal audit of mutual fund.

Constitution of a Mutual Fund

Structure of a Mutual Fund

2.1 Typically, a mutual fund is a trust that pools the savings of a number of investors who share a common financial goal. The money collected is invested in capital market instruments such as, shares, debentures and other securities and money market instruments. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them. A mutual fund offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.



Sponsor

2.2 The Sponsor(s) are those who establish the Mutual Fund Trust and the AMC. They constitute the shareholders of the AMC.

Board of Trustees or Trustee Company

2.3 The trustees of a mutual fund could be constituted as a 'Board of Trustees' or could be incorporated as a 'Trustee Company'. Where a Trustee Company is appointed, the duties of the trustee would be discharged through

Constitution of a Mutual Fund

its directors. Regulation 18 of Securities and Exchange Board of India (Mutual Fund) Regulations, 1996 has laid down the rights and obligations of the trustees. The Trustee Company is entitled to receive trusteeship fees for their services. The Sponsor appoints the trustees for the mutual fund. The trusteeship fee is paid by the mutual fund schemes and forms part of the overall expense ratio approved. The mutual fund's assets belong to the investors and are held in fiduciary capacity for them by trustees. The Trustee Company is the epitome of corporate governance in mutual funds and the trustees are regarded essentially as the front-line regulator. The Trustee Company is entrusted with the responsibility of holding the property of the mutual fund in trust for the benefit of the unitholders.

Assets Management Company (AMC)

2.4 The AMC is a corporate entity, which floats, markets and manages mutual fund schemes and in return receives a management fee paid from the fund corpus. The AMC is accountable to the Trust for its actions. Regulation 25 of Securities and Exchange Board of India (Mutual Fund) Regulations, 1996 has laid down the AMC's obligations. In India, the Sponsor or the Trustee appoints the AMC through an Investment Management Agreement (IMA). The Investment Management Agreement (IMA) contains provisions for the duties and responsibilities of the Assets Management Company. The contents of the IMA are given in the Fourth Schedule to the MF Regulations. In terms of Regulation 24 of Securities and Exchange Board of India (Mutual Fund) Regulations, 1996, no AMC can manage assets of more than one Mutual Fund and in case the AMC decides to undertake any other activity then it has to satisfy SEBI that the key personnel and infrastructure have been segregated activity-wise.

Fund Accountant

2.5 The Fund Accountant is an entity handling the back office operations of the mutual fund for and on behalf of the AMC, viz., services related to fund accounting, purchase processing, corporate actions accounting, valuation and Net Asset Value (NAV) calculation, reporting and other incidental services in respect of the Mutual Fund. An AMC, generally, enters into a service level agreement (SLA) with the Fund Accountant, if outsourced, which will clearly bring out the expectations from the third-party service providers. Periodically, these would be reviewed to reflect at all times, the business requirements currently in practice.

Custodian

2.6 The Custodian is an external entity appointed to perform custodial service for the assets under management of the schemes managed by AMC who is not affiliated to the sponsor and/or its associates. The custodian is responsible for settlement of trades and ensuring custodial services for the fund. The AMC enters into an SLA with the custodian, which will clearly bring out the service delivery expectations from the custodian. Periodically, these would be reviewed to reflect at all times, the business requirements currently in practice. The external entity engaged for custodial services should be registered as a custodian under the SEBI (Custodian of Securities) Regulation, 1996.

Registrar and Transfer Agent (RTA)

2.7 The RTA is an entity appointed by the AMC to render services to its investors/ unit holders viz., receipt and processing of financial transactions (subscription, redemption, switch) from investors, dividend processing and payout, brokerage processing for distributors. Processing of non-financial transactions like, bank mandate, nominee, pledge, change of address, change of email address, transmission of units related request, name correction, etc. Additionally, the RTA might also provide customer care support services through its wide-network of Investor Service Centers (ISCs), its call center and its web portal such as, requests for latest NAVs, requests for balances/ account statements, requests for fund literature. The RTA also manages the dividend distribution process and commission processing for the mutual fund. An AMC, generally, enters into SLA with RTA, which will clearly bring out the expectations from the third-party service providers. Periodically, the SLA is reviewed and revisited in line with regulatory and business requirements currently in practice.

KYC Registration Agency (KRA)

2.8 KRA is an agency registered with SEBI under the Securities and Exchange Board of India [KYC (Know Your Client) Registration Agency] Regulations, 2011. The primary role of KRA is to maintain KYC records on behalf of the intermediaries registered to do business in public space by the market regulator. To aid this function, a financial intermediary, such as, mutual fund will perform the KYC on investors and provide the details to the KRA. The KYC records of customers are maintained centrally by the KRAs

and the customer details can be fetched by the intermediaries. This is done to ensure that the process of verification does not have to be repeated when the client approaches an intermediary for investment. The following companies are the registered KRAs with SEBI:

- CDSL Ventures Limited
- DotEx International Limited
- Karvy Data Management Services Limited
- NSDL Database Management Limited (NDML)
- CAMS Investor Services Private Limited

Distributors

2.9 Individuals, firms and corporate entities are engaged by the AMC for the purpose of distributing, marketing and procuring subscriptions to the schemes of the mutual fund. All distributors appointed by the AMC are AMFI/NISM Registered Mutual Fund Distributors (ARMFA), as stipulated in SEBI Circular dated June 24, 2010.

Types of Mutual Fund Schemes

2.10 Mutual Fund schemes are launched by the AMC after being approved by the Trustees and SEBI. In the past, AMCs had launched many schemes which were similar in nature. In order to bring in consistency in the characteristics of similar type of schemes launched by different mutual funds, SEBI vide circular dated October 6, 2017, provided for categorisation and rationalisation of mutual fund schemes. The objective of the Circular was to bring about uniformity in practice across mutual funds and to standardise the scheme categories and attributes of mutual fund schemes across specific categories. The product offerings need to look different from each other in terms of core characteristics like investment objective and asset allocation. This would ensure that an investor in mutual funds is able to evaluate the different options available, before taking an informed decision to invest in a scheme.

Based on Structures

2.11 Based on structures, mutual fund schemes may be classified as under:

- (a) **Open Ended Schemes:** These are mutual fund schemes which are

Technical Guide on Internal Audit of Mutual Fund

available for subscription and redemptions throughout the year. These do not have a fixed maturity. Investors can purchase and redeem units at the prevalent Net Asset Value (NAV). There is no limitation on the number of units of the mutual fund that can be issued. The key feature of such schemes is access to liquidity through redemption of units at any time they want.

- (b) **Close Ended Schemes:** The unit capital of close ended funds is fixed and only the specified number of units can be subscribed to by the investors. Capital Protection Oriented schemes, Real Estate schemes, Fixed Maturity plans are the types of close ended schemes. These schemes have pre-specified maturity periods. Every close ended scheme (except Equity Linked Savings Scheme) is mandatorily listed on a recognised stock exchange.
- (c) **Interval Schemes:** Interval schemes refer to the schemes that combine the features of both open ended and close ended schemes. The units of interval schemes may be listed and traded on the stock exchange. Investors can also subscribe/ redeem units of these schemes during pre-determined intervals at the prevailing Net Asset Value (NAV).

Illustration of the Calculation of Net Asset Value (NAV) Per Unit

The Net Asset Value (NAV) per Unit of the respective Options under the Scheme is computed by dividing the net assets of the Scheme by the number of Units outstanding on the valuation day as shown below:

Sr. No.	Particulars	Amount (INR)
1.	Market/ Fair value of investment portfolio	A
2.	Current assets	B
3.	Sub-total (1+2)	A+B
4.	Current liabilities	C
5.	Net Assets (3-4)	A+B-C
6.	Units outstanding on the valuation day	D
7.	NAV per unit (5/6)	(A+B-C)/D

Note: The NAV shall be calculated up to four decimal places. However, the AMC reserves the right to declare the NAVs up to additional decimal places, as it deems appropriate.

Classification by SEBI

SEBI has classified mutual fund schemes in to the following five groups:

- Equity Schemes
- Debt Schemes
- Hybrid Schemes
- Solution Oriented Schemes
- Other Schemes

SEBI has specified 36 categories of mutual fund schemes along with their characteristics and uniform description under the aforesaid groups. As per the said SEBI circular, only one scheme per category is permitted, except:

- Index Funds/ ETFs replicating/ tracking different indices
- Fund of Funds having different underlying schemes
- Sectoral/ Thematic funds investing in different sectors/ themes.

Based on structures and categories, the industry data as on September 30, 2020 is as under:

Sr. No	Schemes based on structures	No. of Schemes as on September 30, 2020	No. of Folios as on September 30, 2020	Net Assets Under Management as on September 30, 2020 (Rs. In crore)
A	Open ended Schemes			
I	Income/ Debt Oriented Schemes	326	73,02,363	12,13,950.83
II	Growth/ Equity Oriented Schemes	325	6,39,15,446	7,64,309.50
III	Hybrid Schemes	138	95,52,978	2,94,327.54
IV	Solution Oriented Schemes	34	54,40,696	19,428.57
V	Other Schemes	158	47,77,774	2,37,903.31

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	Total A-Open ended Schemes	981	9,09,89,257	25,29,919.75
B	Close Ended Schemes			
I	Income/Debt Oriented Schemes	645	6,74,595	1,27,133.52
II	Growth/ Equity Oriented Schemes	104	16,39,918	28,563.12
III	Other Schemes	-	-	-
	Total B - Close ended Schemes	749	23,14,513	1,55,696.64
C	Interval Schemes			
I	Income/Debt Oriented Schemes	23	3,710	365.55
II	Growth/Equity Oriented Schemes	-	-	-
III	Other Schemes	-	-	-
	Total C - Interval Schemes	23	3,710	365.55
	Total	1,753	9,33,07,480	26,85,981.94

Source: AMFI

2.12 The details of various categories of mutual fund schemes have been provided below: (Categories of schemes can fall in any of the open ended, close ended or interval structures as mentioned above.)

Equity Schemes

Schemes which invest minimum 65% of its total assets in equity shares. Equity schemes can be of the following types:

- Market Capitalisation Specific Schemes: These can be of the type, such as, Large Cap (1st-100th company in terms of full market capitalisation), Mid Cap (101st-250th company in terms of full market capitalisation) and Small Cap (251st company onwards in terms of full market capitalisation).
- Tax Saving Schemes: These schemes fall in the category of Equity Linked Savings Scheme. These schemes have a lock in period of

3 years. Investment in these schemes qualifies for tax deduction under Section 80 (C) of the Income Tax Act.

- Sectoral/ Thematic Schemes: These schemes invest maximum percentage of their portfolio in a particular sector, e.g. Banking, Pharma, etc. These schemes can provide high return but carry high risk.
- Multi-cap Schemes: These schemes diversify investment across market capitalisation. These schemes are less risky as compared to a market capitalisation specific scheme.
- Focused Equity Schemes: These schemes invest in concentrated stocks.

Debt Schemes

Invest in fixed income instruments, such as, Corporate and Government Bonds, Money Market securities, etc. Debt schemes are less volatile and hence, less risky than Equity schemes. Debt schemes derive return mainly from two sources, interest earned on debt securities invested and capital gains by churning the portfolio. Debt schemes provide variety of benefits to investors, such as, wealth creation, regular income, tax efficiency, etc. Debt schemes can be further categorised on the basis of 'duration of holdings' and 'type of debt securities'.

Debt schemes may be classified on the basis of duration of holdings as follows:

- (a) Short Term Debt Schemes: These schemes aim to provide regular income to investors through investments in debt and money market securities which are of the duration 1 to 3 years.
- (b) Medium Duration Schemes: These schemes aim to provide attractive returns with moderate liquidity through investments in debt securities which are of duration 3 to 4 years.
- (c) Low Duration Schemes: These schemes aim to provide regular income to investors through investments in debt securities of the duration 6-12 months.
- (d) Ultra-Short Duration Schemes: These schemes invest in debt and money market securities of duration 3-6 months. They aim to provide regular income with high degree of liquidity.

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- (e) Savings Schemes: These schemes invest in money market securities to generate stable returns.
- (f) Liquid Schemes: Invest in debt and money market securities with residual maturity of 91 days. These schemes aim to provide attractive returns with high degree of liquidity and low risk.
- (g) Overnight schemes: These schemes invest in overnight securities maturing on the next business day. They generate returns corresponding to the overnight rates.

Debt schemes may be classified on the basis of types of debt securities as follows:

- (a) Corporate Bond Schemes: Schemes that invest in corporate debt securities with moderate liquidity.
- (b) Gilt Schemes: Schemes which invest in Government securities issued by the Central/ State Governments. These schemes carry low risk.
- (c) Credit Risk Schemes: These schemes invest in corporate debt securities of the low investment grade with an intent to generate high returns.
- (d) Dynamic Bond Schemes: These schemes invest in debt securities of various maturities.
- (e) Income Schemes: These schemes aim to generate regular income through investments in debt securities of the duration ranging between 4-7 years.
- (f) Sector Specified Debt Schemes: These schemes invest in debt securities of issuer operating in a specific sector.

Hybrid Schemes

Diversifies investment in both Equity and Debt mutual fund schemes. The aim is to provide capital appreciation by investment in Equity securities and stability and returns through investment in debt securities. Hybrid schemes are sub-categorised into the following:

- (a) Equity-Oriented Hybrid Mutual Fund: These schemes allocate minimum 65% of portfolio in equity securities and balance in debt securities.

Constitution of a Mutual Fund

- (b) Debt-Oriented Hybrid Mutual Funds: These schemes invest minimum 75% of portfolio in debt securities and balance in equity securities.
- (c) Arbitrage Funds: These schemes simultaneously invest in spot and derivatives market to earn through price differential. Surplus funds are invested in debt securities.
- (d) Dynamic Asset Allocation Schemes: These schemes invest in a mix of equity and debt securities while maintaining the allocation dynamically.
- (e) Multi Asset Allocation Schemes: These schemes invest in multiple asset classes, such as, equity, debt, gold, etc.

Solution Oriented Fund

These mutual fund schemes can be of the nature, such as, retirement fund or children benefit fund. The objective of this fund is to create a corpus for a specific purpose, i.e., retirement or a child's education. These schemes have minimum lock period of 5 years/ till the objective is achieved (e.g. till retirement/ child attains majority), whichever is earlier.

Other Schemes

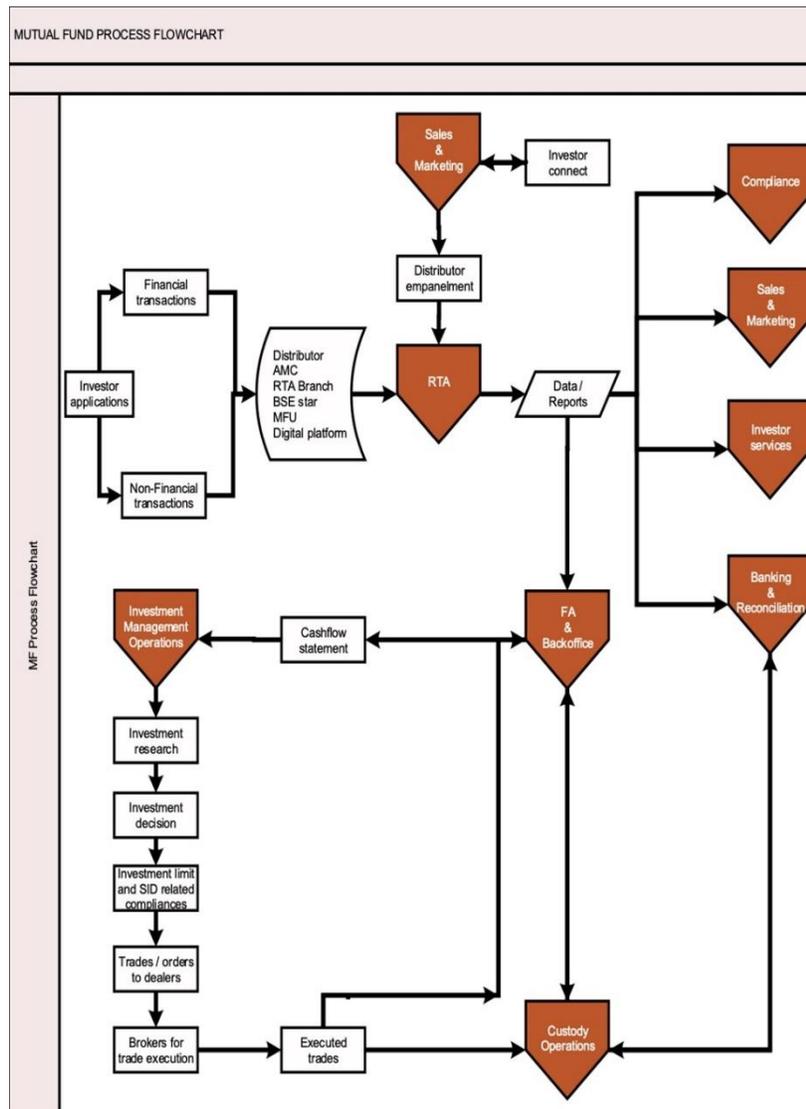
This category includes schemes which do not fall in any of the above categories. This encompasses ETFs, Index Funds and Fund of Fund schemes.

- (a) ETF schemes are passively managed mutual fund schemes. It tracks the performance of indices of an exchange. ETFs schemes are listed in stock exchange and are traded like equity securities. The returns from such schemes would be equivalent to those of the index, subject to tracking errors.
- (b) Index schemes replicate the portfolio of a stock exchange. Index schemes intend to track the returns of a market index. These schemes hold securities almost in the same proportion as its respective index. The returns from such schemes would be equivalent to those of the index, subject to tracking errors.
- (c) Fund of Fund scheme invests in other mutual fund schemes. This allows investors to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories that are all part of one fund. Return is dependent on the return of the underlying funds. The underlying asset could be equity, debt or gold or mix of asset class.

Transaction Flow in a Mutual Fund

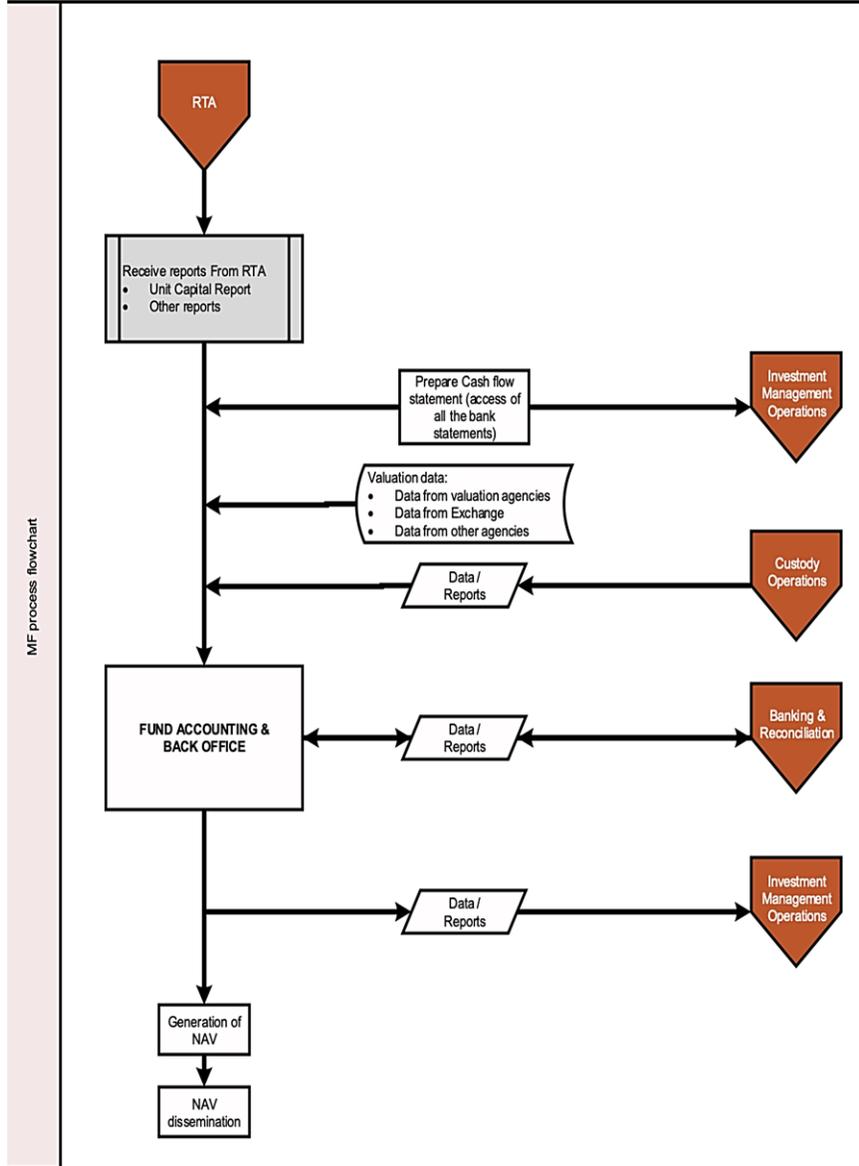
Transaction Flow in a Mutual Fund

3.1 Transaction flow in a Mutual Fund may be depicted in flow chart as follows:



Transaction Flow in a Mutual Fund

MUTUAL FUND PROCESS FLOWCHART



Functions/ Departments/ Activities related to a Mutual Fund

Sales, Distribution & Marketing

3.2 This department floats the schemes and helps in connecting with the investors to pool together their savings. The activities include sales calls, client relationship management, investor education and awareness, client reporting, NFO marketing strategy, product promotion, marketing material, staff commission structuring, staff certification compliance, empanelment of distributors, distributors due diligence, distributor categorisation, finalisation of agreement and commission rates, compliance with AMFI code of conduct and tracking distributor wise sales. The supportive functions are rendered by Registrar and Transfer Agents (RTAs) and Distributors.

Investment Management

3.3 The department invests the money collected from investors in capital market instruments such as, shares, debentures and other securities and money market instruments. The activities include definition of investment universe, investment strategy planning, drafting and implementation of investment policy risk policy, voting and stewardship policy, scheme fund performance monitoring, etc. The supportive functions are rendered by the brokers and custodians.

Custodian Operations

3.4 This department opens/ operates the demat account, settles trades on behalf of the mutual fund, coordinates with third parties for funds and securities, handles corporate actions, maintains records of securities, safe keeps the securities. The supporting functions are rendered by Fund Accounting and Back Office, Banking and Reconciliation Operations.

Banking & Reconciliation

3.5 This department is involved in granting, reviewing and revoking access of the users to the bank portal and to the bank accounts, maintaining inventory of bank accounts, managing the funding and movements to the bank accounts and reconciliation of the bank accounts. The supportive functions are rendered by Custodian Operations, Registrar & Transfer Agent and Fund Accounting and Back Office.

Fund Accounting & Back Office

3.6 This department maintains scheme-wise accounting of the resources raised (unit capital accounting), investments purchased and sold, accounting for corporate actions, accrual and payment of expenses, dividend, redemption, valuation of securities, generation of NAV, certain regulatory filings, etc. The supportive functions are rendered by custodian operations, banking and reconciliation operations, registrar & transfer agent and fund accountant.

Registrar and Transfer Agent (RTAs)

3.7 The Registrar and Transfer Agent is responsible for processing of financial transactions (subscription, redemption, switch, SIP, STP, DTP) received from investors, dividend processing and payout, brokerage processing for distributors, processing of non-financial transactions like, bank mandate, nominee, pledge, change of address, change of email address, transmission of units related request, name correction, etc. Additionally, the RTA also provides customer care support services through its wide-network of Investor Service Centers (ISCs), its call center and its web portal, such as, requests for latest NAVs, requests for balances/ account statements, requests for fund literature. The RTA also manages the dividend distribution process and commission processing for the Mutual Fund.

Compliance and Risk Management

3.8 This department is responsible for monitoring of the risk management and compliance related functions within the AMC including those outsourced. It ensures that the Mutual Fund complies with all the SEBI regulations. This will include activities, like, implementation and review of risk management system, review of investments restrictions, investment decisions and recording of investment decisions, compliance with AML KYC norms, adherence to compliance and other manuals, regulatory filings to SEBI, AMFI, and RBI, preparation and updation of Scheme Information Document (SID), Scheme Additional Information (SAI), Key Information Memorandum (KIM), etc. Compliance and risk management activities cover all the areas within the mutual fund.

Investor Servicing

3.9 This refers to the activity of providing support to investors or

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customers either before or after they invest in the schemes of the mutual fund. This may be done through the AMC branch offices or through the RTA. It also involves handling operational matters and investor grievances for resolution thereof along with the Registrar & Transfer Agent. Certain business processes may be outsourced by mutual funds to third parties with a view to have a lean organization structure and in turn be cost effective.

Chapter 4

Need and Objectives of Internal Audit of Mutual Funds

Background

4.1 Mutual fund industry is a highly regulated industry and is closely knit within the boundaries of various frameworks and regulations. The Trustees are bestowed with the fiduciary responsibilities of smooth functioning of the affairs of the fund and to safeguard the interests of the investors. Since the Trustees are not acting whole-time and reviewing the affairs of the fund, it is necessary for them to have reassurance of auditors on the processes.

4.2 The Mutual fund industry has witnessed explosive growth in AUM during the past ten years. Some of the factors responsible for this growth are as follows:

- Entry of new participants in the industry.
- Frequent and improved regulation – for example, focus on discouraging mis-selling by abolition of upfront fees, incentivising fund houses to penetrate their products in smaller towns and cities.
- Introduction of regulations for increasing investor education and awareness - This initiative has seen a good pay-off. Today the slogan “Mutual Fund Sahi Hai” has become a household catch phrase across the country. The younger generation entering the work population is far more aware of Mutual Fund investments than one generation earlier.
- Advent of systematic investment plans (SIP) and systematic withdrawal plans (SWP) in a big way – This captured the interest of a sizable population of retail investors who are looking for larger returns in modest investment instalments.
- Introduction of direct plans that make investment entry more affordable and attractive.
- Embracing of digitalization which has matched the mobile/ smart phone and internet penetration in the country leading to explosive growth in investments.

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Some of these factors have contributed to increasing number of transactions, number of options and channels to invest. This has increased the overall complexity of the business, operating environment. This further necessitates greater demand for auditors to be independent and well versed with the business of mutual funds in order to support Mutual Funds/AMCs in the management of their universe of risks.

Role of Internal Audit

4.3 The role of internal audit specifically, has significantly increased due to growing expectations from the regulator, company and trustee boards, operations and risk managers and investors. The regulator has become more demanding of the Mutual Fund industry in the last decade with frequent introduction of new regulation and amendment of existing regulation. This causes more demands on the operating infrastructure and environment of the mutual fund industry. The industry's agility and calibrated response to such changes is critical. Likewise, it requires internal auditors to frequently track the changes in regulations, assess the impact of the changes, review the adequacy and appropriateness of management response to these regulatory and operational changes. Thus, there is a lot more expected from the internal auditor, to unlearn old regulation and business practices and re-learn and understand the risk impact of new ones. Needless to say, the internal auditor function is required to sufficiently equip himself to meet this challenge.

Meaning of Internal Audit

4.4 Internal Audit provides independent assurance on the effectiveness of the internal controls and risk management process to enhance governance and achieve organizational objectives. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. It is an independent appraisal function established either by the management of an organization or outsourced to a firm specializing in internal auditing, for the review of the internal control system as a service to the organization.

Objective of Internal Audit

4.5 A dedicated, independent and effective internal audit activity assists both the management and the governing body (e.g., the board, audit committee) in fulfilling their responsibilities by bringing a systematic, disciplined approach to assessing the effectiveness of the design and execution of the system of internal controls and risk management processes.

Need and Objectives of Internal Audit of Mutual Fund

The objective of internal audit is to help in meeting the following requirements of the organisation:

- The entity's risk management processes are robust.
- The entity's operations are conducted in an efficient and effective manner.
- The entity's activities are conducted in accordance with management's explicit instructions, or are conducted according to sound management principles, where no explicit instruction exists.
- The resources of the entity are safeguarded from risks of losses, frauds, etc.
- The accounting and financial information required for decision making is reliable.
- Controls and systems are adequate and functional.

Internal auditors are experts in understanding organizational risks and internal controls available to mitigate these risks; but this alone is not enough. A thorough understanding of the intricacies of mutual fund operations is a key skill required to discharge their responsibilities in a competent and independent manner.

A well-functioning, adequately resourced internal audit function that works collaboratively with the management and the board is a key resource in identifying risks and recommending improvements to an organization's governance, risk management, internal controls and operations. Internal auditors' unique perspectives make them ideal for this role. These perspectives arise from:

- independence
- objectivity
- knowledge of the organisation's business
- understanding and application of sound consulting and audit principles (by virtue of their exposure to other organisations)

A primary lesson to be learnt from the financial failure of organisations is that good governance, risk management and internal controls are essential to the corporate's success and sustainability. In addition, the need for agility in responding to new business requirements triggered by competition or

Technical Guide on Internal Audit of Mutual Fund

regulation is key to prevent entities from failing. However, this agility still needs some checks and balances, both through the internal discipline of the entity in managing the change and the internal audit function in understanding it. To achieve this, one essential component of practices to be followed, is for the internal audit function to track and interpret changing regulations, and understand its practical implementation based on suggestions provided by the AMFI.

Internal Audit of Mutual Fund

4.6 The Internal Audit should:

- Develop good understanding or structure of mutual fund and various entities associated with mutual fund.
- Develop good understanding about Mutual Fund Regulations.
- Need to understand functioning of Securities Market, e.g. Listed equity, Debt, G. Sec, CBLO, Money markets instruments.
- Need to understand the operations at Custodian and Registrar and Transfer Agent.
- Typical process of units allotment w.r.t. cut of time, applicable NAV, Funds availability for deployment.
- Always remember one scheme is completely different than the other scheme of the same mutual fund w.r.t. investors, investment objective, fees, maturity, fund manager, etc.

Computer Aided Audit Techniques (CAATs)

4.7 Mutual fund operations involve voluminous transaction processing. As a result, risk-based approach for sampling may not sometimes provide the assurance required for such a regulated industry, where the entity's ability to identify and mitigate non-compliance with regulation or to identify/ prevent customer complaints is vital. Due to this, CAATs have gained primacy in increasing effectiveness of assurance provided to all stakeholders. Internal auditors should refer to Standards on Internal Audit (SIAs), Standards on Auditing (SAs) and Guidance Notes issued by ICAI on CAATs from time to time. Internal auditors should evaluate applicability of CAATs so as to cover key areas where voluminous data is handled for transactions with key regulatory or commercial impact.

Need and Objectives of Internal Audit of Mutual Fund

The traditional method of auditing allows auditors to draw conclusions based upon a limited sample of a population, rather than an examination of all available data or a large sample of data. CAATs is the practice of using computers to automate the audit processes to address these problems. CAATs normally include use of basic office productivity software, such as, spreadsheets, word processors and text editing programs with more advanced software packages involving use of statistical analysis and business intelligence tools. CAATs have become synonymous with data analytics in the audit process. This tool facilitates auditors to make search from the irregularities from the given data. With the help of this tool, the auditors and accountant of any firm will be able to provide more analytical results. These tools are used throughout every business environment and also in the industry sectors. With the help of CAATs, more forensic accounting with more analysis can be done.

Benefits of CAATs

- They are independent of the system being audited and will use a read-only copy of the file to avoid any corruption of an organization's data.
- Many audit-specific routines are used, such as, sampling
- Provides documentation of each test performed in the software that can be used as documentation in the auditor's work papers.

CAATs may perform the following functions:

- A. Data queries
- B. Data stratification
- C. Sample extractions
- D. Missing sequence identification
- E. Statistical analysis
- F. Calculations
- G. Duplicate transaction identification
- H. Pivot table creation
- I. Cross tabulation

A few examples where CAATs could be used are as follows:

1. RTA Operations: PAN/ PEKRN/ KYC/ AML checks, investor tax status

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checks, mode of holding checks, split transaction identification, accuracy of commission to distributors, identification of data entry errors or blanks in key fields, accuracy of bank IFSC, distributor's own investment identification, contact details discrepancy, etc.

2. Investment Operations: Passive/ active breaches in investment limits as per Schedule VII, inter-scheme deal checks, etc.
3. Banking Operations: Checks on redemption/ dividend pay-outs to one bank across multiple unrelated folios, checks on pay-outs to multiple bank accounts for the same folio at different points in time, etc.
4. Fund Accounting and Back Office Operations: Analysis of journal entries to identify potentially problematic areas, such as, entries with keywords of a questionable nature, entries from unauthorised sources, analysis of manual entries vis-à-vis system generated entries, unusually large number of manual entries or unusually large number of postings just under authorised limits, identification of duplicate entries, ageing analysis, trend analysis, ratio analysis, variance analysis, etc.
5. Custodian Operations: Verification of reconciliation of holdings and corporate actions, etc.
6. Investor Servicing: Analyse the investor requests, queries, complaints and grievances to check the nature, frequency, tax status of the investors, geographical presence, branches involved (of AMC or RTA), ageing, nature of transactions i.e. physical, online, financial or non-financial and make appropriate recommendations to enhance investor satisfaction which can ultimately lead to growth of the business.
7. AMC Branch Operations: Analyse sales data in terms of assets under management of the branch, equity, debt segments, schemes which attract investors, retail or institutional investors, business garnered from distributors, such as, independent financial advisors or national distributors, investor's response to fixed maturity plans, etc.

Artificial Intelligence (AI) and Machine Learning (ML)

4.8 Artificial Intelligence (AI) refers to computers with the ability to duplicate the functions of the human brain. Risks and controls in Mutual Funds and sampling techniques can be redefined with the use of AI in Mutual Funds.

Need and Objectives of Internal Audit of Mutual Fund

Some examples of AI are as under:

- Big Data Analysis
- R Language
- Python

Machine Learning (ML) is the study of computer algorithms that improve automatically through experience. Machine learning algorithms build a mathematical model based on sample data, in order to make predictions or decisions without being explicitly programmed to do so. Machine learning is a key subset of artificial intelligence (AI), which originated with the idea that machines could be taught to learn in ways like how humans learn.

Some examples of Machine Learning are as under:

- E-mail spam filters
- Credit card monitoring software

Following are the examples of audit usage of AI and ML:

- Machine Learning Tool programmed with algorithms, to read documents like leases, derivative contracts and sales contracts to identify key contract terms as well as trends and outliers
- Tool to analyse journal entries to identify potentially problematic areas, such as, entries with key words of a questionable nature, entries from unauthorised sources or an unusually high number of journal entry postings just under authorised limits
- Analysis of transactions in the general ledger to put those transactions into buckets of high risk, medium risk and low risk.

SEBI vide circular dated May 09, 2019 has also commented on the increasing usage of AI and ML as product offerings by market intermediaries and participants in investor and consumer facing products. Mutual funds using AI/ML based applications or systems are required to report to SEBI in the prescribed AI/ML reporting form on a quarterly basis.

CAAT/ AI/ ML can be used for data extraction, extensive coverage of audit, identifying exceptions basis pre-defined logics, etc. ML can help auditors to identify patterns and trends from large data sets and provide insights on probable gaps. AI and machine learning can assist Internal Auditors in any environment to function more efficiently.

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The real value derived from the efforts of the internal auditor can only be measured when the internal audit efforts are aligned to the strategic direction of the organization and operate at a level that improves organizational performance and ultimately delivers better returns to shareholders. This is possible when the internal auditor develops skills and competencies that are sector specific. This technical guide is an attempt to disseminate knowledge on the subject of internal audit of mutual funds and provides relevant guidance on developing mutual fund sector specific knowledge to internal audit professionals.

Audit of Mutual Fund

Statutory Auditor

4.9 The statutory auditor of the mutual fund is a chartered accountant firm appointed by the Trustee. These auditors are independent of the auditors appointed by the AMC to verify its own books of accounts. The scope of the statutory auditor is verification of the reports on the accuracy of accounting records maintained for the Fund, the AMC and the Trustee Company/ board of trustees. SEBI vide circular SEBI/IMD/CIR No. 8/132968/2008 dated July 24, 2008, prescribes new format of Abridged Scheme wise Accounting Disclosures, which are certified by statutory auditors. Under the SEBI Mutual Fund regulations, the statutory auditors of the AMC and Mutual Fund schemes need to be different entities.

The intricacies of the fund management business, with the multiplicity of schemes, plans and transactions and activities,, such as, purchases, redemptions, SIPs, Switches, NAV declaration, dividend declaration, unit premium reserve adjustments, investment accounting, etc. place enormous responsibility on the statutory auditors.

Added to this are the frequent interactions between fund accounting, custody, RTA, and operations require the statutory auditor to be not only proficient in accounting but mature to understand the multiple interactions between departments that help in developing scheme accounts. Care is also required since many regulatory changes necessitate manual workarounds by fund accounting, investments, operations and RTA that may impact controls exercised over the accuracy or completeness of financial information generated in scheme accounting activities.

Internal Auditor

4.10 The Internal auditor is an audit firm (or in-house audit team) appointed by the Trustee Company, to enable it to discharge its responsibilities effectively. The scope of the internal auditors broadly envisages periodic verification of control framework for the operations of the Mutual Fund, AMC and the service providers vis-à-vis the provisions of the MF Regulations/ Trust Deed and various guidelines issued by the SEBI from time to time. Internal auditors need to understand AMC operations as distinct from Mutual Fund operations.

Concurrent Auditor

4.11 It is an audit firm appointed by the Trustee Company, to enable it to discharge its responsibilities effectively. The scope of the concurrent auditors broadly covers day-to-day key operations capturing all deals executed, their confirmations and accounting, liaising with RTA for unit capital and other details, liaising with operations for saleable quantity reports from custody, etc. The ultimate goal is to help assure management that the NAV declared by the fund accountant has been independently reviewed. The role of the concurrent auditor often includes review of daily investment activities, such as, voice recording review, dealing room entry review, etc., to ensure that the investment team operations are within accepted norms of propriety.

Information System Auditor

4.12 Mutual fund industry in India has traversed a long way. Technology is the key driver of its growth. Technology impacts areas such as:

- Digital platforms used for promoting mutual fund units
- Client on-boarding process which includes online portals, e-KYC (Electronic Know Your Customer)
- Systems used for data processing and storing records
- Capturing investor queries, complaints, etc.
- Digitilisation of payments

Information Technology Audits in mutual fund industry can be of the following types:

1. Information Technology General Controls Audit: This covers audit of

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controls around Information Technology controls, such as, entity level controls, physical and logical security, change management, patch management, etc.

2. Information Systems Audit: This covers verification of Information Security Policy, controls surrounding data breach, leakage and its security, etc. An Information Systems Audit is an assessment of controls built around systems and processes involved in the Information Technology (IT) environment of the organisation. The objective of Information Systems Audit is to obtain reasonable assurance that information (both static and transmitted) and IT assets of the organisation are protected from all probable threats in order to achieve organisation's goals. The Information Systems Audit aims to evaluate the design effectiveness and operational efficiency of the information systems of the organisation.
3. Incident Management Review: This covers root cause analysis of the incident and recommendations covering solution of the gap noted.
4. Cyber Security Audit: SEBI Circular dated January 10, 2019 mandates the AMC to have a robust cyber security and cyber resilience framework in order to maintain integrity of data and guard against breaches of privacy.
5. Systems Audit: The requirement of Systems Audit for Mutual Funds was introduced vide SEBI Circular SEBI/IMD/CIR No. 9/176988/2009 dated September 16, 2009. To emphasize the criticality of Systems Audit in technology driven asset management industry and to enhance and standardise Systems Audit, SEBI launched revised guidelines superseding the earlier SEBI Circular dated September 16, 2009. Under the circular SEBI/HO/IMD/DF2/CIR/P/219/57 dated April 11, 2019, an independent CISA/CISM qualified or equivalent auditor is required to be appointed for audit of systems and processes inter-alia related to examination of integration of front office system with the back office system, fund accounting system for calculation of net asset values, financial accounting and reporting system for the AMC, unit-holder administration and servicing systems for customer service, funds flow process, system processes for meeting regulatory requirements, prudential investment limits and access rights to systems interface. Under the present circular, AMCs have been

Need and Objectives of Internal Audit of Mutual Fund

advised to conduct Systems Audit on an annual basis and submit the Systems Audit report to SEBI within six months from the end of the Financial Year. While Systems Audit is regulatory in nature, management mandates various other audits (as mentioned above) where the emphasis is on certain specific aspects of Information Technology.

Chapter 5

Key Risks

Key Risks in Mutual Fund Operations

5.1 The following types of key risks are involved in mutual fund operations:

- **Counterparty/ Credit Risk:** This is the risk associated with the issuer of a debenture/ bond or a money market instrument defaulting on coupon payments or in paying back the principal amount on maturity. Even when there is no default, the price of a security may change with expected changes in the credit rating of the issuer. Securities with a higher risk of default tend to pay higher returns.
- **Liquidity Risk:** Liquidity risk within mutual funds implies difficulties to sell an investment when desired or it has to be sold below its fair value. These are market events that cause excessive strain on the treasury of the fund house resulting in mismatch of cash flow. They lead to unexpected high value redemptions causing liquidity crunch. As a result of liquidity risk, a mutual fund or an AMC may not be able to meet its obligations to pay back its investors. In turn, this could mean that potential investors will lose the money invested in the mutual funds.
- **Interest Rate Risk:** Interest rate risk is the risk of change in the value of an asset as a result of volatility in interest rates. Interest rate changes depending on the credit available with lenders and the demand from borrowers. They are inversely related to each other. Increase in the interest rates during the investment period may result in a reduction of the price of securities.
- **Market Risk:** Market risk is a risk which may result in losses for any investor due to the poor performance of the market. Market risk is also known as systematic risk. As the share prices, valuations and/ or interest rates of securities in which the scheme invests fluctuate, the value of investments in the scheme may appreciate/ depreciate. A few examples are natural disaster, inflation, recession, political unrest, fluctuation of interest rates, etc.

Key Risks

- **Operational Risk:** The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
- **Outsourcing Risk:** Outsourcing risk is the impact of failure of a third party to adequately perform the activity on the financial, reputational and operational performance of the AMC and on the customers and their counterparts. Data protection to prevent misuse of investor information resulting in sharing investor information with competitors, disruption to operations and financial loss to AMC, security and other risks may be adversely affected by the geographical location of the third party.
- **Settlement Risk:** Settlement risk is the possibility that one or more parties may fail to deliver on the terms of a contract at the agreed-upon time. Settlement risk is a type of counterparty risk associated with default risk, as well as with timing differences between parties. Fixed income securities run the risk of settlement, which can adversely affect the ability of the fund house to swiftly execute trading strategies, which can lead to adverse movements in NAV.
- **Compliance Risk** - Compliance risk is exposure to legal penalties, financial forfeiture, loss of reputation and loss of investor confidence an organization faces when it fails to act or disclose facts in accordance with applicable mutual fund laws and regulations, internal policies or prescribed best practices. Few examples of Compliance Risk include:
 - A. **Insider Trading Risks:** 'Front Running' by dealer/ fund manager/ AMC employees based on the non-public information may result in reputational risk and financial loss to AMC. It may also include leakage of sensitive information to insiders or breach of investment restrictions/ norms.
 - B. **Reporting Risks** – Reporting risk is non-compliance in ensuring various regulatory and internal reporting obligations by mutual funds. It may include publishing of wrong NAV by mutual fund. It also includes risk of lack of or any incorrect/ incomplete reporting to the Audit Committee/ Board of Directors/ Trustees/ Senior Management and to the Regulators.
 - C. **Other Risks:** Computation of incorrect NAV, incorrect investment valuations, management override, employee frauds

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including collusion and conflicting functions, misfeasance by brokers, etc.

- **Financial Risk** - Financial risk arises when the financial statement of mutual fund may be materially misstated due to over/under accrual of revenues and expenditures. For example, errors due to incorrect calculations of commissions, dividends, profit and loss on sale of investments, etc.
- **Fraud Risk** - Fraud risk is exposure of an organisation to the wrongful or criminal deception, initiated either internally or externally, with an intention to result in a financial or personal gain. Fraud risk can be broadly classified into three categories viz. asset misappropriation, corruptions and fraudulent financial statements. Internal Audit should consider the potential impact and likelihood of errors or frauds as the key risk factors in performing the risk assessment. Specifically, audit will evaluate management's analysis of the reason for the event, whether it was a result of a control breakdown, and measures, if any, taken in response to the event. In some circumstances, Internal Audit may perform its own analysis of the event and outline recommended remediation procedures.

The modern digital environment has created a world of big data. Locked within this big data are correlations, patterns, trends, relationships, and associations that can provide insight into the nature of organizational, employee and third-party fraud and misconduct. To unlock these insights, organizations can deploy sophisticated forensic-based data analytics to help detect fraud and misconduct and understand the root causes of any irregularities.

- **Information Technology (IT) Risks** - IT risks is a business risk which relates to the use, ownership, operation, involvement, influence, and adoption of IT in an organisation. The internal auditor should assess the IT assets available, the probability of occurrence of IT risks and its consequences.

There could be different types of IT risks resulting from physical threats, such as, unauthorised physical access to IT assets, electronic threats, such as, a hacker could get access to organisation's website, technical failures, such as, bugs observed in software, computer crash

Key Risks

or a complete failure of a hardware, infrastructure failures, such as, disruption to networks or internet connections etc. Cyber and Information security risks are some of IT risks which harm internet-connected systems and information systems of the organisation.

- **Reputational Risk:** The risk of losing business because of negative public opinion and consequential damage to the reputation arising from failure to properly manage some of the above risks, or from involvement in improper or illegal activities by the MF/ AMC or its senior management,, such as, money laundering or attempts to cover up losses.

Chapter 6

Regulatory Framework Governing Internal Audit for Mutual Funds

Regulatory Framework governing Internal Audit of Mutual Funds

6.1 Like provision for appointment of statutory auditors and scope of statutory audit, there is no specific provision for appointment of internal auditors. Provision for internal audit and its scope emerge from various Regulations and circulars as follows:

- Trustees shall ensure before launch of any scheme that AMC has designed internal control mechanisms including internal audit systems. (Reg. 18(4))
- Trustees to obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees and consider the reports of the independent auditors at the meeting of trustees for appropriate action. (Reg. 18(25))
- The Review of Risk Management Systems shall be a part of internal audit and auditors shall check their adequacy on a continuing basis (SEBI circulars on Risk Management).

6.2 This chapter covers illustrative list of risks in mutual fund business. The internal auditor should keep themselves abreast with the changing business and regulatory environment to ensure that the risks associated with the scope of their audit have been adequately identified for review.

6.3 Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system. In addition to the classical aspects to be covered in an internal audit, the internal auditor of a mutual fund has to consider various circulars, regulatory requirements and directives issued by the SEBI.

Regulatory Framework Governing Internal Audit for Mutual Funds

6.4 The Board of Trustees appoint independent internal audit firm to conduct audit of mutual fund operations. The internal audit delivery model in India is largely a fully outsourced model except for a few exceptions where in-house/ co-sourcing model is also prevalent. The prime reason for a fully outsourced model is on account of the lean organization structure of the AMCs in India and more so to improve independence of the internal audit function. Usually, AMCs follow an outsourcing model for several business processes such as, Fund accounting, Custody and Registrar and Transfer operations. The Internal Audit reports to the Audit Committee of the AMC and to the Board of Trustees at regular intervals.

Implementation of Risk Management Guidelines

6.5 SEBI vide Circular No. MFD/CIR/15/19133/2002 dated September 30, 2002 has also advised the Mutual Funds to implement the Risk Management System, progress of which is to be reviewed by the Board of AMC and Trustees. Further, the review of Risk Management Systems shall be a part of internal audit and a report on which shall be placed before the Board of AMC and Trustees who shall make comments on the adequacy of systems in the quarterly and half-yearly compliance reports filed with SEBI.

Chapter on Compliance and Risk Management of this Guide may be referred for a detailed coverage of the above Risk Management Guidelines issued by SEBI.

SEBI Circulars on Internal Audit of Mutual Funds

- SEBI Circular No. MFD/CIR No. 010/024/2000 dated January 17, 2000 states that trustees should constitute audit committee to review internal audit systems and recommendations of internal audit.
- SEBI Circular No. MFD/CIR/09/014/2000 dated January 5, 2020 states that for effective discharge of responsibilities, AMC shall provide infrastructure and administrative support to the Trustees which can be in the form of appointment of independent internal auditors.
- Reconciliation of Government Securities need to be part of internal audit in terms of SEBI Circular No. MFD/CIR/19/22474/2002 dated November 20, 2002.
- SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2002 states that compliance with recording of investment decisions needs to be verified

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by trustees through independent auditors or internal and/or statutory auditors or other systems development by them.

- To supervise the activities of AMC, trustees appoint internal auditors and specify the scope of audit.

Chapter 7

Internal Audit – Scheme Related Documents

Background

7.1 Scheme Information Documents (SID), Scheme Additional Information (SAI) and Key Information Memorandum (KIM) are documents prepared by an AMC containing details about a particular scheme and submitted to the Securities and Exchange Board of India (SEBI) for approval for the launch of a scheme.

The SID and SAI are akin to a red herring prospectus often available for IPOs that contains information about the scheme which a prospective investor should know before investing.

Scheme Information Document (SID)

7.2 The SID contains information relating to the Scheme which among others includes:

- Highlights/ summary of the scheme
- Risk factors and Risk integration mechanism
- Requirement of minimum investors in the scheme
- Investment objective and policies of the scheme
- Asset allocation pattern
- Investment strategies
- Fundamental attributes
- Performance benchmarks to be used
- Details of the Fund Management team
- Investment restrictions
- Details in respect of the units and of the offer
- Part performance plan and options

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- Fees and liquidity provisions
- Annual recurring expenses
- Load applicability
- List of AMC Branches, Investor Service Centre.

Scheme Additional Information (SAI)

7.3 The SAI contains information about the mutual fund, its constitution, and certain tax, legal and general information, like:

- Constitution of the mutual fund.
- Information about the Sponsor, AMC and Trustee Company.
- Information about the service providers, like, Custodian, Transfer Agent, Statutory Auditor, Legal Counsel, Fund Accountant, Collecting Bankers.
- Valuation norms.
- Tax treatment for investors and the mutual fund.

The SID should be read in conjunction with the SAI and not in isolation.

Key Information Management (KIM)

7.4 KIM is a condensed version of SID and contains the essential components of the offer document. KIM is made available with every application form.

Internal Audit

7.5 Various steps in internal audit of KIM, SID and SAI are as follows:

1. Review whether the format of SID, SAI and KIM are as prescribed by SEBI.
2. Review of SID to confirm inclusion of the following key information:
 - Risk factors including general and scheme specific risk factors at a single place in the SID.
 - Note on the investment strategy followed for the scheme.
 - Types of securities/ instruments in which the scheme would invest and a brief narration on the same.

Internal Audit – Scheme Related Documents

- A due diligence certificate stating that the SID is in accordance with the SEBI (Mutual Funds) Regulations is included therein.
3. Confirm that contents of the SID including figures, data, yields, etc. are factually correct.
 4. Review of the Trustees certification provided under circular SEBI/IMD/CIR No. 5/70559/06 dated June 30, 2006.
 5. Review of the approval of the Trustees and Board of Directors of AMC for the launch of the Scheme. While approving the scheme, the trustees may also review the systems, adequacy of key personnel, compliance mechanism, etc. as required under Regulation 18(4) of SEBI (Mutual Fund) Regulations, 1996.
 6. Review of the letter from the Trustees submitted while filing a new SID, confirming that the trustees have ensured that the AMC complies with the requirements of Regulation 18(4) of SEBI (Mutual Fund) Regulations, 1996.
 7. Review of the addendum displayed on the SID in the form of a notice in all the investor service centres and distributors/brokers office. In addition, the public notice given in respect of such changes in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the Mutual Fund is situated will need to be reviewed.
 8. Review of the disclosure in SAI, of the fund's policy for dealing with unclaimed redemption amounts in line with SEBI Circular No. MFD/CIR/9/120/2000 dated November 24, 2000.
 9. Review of the following statement incorporated on the last page of the SAI "Notwithstanding anything contained in the Statement of Additional Information the provisions of the SEBI (Mutual Funds) Regulations, 1996 and the Guidelines thereunder shall be applicable"
 10. Hosting of the Draft SID, a public document, on the SEBI website for 21 working days. If there are no suggestions from SEBI within 21 working days, the SID can be considered to be final. The final SID is hosted on the AMFI website 2 days prior to the opening of the New Fund Offer (NFO).
 11. Updation of SIDs within 3 months of the end of financial year, if the scheme is launched in the first 6 months of financial year and within 3

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months of the end of next financial year if scheme is launched in the second 6 months of financial year. Review whether the subsequent updations of SID are done on a yearly basis.

12. Review updation of SAI at the end of 3 months from the end of financial year and of any material change on an ongoing basis and upload on the Mutual Fund's and AMFI's website.

Key Risks

Particulars	Risk Type
SID, SAI and KIM are not prepared and published in compliance with the SEBI regulations	Compliance/ Reputational
Risk of erroneous and misleading information updated in the SID, SAI and KIM	Compliance/ Reputational

Internal Audit Checklist

Sr. No.	Particulars	Remarks
1.1	Verify whether AMC has ensured compliance with Standard Observations prescribed by SEBI to ensure minimum level of disclosures in the SID and SAI. Also, verify whether while filing the SID and SAI, AMC has highlighted and clearly mentioned the page number of the SAI and SID on which each standard observation has been incorporated.	
1.2	Verify whether a letter from the Trustees is submitted while filing a new SID for the open-ended and close-ended schemes, confirming that the AMC complies with the requirements of Regulation 18(4) of SEBI (Mutual Fund) Regulations, 1996.	
1.3	Verify whether the SID, SAI and KIM are in the prescribed format and are available on the website of the Mutual Fund as per the SEBI circular dated September 29, 2009.	

Internal Audit – Scheme Related Documents

	Whether the Draft SID is hosted on SEBI website for 21 working days.	
1.4	Verify whether the 'product label' is disclosed in the front page of initial offering application forms, KIM and SID.	
1.5	<p>Verify whether disclosures contained in the SID is revised and updated on change in the fundamental attributes of the Scheme due to following:</p> <ul style="list-style-type: none"> ▪ Conversion of the Close Ended Scheme(s) to the Open-Ended Scheme(s) ▪ Consolidation or merger of Mutual Fund Schemes ▪ Launch of additional Plans <p>Verify whether copy of the draft SID is filed with the Board as required under Regulation 28(1) of the Mutual Funds Regulations along with filing fees prescribed under Regulation 28(2) of the Mutual Funds Regulations of SEBI (Mutual Fund) Regulations, 1996 in the above situations.</p>	
1.6	Verify whether the performance of schemes making overseas investments with appropriate benchmark(s) is disclosed in the SID for review of performance by Board of the AMC and Trustees.	
1.7	Verify whether appropriate disclosures with respect to compliance with prudential limits and disclosure on portfolio concentration risk is made in SID and KIM of the debt schemes.	
1.8	<p>Verify whether following additional disclosures in the SID/ SAI and KIM are made without indicating portfolio or yield, directly or indirectly:</p> <ul style="list-style-type: none"> ▪ Credit Evaluation Policy for investments in debt securities; ▪ List of sectors where Mutual Funds/ AMCs would not be investing; ▪ The type of instruments which the schemes 	

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	<p>propose to invest viz. CPs, CDs, Treasury bills, etc.;</p> <ul style="list-style-type: none"> ▪ The floors and ceilings within a range of 5% of the intended allocation (in %) against each sub asset class/ credit rating. 	
1.9	<p>Verify whether the AMC has filed its reply to the modifications/ observations suggested by SEBI on SID as required under Regulation 29(2), if any, within six months from the date of the SEBI Observations letter. In case of lapse of the six months period for filing the reply, review whether the AMC has refiled the SID along with filing fees.</p> <p>Verify whether the AMC intends to launch the scheme at a date later than six months from the issuance of SEBI Observations Letter, it shall refile the SID with SEBI under Regulation 28(1) along with filing fees.</p>	
1.10	<p>Verify whether the soft copy of the SID is uploaded on the AMFI website two working days prior to the launch of the Scheme.</p>	
1.11	<p>In case of any changes in fundamental attributes of the scheme, whether the SID/ KIM has been revised and updated immediately after completion of duration of the exit option.</p> <p>Verify whether SID is updated within 3 months of the end of financial year if scheme is launched in first 6 months of financial year and within 3 months of the end of next financial year if the scheme is launched in the second 6 months of financial year. Thereafter, SID and KIM are required to be updated on as yearly basis. SAI should be updated at the end of 3 months from the end of the financial year and any material changes should be updated on an ongoing basis and uploaded on Mutual Fund and AMFI website.</p>	

Internal Audit – Scheme Related Documents

1.12	Verify whether in case of any other change in the scheme, the AMC displays the addendum on its website and issues the same to all Distributors and Investor Service Centres.	
1.13	Verify whether a public notice is given in respect of such change in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the Mutual Fund is situated.	
1.14	Verify whether copy of all changes made to the scheme are filed with SEBI within 7 days of the change.	

Key SEBI Circulars

Circular	Date	Brief Description
SEBI/IMD/CIR No. 5/70559/06	June 30, 2006	Undertaking from Trustees for new scheme offer document
SEBI/IMD/CIR No. 5/126096/08	May 23, 2008	Simplification of Offer Document and Key Information Memorandum of Mutual Funds Scheme
SEBI/IMD/CIR No. 10/178129/09	September 29, 2009	Statement of additional information (SAI) & Scheme Information Document (SID) to be made available on SEBI website.
SEBI/IMD/MC No.3/10554/2012	May 11, 2012	Master Circular for Mutual Funds (For Standard Observations, please refer to - https://www.sebi.gov.in/sebi_data/commondocs/formats_p.pdf)
SEBI/HO/IMD/DF5/CIR/P/2018/109	July 10, 2018	Master Circular for Mutual Funds

Chapter 8

Internal Audit - Investment Management Operations

Background

8.1 Investment management is the core function in a Mutual Fund. The fortunes and reputation of the AMC/ Mutual Fund largely depends on the success of the investment management function.

The investment management function has several facets, the employment of professional fund managers, research (of individual assets and asset classes), dealing, settlement, reporting and compliance. The investment management team comprises Fund Managers and Dealers, properly segregated between Equity and Fixed Income Trading Desks. The Fund Managers perform discretionary investment management function, i.e., without involvement of the client/ investor, but within the boundaries of the scheme objectives.

The role of the Investment Committee is critical in investment management. The Committee exercises oversight and governance over the investment management function. It closely and frequently monitors the performance of all the investment schemes, performance of investment management team. Its role also includes evaluation and management of market, credit, liquidity, operations and regulatory risks emanating from Investment Management activity. It is also involved in devising plans of action in case of credit defaults, high price volatility and excessive portfolio stress due to redemption pressure.

The function is supported by the Middle Office which is a part of risk management or compliance function with significant use of technology. The Back Office settles the trades and provides overall support to the investment management process.

The investment management function of mutual funds is, therefore, considered a key focus area during regulatory reviews. The investment management function involves coming up with an investment strategy to meet the scheme objectives, to divide the investment portfolio

Internal Audit - Investment Management Operations

among different asset classes and manage (including sell/ rebalance the holdings in) the portfolio with the objective of enhancing its value while appropriately managing market, credit, liquidity, operations and regulatory risks emanating from Investment Management activity.

Internal Audit

8.2 Internal audit of investment management activities includes the following:

Governance

- Existence of a documented Investment Policy articulating its investment strategy and risk policy and its alignment with the investment objectives of the Mutual Fund Schemes and regulatory requirements.
- Existence of an effective investment committee providing oversight and monitoring over the Investment function, with participation from key members of the investment management team and other key members of the AMC Management.
- Definition of Investment Universe.
- Segregation of duties between Front Office, Middle Office and Back Office. (also refer to Section III of SEBI Risk Management Guidelines MFD/CIR/15/19133/2002 dated September 30, 2002 in this regard).
- Existence of and compliance with Error Trade Policy.
- Existence of and compliance with Dealing Room Policy.
- Existence of and compliance with Best Execution and Soft Dollar Policies.
- Existence of and compliance with Investment Valuation Policy.
- Existence of and compliance with Stewardship Code.
- Existence of compliance with the Proxy Voting policy.
- Existence of and compliance with the Policy on Governance of the Polling Process for valuation.

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Dealing and Investment Management

- Dealing room controls, including voice recording, restrictions on use of mobile phones, dealing room surveillance, access controls, etc.
- Seamless flow of deal requisitioning, ordering and confirmation process with proper segregation between fund managers and dealers, middle office, back office and research.
- Ensuring best execution of trades and regulatory compliance for inter-scheme deals.
- Compliance with regulation in relation to management of NFO funds.
- Monitoring of and compliance with regulatory and internal investment limits (joint responsibility of Investment Management and Middle Office/ Compliance teams).
- Monitoring of portfolio and sectoral concentration risks, prudential investment norms, credit events.
- Review of scheme/ fund performance with benchmarks stated in the scheme related documents, if any, or with comparative benchmarks.
- Tracking and communicating decision on proxy voting for certain major matters in the investee companies.
- Compliance of investments in money market instruments and short-term deposits with regulatory requirements.
- Adherence with overseas investment norms and limits and appropriate disclosures in offer documents.
- Executing primary market transactions as per the laid down procedures including, authorization and allocation between schemes.
- Inter-scheme transfers of securities: Compliance with internal policy, and requirements of the Seventh Schedule of the SEBI MF regulations. Documentation of rationale and approvals for inter-scheme deals.
- Investment limit monitoring for schemes/funds, position monitoring for derivative transactions as per SEBI MF regulations.
- Monitoring saleable quantity positions daily to prevent any short sale of securities.
- Adequacy of response by Investment Management in respect of

Internal Audit - Investment Management Operations

events that trigger Business Continuity Plan (BCP) /Disaster Recovery (DR).

Middle Office Operations

- Review the management and updation of the internal policies governing Middle Office function.
- Review of the mechanism for monitoring regulatory updates and overseeing operational changes to meet new regulations.
- Review of compliance with regulatory and internal investment limits.
- Monitoring and oversight exercised over security master, changes to the security master including ratings of securities, deal/ trade documentation and reporting, inter-scheme dealing, dealing room activity, exception report management, etc.
- Regulatory compliance over broker empanelment, restrictions on broker transactions, etc. [Reg. 18(4)(g), 25(7)(a) and 25(7)(b)].

Key Risks

Particulars	Risk Type
Volatility in investment performance due to changes in market conditions	Market/ Credit/ Liquidity
Quality of investment research, facilities, people, procedures	Market
Execution of deals at sub optimal prices	Operational/ Financial/ Reputational/ Compliance
Trades executed with unauthorised brokers	Compliance/ Operational/ Financial
Investments with associates at prices other than arms' length	Compliance/ Operational/ Financial
Inter-scheme deals not executed in the interest of scheme holders	Compliance
Style drift and portfolio/ sectoral concentration	Compliance/ Market/ Liquidity
Interest rate movements	Market

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Short Sale (sale orders made in excess of deliverable quantity)	Compliance Financial
Trade failures/ trade cancellations	Operational/ Financial/ Reputational
Trades not allocated in a rational and fair manner between competing schemes (block trades) where trade quantity < order quantity	Compliance/ Operational
Record retention is not per regulatory requirements and internal policies	Compliance
Incorrect/ unauthorised/ duplicate security master records created in the trading systems.	Operational/ Financial
Inability to continue business due to disruption	Compliance/ Liquidity/ Reputational
Inability to fund redemptions	Liquidity/ Reputational
Non-compliance with regulations incl. breaches in regulatory investment limits	Compliance/ Reputational

Internal Audit Checklist

Sr.No.	Particulars	Remarks
Dealing Room Activity and Investment/ Fund Management		
1.1	Verify whether the Dealing Room Policy is in place. It is approved by Board of AMC and Trustees and adhered to.	
1.2	Verify whether Dealing Room access is strictly restricted on the basis of a valid requirement.	
1.3	Verify the existence and adequacy of the Voice Recording Policy, review comprehensiveness of policy to ensure coverage of all telephone lines of Fund Managers and the dealing team, including all communication tools, such as, messaging systems between brokers and traders.	

Internal Audit - Investment Management Operations

1.4	Verify that voice recording review is completely independent of the investment function and is vested with a control functions, such as, risk or compliance to ensure the propriety of dealer trades. Verify that records of such reviews are maintained by the Risk/ Compliance function.	
1.5	Verify the existence of Trade/ Dealer Error Policy to ensure that root cause of erroneous trades is identified and discussed with and reported to senior investment management to prevent recurrence of such errors. Verify that losses due to error trades are borne by the AMC.	
1.6	Verify whether a Best Execution Policy is in place to ensure that trades are executed at most beneficial terms and the same is adhered to.	
1.7	Verify whether the investment management team has obtained access to research reports from brokerage houses during their negotiation with brokers during empanelment (Soft Dollar Arrangement). Verify that Soft Dollar Arrangement is disclosed on the website.	
1.8	Verify whether a broker policy is in place to address broker empanelment and de-empanelment procedures, restrictions or limits on allocation of business to brokers, periodic monitoring of broker performance, etc.	
1.9	Verify whether systems are configured to support restrictions on order price or order quantity within Fund Manager's defined price/ quantity range.	
1.10	Verify whether dealers and fund managers maintain price sensitive and confidential information under lock and key to prevent unauthorised access to such information.	
1.11	Verify that dealing rooms for other lines of business (such PMS, AIF and Pension Fund Management) are	

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	clearly segregated with no sharing of human resources or infrastructure.	
1.12	Verify whether a detailed research report analysing various factors for taking each investment decision for the first time has been maintained and the reasons for subsequent purchase and sales in the same scrip has also been recorded as per the guidelines laid down (SEBI MFD/CIR/6/73 /2000 dated July 27, 2000).	
1.13	Review whether there is a difference of more than 10% between the annual returns provided by the schemes managed by the same fund manager, and if yes, whether it has been reported to the trustee and explanation for the same has been disclosed on the website of the AMC.	
1.14	<p>Verify the following investment management activities:</p> <ul style="list-style-type: none"> ▪ Regulatory and internal investment limits are complied with and supported by robust limit breach reports. ▪ Compliance with asset allocation pattern and scheme objectives. ▪ Compliance with regulation w.r.t. inter-scheme transactions, cross trading, etc. ▪ Compliance with NFO requirements to ensure that investments are made only after NFO closure. ▪ Compliance with guidelines and norms applicable for foreign investments ▪ Compliance with regulatory requirements for derivative transactions, such as, gross exposure limits, backing of long positions with cash/ underlying stock, etc. ▪ Compliance with norms related to short sale positions and for securities lending, if any. ▪ Whether insurance cover is obtained for Key Management personnel. 	

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1.15	Verify that admin rights in systems are vested with the appropriate authority.	
1.16	Verify that all orders and trades are executed through the system, especially in respect of equity trades. Verify that orders/ trades are correctly executed for corporate actions, such as, rights shares, buy backs, exercise of call/ put options, etc., after proper authorisation.	
1.17	Verify that systems are in place to prevent investment limit breaches preferably in an online, real-time environment, at start of day, and during the passage of deal instructions from Fund Manager to Dealer and from Dealer to Broker/ Counterparty (preferably, pre-deal execution limit check). Such controls are considered necessary especially for equity investments.	
1.18	Verify whether Investment team continuously reviews the performance and management of schemes.	
1.19	Verify whether monitoring of emerging credit risks and reporting of adverse credit events is done in a continuous and timely manner, and that mitigating strategies are devised and timely deployed. Such actions should be done in consultation with Investment Committee.	
1.20	Verify if investment performance reports are shared with AMC Management and Trustees periodically. In case of change in investment strategy verify, if reports are provided to AMC Management and Trustees.	
1.21	Verify that investments in Money Market Instruments and Short-Term Deposits comply with the regulatory guidelines and that such money market investments are properly apportioned among schemes, i.e.: <ul style="list-style-type: none"> ▪ Whether idle funds deployed in overnight/ short term investments are apportioned pro-rata among the schemes having surplus idle funds. 	

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	<ul style="list-style-type: none"> ▪ Whether funding for redemption proceeds are tracked/ planned to avoid possible risk of fund overdraft. ▪ Whether regulatory guidelines and restrictions on cross investments with. <p>Banks in schemes and FDs placed with them is monitored.</p>	
1.22	Verify the mechanism of tracking of investee company Annual General Meeting (AGM)/ Extraordinary General Meeting (EGM)/ Court Convened Meeting (CCM), and process of attending and voting at such meetings.	
1.23	Verify whether the AMC has disclosed its general policies and procedures for exercise of voting rights in respect of the shares held by it.	
1.24	Verify whether the AMC has recorded the specific rationale supporting its voting decision (for, against or abstain) with respect to each vote proposal on the matters specified in the SEBI Circular.	
1.25	Verify whether the details of the votes cast have been disclosed by the AMC on its website, on a quarterly basis, in the prescribed format within the required time limits.	
1.26	Verify whether, on an annual basis, the AMC has obtained Auditor's certification on the voting reports being disclosed by them and whether such Auditor's certification has been submitted to the trustees.	
1.27	Verify whether summary of the votes cast across all the AMC's investee companies and its break-up in terms of total number of votes cast in favour, against or abstained from has been disclosed in the Annual Report along with the Auditor's certification for the same.	
1.28	Verify the daily reports generated and submitted to Investment Management.	

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	Verify if error trades are identified and reported timely and accurately.	
1.29	Verify all reports submitted to Management on a periodic basis and reports submitted to Trustee/ Board on a quarterly basis.	
Investment Management Governance		
2.1	Verify the existence of an Investment Committee comprising of key relevant committee members and permanent invitees.	
2.2	Verify whether an Investment Committee approved Investment Policy is in place, which is aligned, inter-alia, with Chapter 12 (Investments by Schemes), and Seventh Schedule (Restriction on Investments) of the SEBI Mutual Fund Regulations, 1996. Chapter 12 covers investment norms required to be followed, such as, Investments by Index Funds, Liquid Schemes, Close Ended Debt Schemes, Prudential limits and disclosures on portfolio concentration risk in debt oriented mutual fund schemes, etc.	
2.3	Verify whether guidelines have been laid down for recording the basis of taking individual scrip-wise decision in equity and debt securities. Verify if the AMCs and the Trustees have decided the contents of Research Reports to be maintained (SEBI MFD/CIR/6/73/2000 dated July 27, 2000). Review if standard format/ baseline template has been defined for the research report.	
2.4	Verify whether all research reports are maintained in a system/ dedicated folders with access restricted to only authorised officials.	
2.5	Verify whether credit risk policies and systems are in place to conduct an in- house credit risk assessment/ due diligence of debt and money market instruments/ products at all points of time including generation of early warning signals (including yield based alerts,	

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	change in ratings of securities) on deterioration of credit profile of the issuer, pledging/un-pledging, credit risk management and to take appropriate measures and report to the Trustees.	
2.6	Verify whether there is a detailed written policy on creation of segregated portfolio duly approved by the Trustees (only if the SID of the Scheme has provisions of the same with adequate disclosures).	
2.7	Whether there are guidelines for the mutual fund to participate in Stock Lending Scheme and whether these comply with the guidelines issued by SEBI in this regard (SEBI Circular No - SEBI/IMD/CIR No. 14/187175/2009 dated December 15, 2009).	
2.8	Verify the mechanism by which Investment Management monitors and manages portfolio concentration risk, sectoral concentration risk, prudential investment limits including major credit events and defaults, etc.	
2.9	Verify the minutes of the Investment Committee to ensure that all key decisions, performance reports, incidents, credit risk events, etc. are discussed, recorded and decisions properly executed by the Investment Management team.	
2.10	Verify if there is a written policy duly approved by the Trustees and Board of the AMC on governance of the polling process.	
2.11	In case, the Mutual Fund is identified for polling verifying the following: <ul style="list-style-type: none"> ▪ Adherence with the policy on governance of polling process. ▪ Detailed reasons for not participating in the polling process is documented. ▪ Necessary audit trail is maintained for all polls submitted. ▪ Waterfall approach is disclosed on the website as a part of the Valuation Policy. 	

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2.12	Verify the timeliness and accuracy of all reports submitted to the Investment Committee and those submitted by the Investment Committee to the Boards of the AMC/ Trustee Company.	
2.13	Verify preparedness of Fund Management and Dealing teams to support business continuity.	
2.14	Verify their participation in mock BCP/DR drills.	
2.15	Verify if special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
2.16	Verify transactions to determine that business disruption is minimised.	
2.17	Verify documentation on back-up plan in case Fund Manager is not available or unable to perform his duties due to exigencies.	
Segregation of Duties – Front Office/ Middle Office/ Back Office		
3.1	Verify whether there is segregation of duties between the Front Office/ Middle Office/ Back Office in Mutual Fund.	
3.2	Verify the defined roles and responsibilities of Front Office/ Middle Office/ Back Office to ensure that there is no conflict of interest in the roles of Front Office/ Back Office/ Middle Office. Also, verify the authorisation matrix for the same.	
3.3	Verify whether the role of the Research team is independent from the Investment Management team.	
3.4	Verify that the documented roles and privileges are aligned with roles granted in systems used by the Front Office/ Middle Office/ Back Office and the same is periodically reviewed.	
3.5	Verify that the Middle Office is vested with assertive independent charge to discharge its responsibilities properly.	
3.6	Verify whether the organisational mandatory leave policy is applicable to Front Office/ Back Office/ Middle Office and is adhered to.	

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3.7	Verify that systems are in place to enforce segregation between Fund Managers and Dealers and also between Equity and Debt Investment desks. The Research team's role vis-a-vis Fund Management and Dealing should be demarcated, as required.	
Role of Middle Office		
4.1	Verify the existence, accuracy and currency of existing internal policies and procedures for governance of the Middle Office function including investment limit monitoring.	
4.2	Verify that Middle Office monitors the changes in regulatory investment limits and ensures that limits to be monitored comply with regulatory limits as provided in Seventh Schedule of the SEBI Mutual Fund Regulations, 1996, read with Chapter 12 of the SEBI Mutual Fund Master Circular.	
4.3	Verify whether limits are properly input for new schemes and monitored through the system. Verify that modifications to limits are in compliance with changes in regulation, appropriately approved and modified using system-based maker-checker controls.	
4.4	Verify that access rights to limit monitoring systems are restricted to personnel with valid business requirement.	
4.5	Verify whether the process and controls by which mid-office (Compliance) exercises oversight over the following activities: <ul style="list-style-type: none"> ▪ Intimation of soft limits breach alerts. ▪ Changes in the security master including ratings of fixed income securities and updating them in security master. ▪ Other changes to masters, such as, scheme name, securities, issuer, broker masters under a maker-checker mechanism. ▪ Monitoring of inter-scheme deals in compliance with regulation and internal guidelines. ▪ Exception report generation for limit breaches. 	

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**Key SEBI Circulars
(Issued after Master Circular dated July 10, 2018)**

Circular	Date	Brief Description
SEBI/HO/IMD/DF4/CIR/P/2019/102	September 24, 2019	Valuation of Money Market and Debt Instruments
SEBI/HO/IMD/DF2/CIR/P/2019/127 SEBI/HO/IMD/DF2/CIR/P/2018/160	November 07, 2019 December 28, 2018	Creation of segregated portfolio in mutual fund schemes in case of default of interest/principal of unrated debt/money market instruments
SEBI/HO/IMD/DF2/CIR/P/2019/104	October 01, 2019 December 10, 2019	Review of investment norms for mutual funds for investment in Debt and Money Market Instruments
SBI/HO/IMD2/DoF4/OW/P/19s399 / 2019	July 30, 2019	SEBI's adverse views from inspection on various AMC/Mutual Fund (Circular addressed to AMFI)

Chapter 9

Internal Audit – Fund Accounting and Back Office Operations

Background

9.1 The Front Office, Middle Office and Back Office are often used to describe the functions in investment banks, mutual funds and financial institutions.

The Front Office is, literally, the Mutual Fund's interface with the market. A Front Office function in a mutual fund can be considered to include activities of setting up trade policies, initiating deal agreements, setting up deal sheets/ term sheets. It can be considered to include Sales and Marketing teams, Trading Desks, Market Research Analysts, Portfolio (Fund) Managers, etc. They are the revenue generators. Generally, the middle and back office involves non-revenue generating operations.

The Middle Office function involves functions that directly support the Front Office. Functions, such as, Product Control, Risk Management, Regulatory Reporting, Compliance, etc. are, usually, considered to be Middle Office. The Front Office depends on the support of the Middle and Back Offices to function effectively.

The Operations function is considered as the Back-Office function. Traditionally, the Back Office operations have encompassed the areas within fund administration. IT functions/ systems, operational risk control, settlements, collection/ transfer of securities, registrations with clearing houses, custodial services, fund accounting, etc. are included in the Back Office. A Mutual Fund's Fund Accounting and Back Office Department houses the administrative and support functions necessary to run the Mutual Fund.

Mutual fund accounting and Back Office encompasses a variety of basic tasks, which may be performed by in-house staff or outsourced to service providers,, such as, custodian and specialised agencies. The activities include updating accounting books, performing custody, cash and bank reconciliations, processing investment transactions, allocating fund income

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and expenses, passing journal entries, MIS preparation, calculating NAVs and returns preparing financial statements and portfolio statements and coordinating for the audit of the mutual fund activities (internal, concurrent, statutory and regulatory).

Internal Audit

9.2 Internal audit of Fund Accounting and Back Office activities includes the following:

- Maintenance of proper books and records for each Scheme (Regulation 50) and preserving the same for eight (8) years.
- Appropriate functional classification of activities between Front Office, Middle Office and Back Office.
- Opening, control and accounting related to fund bank accounts (sometimes also considered as a Treasury function) (Refer Chapter on Banking Operations and Reconciliation).
- Process of opening and updating security masters in the investment management software and fund accounting application.
- Recording of all primary market securities transactions.
- Recording of secondary market securities transactions, such as, buy and sell of portfolio investments based on the STP processing, in case of equities, and other documents, like, Deal Slips, Information Memorandum, counter party confirmations, custodian confirmations, etc.
- Recording of Inter Scheme trades at the correct rates and in compliance with regulatory requirements.
- Recording/ accruing all corporate actions/ incomes, such as, dividends and interest (on bonds and other similar fixed income securities) and ensuring collection of all dividends and interest.
- Proper amortisation of discount or premium on bonds.
- Recording all realized gains that result from securities transactions in the fund.
- Settlement of daily purchases and sales of securities, mark to market and daily pay-ins/ pay outs in case of derivatives, ensuring collection of dividends and interests (Refer Chapter on Custodian Operations).

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- Recording all inflows and outflows of funds due to purchases, redemptions, switches, movements under systematic transfer plans of units by investors.
- Maintaining records of units owned and transactions made by unit holders in the Scheme/ Fund on an overall basis.
- Accrual of permissible expenses – these would include management fees, trustee fees, other recurring expenses.
- Payment of fees, recurring expenses and other permitted fund related expenses and charging it correctly to individual schemes.
- Calculating distributable surplus and funding of dividends and tax in relation to the same, if any.
- Accounting for Equalisation (Ninth Schedule Part A – (i), Eleventh Schedule– 2.a.x(a)).
- Calculation and payment of regulatory payouts – Securities Transaction Tax/ Taxes Deducted Source/ Goods and Service Tax including filing the requisite returns as required.
- Write back of exit loads to the Scheme on a daily basis.
- Pricing/ Valuation of the portfolio investments of the fund.
- Reconciliations of the subscription, redemption, switch, dividend, broker, custodian, bank and investment manager statements (Also refer to Chapter 7E on Banking Operations & Reconciliation).
- Whether borrowings by the Schemes are within the SEBI Regulations.
- Identification and classification of securities as below investment grade or default.
- Calculation of Net asset Value (NAV).
- Verification of timely upload of NAVs.
- Preparation and filing of local/ regulatory body filings/ reports (Also refer to Chapter 7H on Compliance & Risk Management).
- Calculation of the total returns and other performance measures of the fund.
- Financial statement preparation and audit (internal/ statutory/ Regulatory) liaising.

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- Financial reporting to Regulators and to unit holders.
- Scheme-wise annual report to be hosted on the Mutual Fund/ AMC and the AMFI website.
- Disclosure of half-yearly unaudited financial results within one month of the close of each half-year.
- Portfolio Disclosure within 10 days of the end of the month/ half-year.
- Supervision of the orderly liquidation and dissolution of the Schemes/ fund (if required and in case of close ended funds).

Note: In most mutual funds' accounting departments, these activities are automated. However, some manual input, reviews, and adjustments are still necessary.

Key Risks

Particulars	Risk Type
Absence of maker-checker process/ authorisations	Financial/ Operational
Deal Accounting Errors	Financial/ Operational/ Compliance Reputational/
Settlement errors	Financial/ Operational/ Compliance Reputational
Portfolio/ Investment Valuation Errors	Financial/ Operational/ Compliance Reputational
NAV Errors	Financial/ Operational/ Compliance Reputational
Incorrect financial reporting	Operational/ Compliance/ Reputational
Incorrect Portfolio Reporting	Operational/ Compliance/ Reputational
Investor losses/ claims arising from errors and omissions	Financial/ Operational Compliance Reputational
Claims against the employees/ directors arising from errors and omissions	Financial/ Compliance/ Reputational

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Non-compliance with Regulatory requirements relating to NAV upload, borrowings, equalisations, etc.	Financial/ Operational Compliance Reputational
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Internal Audit Checklist

Sr. No.	Particulars	Remarks
Manuals, Policies and Procedures		
1.1	<p>Check and review whether Manuals and/ or Policy and Procedures document/ Agreements/ SLAs is available for various matters:</p> <ul style="list-style-type: none"> • Trust Deed • Agreement with RTA • Agreement with Custodian • Agreements with Banks, if any • Accounting manual • System (Accounting Software) Operations manual • System (Investment Management Software) manual • Operations Manual • Cyber Security and Cyber Resilience Policy • Distributor Empanelment Policy • Dividend/ Processing Policy • Compliance Manual • Code of Conduct • Investor Servicing Manual • Investment Policy (including Risk Management Policy) • Policy in respect of segregated portfolio • Brokerage Processing Policy • Valuation Policy • NAV Error (Tolerance) Policy • Outsourcing Policies and Guidelines. 	

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	<ul style="list-style-type: none"> SLAs between Fund Accounting/ Back Office and other functions in the AMC for inter-function deliverables <p>Note: The above listing is illustrative and few documents are recommendatory in nature.</p>	
Approvals and Delegation of Authority		
2.1	Verify the delegation of authority are as prescribed by various manuals of the Board of the AMC/ Trustees and its implementation.	
2.2	Verify whether the limit wise authorisation matrix has been defined in the System and is supported by proper approvals.	
2.3	Verify whether the transactions are approved by the appropriate authority and that they are within the various limits of authorization.	
2.4	Verify amendments, if any, to the delegations and whether the same is approved by the Board of the AMC.	
Overall Review: Accounting System/ Process		
3.1	Verify the extent of automation in accounting system/ application used for fund accounting and back office.	
3.2	Verify the extent of manual interventions/ manual entries involved in accounting, review the existence of maker-checker for the manual entries and assess the risks associated with the same.	
3.3	Sample review the systemic and manual entries generated/ passed, based on the types of entries and based on the assessment of risks attached to such entries.	
3.4	In case the accounting function is outsourced, assess the flow of data/ documents between the in-house Operations Team and the outsourced function, the security surrounding such information flows, risks attached to the same and correctness of accounting of such information/ data, in addition	

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	to reviewing the matters mentioned in Point 2 and Point 3.1 to 3.3.	
3.5	Verify the correctness of the reporting/ data deliverables (received and delivered) under the SLAs entered into by Fund Accounting for various activities/ functions.	
3.6	Check whether the function has gone through any other reviews/ audits like ISAE 3402, SAS 70 or equivalent, concurrent audit, SEBI inspection, review on compliance with guidelines relating to outsourced service provider, etc. and if yes, review the relevant reports and its impact on the internal audit in terms of a risk based approach to audit.	
Cash Management		
4.1	Verify whether a robust cash management/ Cash Flow System is in place.	
4.2	Verify whether all inflows from under-mentioned are properly considered: <ul style="list-style-type: none"> • Inflows from sales of investments • Inflows from subscriptions of units • Inflows from corporate actions, if any • Inflows for switch-ins of units 	
4.3	Verify whether all outflows from the under-mentioned have been properly considered: <ul style="list-style-type: none"> • Outflows for purchases of investments • Outflows for redemptions of units • Outflows for dividend payouts, if any • Outflows for switch-outs of units • Outflows for expense payouts • Outflows of statutory/ regulatory payouts 	
4.4	Verify whether all the bank statements are regularly matched/ considered properly for Cash Flow purposes	

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4.5	Verify that bank reconciliation statements have been signed off on a daily/ periodical basis.	
4.6	Verify whether entries from the cash flow have been correctly passed in the accounting system (Refer Point 16 below on Reconciliations and Para on Banking Operations and Reconciliation).	
Investment		
5.1	Verify whether there is a record of all deals that have been done. Verify that each deal has a deal slip/ system record with appropriate details viz., security name, quantity, amount, broker name, etc. (Ideally, system should have all requisite fields as mandatory fields without which deal slip should not be generated).	
5.2	Verify whether all deal slips are serially numbered and are available.	
5.3	Verify whether new security masters are created or existing security masters have been modified based on the Information Memorandums, term sheets, deal slips/ other appropriate documentation.	
5.4	Verify whether there is a four-eye principle of maker-checker for security master creation and updation/ modification.	
5.5	Verify whether there is a process of system logs being created for modification of deals/ security masters with proper approval process and that these logs are reviewed periodically.	
5.6	Verify that all deals are accounted on trade date.	
5.7	Verify whether SEBI Circular SEBI/HO/ IMD/ DF2/CIR/P/2019/104 dated 01-Oct-2019 for investment in listed/ to be listed/ unlisted/ unrated debt and money market instruments have been followed.	
5.8	Verify whether intimation for the trades sent to custodian is with proper documentation (such as, amount, quantity, value, description, etc.).	

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5.9	Verify whether the trades are supported by proper supporting like deal ticket, term sheet, offer document/ information memorandum, issuer confirmation, third party confirmation, NDS-OM confirmation, broker notes or STP dump, allotment letters, CCIL confirmation, deposit receipts/ bank confirmations for short term deposits, as the case may be.	
5.10	Verify whether brokerage and transaction costs paid for purpose of execution of trade is included in the cost of investment.	
5.11	Check whether brokerage and transaction costs paid for investments are included in the cost of investment does not exceed 0.12 percent in case of cash market transactions and 0.05 percent in case of derivatives transactions (Regulation 52 (6A)(a)). Review whether brokerage and transaction costs exceeding the limits mentioned above have been considered as part of the permissible recurring expenses.	
5.12	Verify whether mark to market margins, pay-ins and pay-outs in case of derivative transactions and other fund obligations have been correctly recorded based on the information received from the Custodian Operations team.	
5.13	Verify, if there are any error trades, whether deals are authorized and matched with the underlying document, such as, counterparty confirmation.	
5.14	Verify whether the system is correctly calculating and accounting the profit/ loss on sale trades after the deal entry.	
5.15	Verify whether the profit/ loss on inter-scheme trades is being accounted separately for appropriate disclosure in the financials.	

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5.16	Verify that there is adequate segregation of duties between people booking, confirming and accounting the trades (system should not allow a single person to complete a transaction).	
5.17	Verify whether all dividend, interest and other corporate actions have been accounted on accrual basis and on their respective ex-dates, as applicable, based on the information received from the Custodian Operations team.	
5.18	Verify whether the trades data has been correctly and on a timely basis uploaded into F-TRAC/CBRICS in case of debt and money market instruments per the regulatory requirements.	
5.19	Verify details of debt and money market securities transacted (including inter-scheme transfers) transacted, settlement date wise, have been disclosed on the AMC website/ forwarded to AMFI within 30 days as per SEBI Circular Cir/IMD/DF/6/2012 of February 28, 2012. (Also refer Chapter on Investment Management and Chapter on Custodian Operations for related areas).	
Distributable Surplus/ Dividends		
6.1	Verify the calculation of Distributable Surplus is in line with the SEBI guidelines.	
6.2	Verify that Unit Premium Reserve not attributable to realised gains is not used to pay dividend (SEBI Circular SEBI/IMD/CIR No 18/ 198647/ 2010 of March 15, 2010) and hence is excluded from the calculation for available distributable surplus.	
6.3	Verify the existence of maker-checker process for calculation and confirmation of distributable surplus.	
6.4	Verify whether the procedure for Dividend Distribution as mandated by SEBI in its circular SEBI/IMD/CIR No.1/64057/06 dated April 4, 2006 has been complied with.	

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6.5	Review whether dividend liability, tax liability on dividends and dividend reinvestment entries have been correctly passed in the respective schemes based on the feed received from RTA.	
6.6	Review whether the dividend funding entries have been correctly passed based on the information provided by BOT/ Treasury team.	
6.7	Review the treatment of dividends and related taxes on account of back-dated/ as of processing of units by the RTA.	
Expense Accrual (including Total Expense Ratio)		
7.1	Verify whether expenses have been correctly accrued in the various schemes and are within the maximum permissible limit as per MF Regulations.	
7.2	<p>Verify whether the total expense ratio of the scheme including the weighted average of the total expense ratio levied by the underlying scheme(s) is within the under-mentioned limits:</p> <ul style="list-style-type: none"> • In case of FOF Scheme investing in liquid schemes, index fund scheme and exchange traded funds, within 1% of the daily net assets of the Scheme. • In case of FOF Scheme investing a minimum of 65% of assets under management in equity oriented schemes as per SID, within 2.25% of the daily net assets of the Scheme. • In case of FOF Scheme investing in schemes other than as above, within 2% of the daily net assets of the Scheme. <p>Provided that the total expense ratio to be charged over and above the weighted average of the total expense ratio of the underlying scheme shall not exceed two times the weighted average of the total expense ratio levied by the underlying scheme(s), subject to the overall ceilings as stated above.</p>	

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7.3	Verify whether the total expense ratio of an index fund scheme or an exchange traded fund does not exceed 1% of the daily net assets.	
7.4	In case of other open-ended schemes, other than those specified above, the total expense ratio shall not exceed the percentages as per the AUM slabs specified.	
7.5	In case of close-ended and interval schemes, <ul style="list-style-type: none"> • The total expense ratio of equity-oriented scheme(s), shall not exceed the 1.25% of the daily net assets of the scheme • In case of other schemes, the total expense ratio shall not exceed 1% of the daily net assets of the scheme. (Securities and Exchange Board of India (Mutual Funds) (Fourth Amendment) Regulations, 2018 dated December 3, 2018).	
7.6	Verify whether all fees and expenses charged in a direct plan (in percentage terms) under various heads including the investment and advisory fee do not exceed the fees and expenses charged under such heads in a regular plan.	
7.7	Verify whether change in base TER in comparison to the previous base TER is intimated to investors via email/ sms atleast three working days prior to such change along with a notice on the AMC website (not applicable to decrease in base TER due to various regulatory requirements) (SEBI/HO/IMD/DF2/CIR/P/2018/18 dated February 5, 2018).	
7.8	Review whether change in TER is placed before the Trustees on a quarterly basis with rationale for the change.	
7.9	Review whether change in TER reported to the AMC Board with rationale for the change recorded in writing.	

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7.10	Review whether GST on investment and advisory fees is in addition to the maximum limit of TER as prescribed in Regulation 52. (SEBI Circular CIR/IMD/DF/21/2012 dated September 13, 2012).	
7.11	Review whether GST on other than investment and advisory fees is within the maximum limit of TER as prescribed in Regulation 52. (SEBI Circular CIR/IMD/DF/21/2012 dated September 13, 2012).	
7.12	Check whether the additional expenses incurred under different heads mentioned in Regulation 52(2) and Regulation 52(4) does not exceed 0.05% of the daily net assets of the Scheme. (Regulation 52 (6A)(c) (not eligible for schemes where exit load is not levied/ not applicable) (SEBI MF (Second Amendment) Regulations, 2018 dated May 31, 2018).	
7.13	Review whether the additional expenses towards inflows from beyond top 30 cities (as specified by AMFI) only from retail investors does not exceed 0.30% of the daily net assets of the scheme subject to the conditions laid down (SEBI/HO/IMD/DF2/CIR/P/2018/16 – February 5, 2018, SEBI/HO/IMD/DF2/CIR /P/ 2018/137 – October 22, 2018).	
7.14	Verify that the additional expenses towards inflows from top 30 cities so charged is clawed back in case the same is redeemed within 1 year.	
7.15	Verify whether the TER of the separate plan of Liquid Scheme/ Money Market Mutual Scheme floated by mutual funds specifically for deployment of unclaimed amounts is capped at 50bps (SEBI/HO/IMD/DF2/CIR/P/ 2016/37 of February 25, 2016).	
7.16	Verify whether AMC has disclosed on a daily basis, the TER (scheme-wise, date-wise) of all	

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	schemes under a separate head – Total Expense ratio of Mutual Fund Schemes) on its website and on the AMFI website in the specified downloadable excel format.	
Expense Pay Out Processing/ Accounting		
8.1	Verify the process adopted and controls existing for registering/ empanelling vendors for various services.	
8.2	<p>Verify the processes adopted for :</p> <ul style="list-style-type: none"> • inwarding of invoices • ensuring booking of only those expenses which are permissible under the SEBI Regulations • ensuring that duplicate invoices/ expenses are not approved/ paid • approval of expenses per the authorisation matrix • allocation of common expenses to multiple schemes is fair and correct and as per the policy laid down for the same • control over cheque leaves/ cancelled cheques, issue of cheques after sign off by the authorised signatories in case of issue of physical cheques • control over the online process of payments as per the policy for online approvals • correct accounting of the expenses as per the policies laid down 	
8.3	Review whether all scheme related expenses including commission paid to distributors is paid from the scheme only within the regulatory limits and not out of the books of the AMC, its associate, sponsor, trustee or any other entity through any route. (SEBI/ HO/IMD/DF2/CIR/P/2018/137 dated October 22, 2018 and AMFI letter to SEBI – AMFI/17/SEBI/50/2018-19 of October 31, 2018 and SEBI clarifications per its letter	

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	SEBI/HO/IMD/DF2/OW/P/2019/4263/1 dated February 21, 2019).	
Borrowings		
9.1	Whether Schemes have borrowed money.	
9.2	Whether borrowings have been made only to meet temporary liquidity needs for repurchase, redemption of units, payment of interest or dividend to the unit holders.	
9.3	Whether the borrowings are within the prescribed limits.	
9.4	Whether the borrowing is for a period exceeding 6 months.	
9.5	Whether the cost of borrowings (interest) is borne by the Scheme to the extent not exceeding the portfolio yield of the scheme and borrowing cost exceeding portfolio yield is borne by the AMC. (SEBI/HO/IMD/DF2/CIR/P/2019/ 42 dated March 25, 2019).	
Advance/ Loans		
10.1	Verify that the mutual fund has not advanced any loans for any purpose (Regulation 44(1)).	
Exit Load		
11.1	Verify that exit load, net of GST is credited to the Scheme (Regulation 51A)(SEBI Circular CIR/IMD/DF/21/2012 dated September 13, 2012).	
11.2	Check that no exit load has been charged in the separate plan of Liquid Scheme/ Money Market Mutual Scheme floated by mutual funds specifically for deployment of unclaimed amounts (SEBI/HO/IMD/DF2/CIR/P/2016/37 of February 25, 2016).	
11.3	Review whether exit load, in case of liquid funds, has been charged in a graded manner in case of investors exiting the liquid fund within 7 days as	

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	mandated per SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2019/101 September 20, 2019 and AMFI letter dated October 11, 2019 and SEBI letter dated October 15, 2019.	
11.4	Verify that the AMCs have not charged any load on bonus units and units allotted on reinvestment of dividend (SEBI Circular No. SEBI/IMD/CIR No. 14/120784/08 dated March 18, 2008).	
Investor Education Fund		
12.1	Verify that the mutual funds/ AMCs daily set aside at least 2 basis points of the daily net assets within the maximum limit of TER for investor education and awareness initiatives.	
12.2	Verify whether 1 basis point of the daily net assets has been paid by the mutual fund to the AMFI.	
12.3	Review whether expenses towards investor education and awareness initiatives in excess of the amount set apart through 2 bps has been borne by the AMC (SEBI clarification dated February 21, 2019).	
Unclaimed Redemption and Dividend Amounts		
13.1	Review whether unclaimed redemption and dividend amounts have been deployed in call money market or money market instruments or invested in a separate plan of Liquid Scheme/ Money Market Mutual Scheme floated by mutual funds specifically for deployment of unclaimed amounts (SEBI/9/120/2000 dated November 24, 2000 and SEBI/HO/IMD/DF2/CIR/P/2016/37 of February 25, 2016).	
13.2	Review whether the income on amounts unclaimed for more than 3 years is used for investor education purposes.	
13.3	Review if the AMC has disclosed on its website, the list of names and addresses of investors who has unclaimed redemption/ dividend amounts.	

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Investment Valuation		
14.1	Verify whether valuation of debt and money market instruments, mutual fund investments, equity investments, derivatives investments and gold and real estate and infrastructure investments are valued as per MF Regulations and Valuation Policy (Seventh Schedule – not applicable to Gold Exchange Traded Fund Scheme) and SEBI Circulars issued from time to time (latest SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019 on debt and money market instruments).	
14.2	Check whether the Fund uses appropriate sources for obtaining security level prices for deriving the market value/ fair value of the investment.	
14.3	Verify whether inter-scheme transfers have been done as per the norms and approved framework (Refer Chapter 7H on Compliance and Risk Management for further details).	
14.4	Whether there is a process of classifying money market or debt securities as “below investment grade” if the long-term rating of the security issued by a SEBI registered Credit Rating Agency (CRA) is below BBB- or if the short-term rating of the security is below A3. Whether there is a process of classifying a money market or debt security as “Default” if interest and/ or principal amount has not been received, on the day such amount was due or when such security has been downgraded to “Default” by a CRA (SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019)	
14.5	Whether valuation of “below investment grade” securities is as per the prices provided by the valuation agencies or on the basis of indicative haircuts provided by these agencies till such prices are provided by the valuation agencies	

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	(SEBI Circular SEBI/HO/IMD/DF4/CIR/P/2019/41 dated March 22, 2019)	
Unit Capital/ Corpus		
15.1	Verify whether there is an internal process, existing to ensure that units are daily reconciled between the NAV Report and Report of Registrar and Transfer Agent.	
15.2	Review the process and treatment of units processed by RTA on back-dated/ as of basis and its impact on the NAV.	
15.3	Review the process of passing entries for dividend liability, TDS on dividends and dividend reinvestment based on the feeds received from RTA.	
Reconciliations		
16.1	Verify whether there is a process of sharing the ledger accounts related to all accounts requiring reconciliations with the Reconciliation Team as per the agreed periodicity (this may sometimes be automated and/ or the reconciliation team is given restricted access to generate the required information (including bank statements) by themselves).	
16.2	Review whether the reconciliation is a manual or an automated process; in case of existence of manual activities surrounding the performance of the reconciliation, appropriate checks and balances exist in the process to enable drawing up the correct reconciliation as per the SOP for the same.	
16.3	Whether timelines and Turn Around Time (TAT) have been laid down for preparation and review of reconciliations and for taking corrective actions/ passing rectification entries.	
16.4	Whether there is a process of flagging of and/ or escalating unusual /old entries as per the agreed policy.	

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16.5	<p>Custody Holding Reconciliation</p> <ul style="list-style-type: none"> • Review whether the details of scheme wise investment holdings are shared with the Custodian/ authorised agency on a daily basis for the purpose of reconciliations of the investment holdings, scheme wise, with the scheme wise investment holdings as per the Custodian. • Review whether the scheme wise investment holdings are received from the Custodian and also shared with the authorised agency (if appointed) on a daily basis. • Review whether the investment holding reconciliation is performed on a daily basis by the Custodian/ authorised agency. • Whether there is a process of daily review of the investment holding reconciliations and escalation and prompt resolution of issues, if any. • Review whether there is a process of check of the physical holdings, if any, with the Custodian, on a periodical basis. 	
16.6	<p>Investment Bank, Operative Bank and Expense Payout Bank Reconciliations:</p> <ul style="list-style-type: none"> • Whether reconciliation is performed on a daily basis. • Confirm existence of a process of independent review of the reconciliation. • Review whether an ageing analysis is performed of the items pending in the reconciliation. • Confirm existence of process of root cause analysis for the items appearing in the reconciliation. • Review the escalation and reporting of pending reconciliation items. 	

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	<ul style="list-style-type: none"> • Review corrective actions/ rectification entries to resolve the pending items in the reconciliation. • Review communication with functions to initiate preventive measures in connection with the pending/ recurring items in the reconciliation. <p>(Also refer Chapter on Banking Operations and Reconciliations, and Chapter on Custodian Operations for additional details).</p>	
Securities classified as Below Investment Grade or Default		
17.1	Verify whether money market of debt security is correctly classified as “Default”.	
17.2	Verify whether there is a process of prompt intimation to the valuation agencies of any instance of non-receipt of payment of interest and/ or principal amount (part or full) in any security (SEBI/ HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019).	
17.3	Verify whether the accounting treatment of accrued interest, future interest accrual and future recovery in case of money market and debt securities classified as below investment grade or default is as per the SEBI Regulations.	
17.4	Verify whether appropriate disclosures with respect to securities classified as below investment grade or default have been made as required by the SEBI MF Regulations/ Circulars.	
Regulatory Pay Outs and Filings		
18.1	<p>Verify whether the following statutory compliances in relation to income tax, GST and such other statutory matters have been complied within the due dates of the same (including review of the correctness of the filings):</p> <ul style="list-style-type: none"> • Payment of taxes deducted at source 	

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	<ul style="list-style-type: none"> • Payment of GST on exit load • Payment of STT • Generation and issue of TDS Certificates • Filing of quarterly eTDS returns • Filing of GST related returns (GSTR 1, GSTR 3B) • Filing of Annual Income Tax Returns • Filing of Annual STT Return • Filing of Form 61 (Form 60 received) • Filing of Statement of Financial Transactions (Form 61A) • Filing of Form 61B (FATCA/ CRS) • Filing of STR with the FIU 	
18.2	Verify whether FA and Back Office is involved in any other statutory filings/ data sharing for statutory filing, and if yes, review the timeliness and accuracy of the data/ filing (For Other Regulatory Filings please refer to Chapter on Compliance and Risk Management)	
Verification of Net Asset Value (NAV)		
19.1	Verify whether equalisation entries have been correctly dealt with in the Scheme/ Fund accounts.	
19.2	Verify the process and treatment of units processed by RTA on back-dated/ as of basis and its impact on the NAV.	
19.3	Verify whether realized and unrealized incomes including income accruals (interest & other corporate action) are correctly accounted at the time of generation of NAV.	
19.4	Verify whether there are procedures and functions surrounding the undermentioned activities to ensure correctness of NAV on a daily basis: <ul style="list-style-type: none"> • Corpus/ unit capital movements • Change in investment valuations (unrealised appreciation/ depreciation) 	

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	<ul style="list-style-type: none"> • Change in realised gains/ losses • Expense accruals 	
19.5	Verify whether the NAVs are correct and tally with the System.	
19.6	Verify whether the NAVs are timely uploaded on the AMFI website.	
19.7	In case of an infrastructure debt scheme, verify whether the NAV is calculated and declared atleast once a quarter (Regulation 49Q).	
19.8	Verify whether NAV is computed and declared for Liquid schemes for 'Non-business days' including Sunday.	
19.9	Verify whether checklist is maintained and signed off to ensure completion of all daily NAV activities (Refer the illustrative calculation of NAV per unit given in the Annexure at the end of this Chapter).	
19.10	Verify whether the process of computing the NAV of each scheme is by dividing the net assets of the scheme by the number of units outstanding on the valuation date.	
19.11	Verify whether there is a process to ensure that the repurchase price of units is not lower than 93 percent of the Net Asset Value and the sale price is not higher than 107 percent of the Net Asset Value. Review whether the process also ensures that the difference between the repurchase price and the sale price of the unit does not exceed 7 percent calculated on the sale price.	
Liquidation and Dissolution of Schemes/ Funds (if required and redemption of close ended funds)		
20.1	Verify whether a Close Ended Scheme has been correctly wound up on the expiry of the duration of the Scheme	
20.2	Verify whether a Scheme (other than a close ended scheme) is wound up, check proper	

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	<p>documentation and due process has been followed for winding up is done:</p> <ul style="list-style-type: none"> • on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or • on passing a resolution of at least seventy five percent of the unit holders of a scheme to wind up the scheme; or • on the direction of the Board, in the interest of the unit holders. 	
20.3	<p>Verify where a Scheme has been wound up as above, whether notice has been given by Trustees disclosing the circumstances leading to the winding up of the Scheme</p> <ul style="list-style-type: none"> • to the Board; and • two daily newspapers having circulation all over India and a vernacular newspaper circulating at the place where the mutual fund is formed. 	
20.4	<p>Verify whether the procedure and manner of winding up is as laid down in the SEBI Regulations have been followed.</p>	
20.5	<p>Verify whether "Default" or illiquid investments realised on the maturity or winding up of schemes, if substantial, have been distributed to the investors (also applicable to close ended schemes). In case the amount is not substantial it may be used for the purpose of investor education (SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019)</p>	
20.6	<p>In case of schemes which have matured/ wound up:</p> <ul style="list-style-type: none"> • verify whether the NAV on the date of maturity/ winding up has been frozen. • verify whether the redemptions to all the 	

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	<p>investors have been made at the NAV as at the last day of the closure.</p> <ul style="list-style-type: none"> • verify whether no additional expenses have been charged to the maturity/ winding up. • verify whether expenses accrued for the recurring and other liabilities have been correctly paid off. • verify whether bank accounts of the schemes which have been wound up or matured have been closed after due approval. • verify whether the units of a mutual fund scheme are delisted from a recognised stock exchange. 	
Insurance		
21.1	<p>Verify whether the Mutual Fund have insurance cover against third party losses arising from errors and omissions of directors, officers, employees, trustees, RTA, etc. of a minimum level of Rs. 5 crore (for assets exceeding Rs. 100 crore).</p> <p>Verify whether the Mutual Fund has insurance to cover asset based losses (due to natural or unnatural disasters, such as, fire, flood, burglary, etc.) as well as financial or data losses. (SEBI Circular - MFD/CIR/15/19133/2002 dated September 30, 2002).</p>	
Accounting Policies and Standards		
22.1	<p>Verify whether the Fund has followed the Accounting Policies and Standards laid down in the Ninth Schedule to the SEBI Regulations (Mutual Fund) 1996</p>	
Annual Report		
23.1	<p>Verify whether the process of preparing the financials and the Annual Report and ensure the existence of appropriate financial and other controls to ensure preparation of correct financials and Annual Report.</p>	

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23.2	Verify whether Annual Report and Annual Statement of Accounts have been prepared as specified in the Eleventh Schedule.	
23.3	Verify whether the Scheme wise annual report has been hosted on the Mutual Fund/AMC and the AMFI website as per SEBI Regulations.	
Half Yearly Financial Results		
24.1	Verify whether the process of preparing the half yearly financial results and ensure the existence of appropriate financial and other controls to ensure preparation of correct half yearly financials.	
24.2	Verify whether the half yearly financial results have been prepared as specified in the Twelfth Schedule of the MF regulations.	
Monthly and Half Yearly Portfolio Disclosures		
25.1	Verify whether the process of portfolio disclosures and ensure the existence of appropriate controls to ensure preparation of correct portfolio statements for disclosure.	
25.2	Verify whether the Portfolio disclosures have been made as specified in Regulation 59A and SEBI circulars issued from time to time (SEBI CIR/IMD/DF/21/2012 dated September 23, 2012).	
Disaster Recovery and Business Continuity		
26.1	Verify preparedness of the Operations Team and Back Office to support business continuity.	
26.2	Verify their participation in mock BCP/DR drills.	
26.3	Verify if special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
26.4	Verify transactions to determine that business disruption is minimised.	

Chapter 10

Internal Audit – Custodian Operations

Background

10.1 A Custodian is a designated functionary within a Bank or a financial institution who ensures that securities of the client are maintained in a safe and secured manner in electronic or physical form. The Custodian holds client securities and monies in trust and keeps the securities in safe custody which minimizes the risk of theft or loss of securities.

Custodians also offer other services, such as, settlement of securities, co-ordination with third parties for securities and funds, handling corporate actions, maintaining records, depository participant services, etc. Custodians facilitate settlement and act as clearing members on the Exchange. They settle trades on behalf of their clients. The custodian charges a custodial fee to their clients and such fees may vary depending on the type and nature of services availed. Custodial fee is one of the components of the Total Expense Ratio of the Mutual Fund scheme. It is a highly regulated function.

With changing business scenarios, technology plays a key role in custody business to make processes efficient and effective. Custodians need to be responsive to these technological changes in order to achieve expected growth and be ready for the future.

Role of Technology in Custody Business

10.2 Technology has become a key factor of the custody business. In the past decade, technology in the financial services sector has seen significant changes. Given the evolved set-up, most of the activities currently are undertaken with the help of advanced systems and integrated connections with all intermediaries. Manual intervention is at the lowest level in the custodian business presently.

Custody business in Mutual Funds sector is set to evolve with new technological advancements, such as, Robotic Process Automation (a set of software tools which performs repetitive business processes, RPA), Block chain (a form of distributed database for recording transactions), Artificial Intelligence (AI), etc. This could replace the tasks, such as, reconciliations

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and reporting, etc. and make the custody business more efficient and cost effective.

Custodian Function in Mutual Funds

10.3 Appointment of a Custodian is a pre-requisite for registration of Mutual Funds in India. The SEBI (Mutual Fund) Regulations mandate that investment advisor, fund managers and assets of the mutual fund are kept separate and protected. SEBI (Mutual Fund) Regulations, 1996 also provide norms to ensure independence of the Custodian. The Mutual fund is required to enter into an agreement with the Custodian for the efficient and orderly conduct of custody related affairs.

SEBI (Custodian of Securities) Regulations, 1996 prescribed guidelines for:

- Registration of a Custodian
- General obligations and responsibilities of a Custodian

Every Custodian is required to abide by the Code of Conduct as set out in the Third Schedule and maintain highest standards of integrity, fairness and professionalism in discharge of its duties. Custodian is responsible to establish and maintain adequate infrastructural facilities to be able to discharge custodial services to the satisfaction of its clients.

The Mutual Fund Operations team at AMC (Back Office team/ Custody team where applicable) co-ordinates with the Custodian (Third Party Vendor) in order to ensure that custodial services are performed effectively. The Custodians also provide custodial services for securities including gold or title deeds of real estate assets of a Mutual Fund scheme.

Custody Process

For Equity Trades

1. Primary Market Transactions

- Mutual Fund Operations team communicates the intention of the Mutual Fund to participate in the Initial Public Offering (IPO)/ Follow on Public Offer (FPO) of a company by giving the details of shares to be applied per scheme. The Custodian assists the client in applying for issuances in the primary market.
- Custodian blocks the payment due in Applications Supported by Blocked Amount (ASBA) account.

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- On allotment of the shares/ securities, the client (Mutual Fund) is intimated about the details, such as, applied quantity, allotted quantity, refund (if any), unblocked amount, etc.
 - On receipt, the Custodian matches the quantity of shares/ securities received with the quantity applied and quantity allotted and intimates to the client.
 - Listing related information of primary market investments is also communicated by the Custodian.
 - Mutual Fund Operations team accounts for the entries of securities purchased in the primary market as per the quantity of shares applied. Custodian informs about the allotment information to the Mutual Fund. Partial allotment, if any, is appropriately adjusted in books.
- 2. Secondary Market Transactions** (Domestic and Foreign Equity, Derivatives, including securities lent and borrowed)
- Custodian receives trade details from the Mutual Fund Operations team through Straight Through Process (STP). The Custodian is also provided with the details of collaterals for trading in derivatives, if any.
 - Custodian intimates the client about approaching due dates for exercising call and/ or put option. Mutual Fund Operations team communicates to the Custodian about the intention of the Fund/ Scheme to avail call/ put option or to roll over the contract or where required, to physically settle the stock derivatives contract.
 - Trades are matched with the trades data directly received from the broker/ exchange.
 - Unmatched trades, if any, are communicated to the Mutual Fund Operations team.
 - Fund obligations and margin money amount (for derivatives) are informed to the Mutual Fund Operations team.
 - Funds received from the Mutual Fund are transferred to Exchange Account.
 - Securities and funds are settled as per the Clearing and Settlement schedules of the Exchange.
 - Reconciliation is performed of the holdings in securities and of the fund's movement. Differences, if any, are settled with respective parties.

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3. Corporate Action (Domestic and Foreign Equity, including securities lent and borrowed)

- Custodian tracks and intimates the client about change in paid up capital of investee companies, rights and bonus issues, stock splits, business combinations (merger/ demerger), buy backs and other corporate actions, issue of temporary ISIN, etc.
- Corporate actions are tracked on a daily basis from NSE/ BSE or from reports received from Investee Company/ corporate action vendor, if any. Corporate actions in foreign securities are tracked based on information received from vendor.
- Custodian intimates the client about forthcoming corporate actions, such as, bonus, dividend, rights etc. Corporate actions are accounted for in scheme books by Mutual Fund Operations team. Corporate actions, such as, bonus, rights are put under 'hold' in the scheme books. Hold is released on receipt of corporate actions.
- Monetary corporate actions received are credited to client (Mutual Fund) account and intimation is sent to the client.
- Reconciliation is performed by matching corporate actions received against those that are receivable.
- Custodian follows-up for collection of the corporate actions before their respective due dates.
- Custodian intimates the client of non-receipt/ delay in receipt of shares/ securities, corporate actions, sale proceeds of investments, if any.
- Custodian shares with the client the notices received for meetings of the investee companies for proxy voting and assists in proxy voting, if agreed with the client.

For Debt Trades

1. Primary Market Transactions

- Indian Primary Market in Corporate Debt is basically a private placement market with most of the corporate bond issues being privately placed and the Custodian assists the client in the primary market transactions.

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- Custodian intimates the client on receipt of debt securities from the issuer.
 - Mutual Fund Operations team accounts for such primary market debt securities transactions.
 - Custodian also assists the client in monitoring the terms of deals which involves securities with higher credit risk.
- 2. Secondary Market Transactions**
- Trade details are reported to the Custodian either by e-mail/ secure fax or through a safe reporting system of the Custodian.
 - Settlement team of the Custodian matches the trade details with the trades reported on FIMMDA platforms (CBRICS/ F-TRAC), NDS-OM.
 - Unmatched trades, if any, are communicated to the Mutual Fund Operations team.
 - Securities and funds are settled as per the Clearing and Settlement Schedules.
- 3. Corporate Action**
- Custodian tracks and intimates the client about coupon payments, redemptions, call or put options, etc.
 - Custodian tracks the corporate actions based on the security master created (containing redemption dates, maturity dates, interest due dates, put and call option dates)
 - Custodian provides an interest/ redemption/ maturity forecast report to the Mutual Fund
 - Custodian follows-up for collection of the corporate actions and redemption/ maturity proceeds of investments before its due date.
 - Custodian intimates the client of non-receipt/ delay in receipt of securities, corporate actions, sale proceeds of investments, if any
 - Confirmation is sent to client on receipt of funds.
 - Timely and ongoing intimations from the Custodian facilitates the client to take appropriate decisions to identify Non-Performing Assets (NPAs) and account for the same.

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- Reconciliation is performed by matching corporate actions received against those that are receivable.

For Creation and Release of Pledge

The Custodian is intimated of any pledge which may need to be created (with proper supporting documentation) on the shares/ securities held by a scheme. This may, generally, happen in case of any borrowings made by the Mutual Fund to fund its redemption or for any other permitted purposes. The Custodian accordingly creates the pledge on the shares/ securities and provides an official confirmation of the same. The Custodian will also release the pledge on completion of all the terms basis which the pledge was created.

For Other Services

- Facilitating opening of bank and demat accounts.
- Forex booking of inbound and outbound remittances.
- Providing storage vault services.
- Providing regulatory and other reports.
- Tracking of inward remittances and transfer to client account.
- Co-ordinating with exchanges for securities and fund movement and margin requirements for derivative transactions.
- Facilitating transfer of ownership of securities (as applicable to legacy shares held in physical form).
- Responding to client queries and complaints, if any.

Key Risks

Particulars	Risk Type
Absence of adequate insurance cover for errors and omissions	Operational/ Financial/ Compliance
Absence of reconciliation/ timely reconciliation between custodian books and fund accounting books	Operational/ Financial/ Compliance/ Reputational
Processing errors in securities transactions, corporate actions, holding reconciliations, forex booking, pledge for borrowings,	Operational/ Financial/ Reputational

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transfer of inward remittances to client account, derivative margin requirements	
Storage of physical securities/ gold may not be safe and secured	Operational/ Financial/ Reputational
Incorrect reporting to client	Operational/ Financial/ Compliance/ Reputational
Technological challenges resulting in incorrect/ delay in processing	Operational/ Reputational
Failure to securities or provide payment for securities	Operational/ Financial
Non-compliance with applicable Regulations	Compliance/ Financial
Inability to maintain going concern	Operational/ Reputational/ Compliance

Internal Audit Checklist

Review of Service Level Agreements		
1.1	Review of adherence to terms mentioned in SLA with the Custodian with specific reference to agreed deliverables, fees charged by the Custodian, timelines as agreed for deliverables, etc.	
Custodian Obligations		
2.1	Identify storage procedures and arrangements. Verify if the practice of dual key custody is followed to access the vault. Verify that enhanced controls, such as, motion sensor, entry through authentication of devices are available for gold stored in vault. Also, verify that additional verification is performed for gold including assay certification, confirmation on movement of gold bars from custody to custody, custom clearances, etc.	
2.2	Review of physical and logical security to determine the adequacy of access and authorisation controls. This would cover maintaining visitor log, allowing access to authorised personnel, CCTV monitoring, entry with access card, etc.	

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2.3	Review of withdrawal/ submission of securities to the vault along with timeliness of movement of securities.	
2.4	Obtain report from the Custodian for scrips not yet in custody and review the adequacy of follow up procedures.	
2.5	Identify policies and controls in place to safeguard assets against physical hazards.	
2.6	Review adequacy of insurance coverage to comply with regulatory requirements.	
2.7	Review that proxy voting notifications are received from the Custodian on a timely basis and proper procedures in line with applicable laws and regulations are adhered to.	
2.8	Review the process of creation and removal of pledge on securities and ensure that the same is in line with the instructions received from AMC.	
Market Operations		
3.1	Verify accuracy of classification into primary, secondary and inter- scheme transactions. Verify sample Delivery Instructions for Purchase (DIP)/ Delivery Instructions for Sale (DIS) for classification.	
3.2	Verify that appropriate procedures are available for Delivery vs. Payment Trades (where trades could not be timely confirmed by the Custodian on Exchange). Verify if reasons for such delay are identified and fixed to avoid occurrence in future. Note: Generally, all secondary market equity trades are performed through STP.	
3.3	Verify the accuracy of transaction processing by verification of authorisation from sample DIP/ DIS. Verify if accurate and timely instructions and trade details are communicated to the Custodian.	
3.4	Review margin money deposits (physical/ electronic) to ensure that margin deposits placed are appropriate to take desired exposure.	
3.5	Check the reconciliation of investment holdings as per custody books (including with saleable quantity report received from the Custodian) with demat statement.	

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	Ensure that mismatches, if any, are identified and appropriately acted upon.	
3.6	Verify that reconciliation is performed for holdings of securities in vault with custody books.	
3.7	Review the process of updating custody books with securities received/ delivered. Verify the gold rate for purchase and sale of gold.	
3.8	Verify whether appropriate procedures are followed for securities involved in transactions pending settlement. Verify that timely notification is sent to AMC for auction/ close-out transactions.	
3.9	Review if physical settlement of derivatives, if any, adheres to applicable regulatory requirements (SEBI Circulars dated April 11, 2018 and December 31, 2018).	
Corporate Action		
4.1	Review the accuracy and timeliness of completion of monetary and non-monetary corporate actions, such as, bonus updation, dividend, interest, debenture conversions, rights entitlement, buyback, etc.	
4.2	Review the portfolio of clients (scheme-wise) with focus on unsettled contracts, pending physical deliveries (legacy shares), etc. Verify if controls over security of legacy shares are appropriate.	
4.3	Review adequacy of follow-up on long outstanding corporate actions.	
4.4	Review unclaimed and unsettled corporate actions and assess reasons. Verify if appropriate and timely actions are taken to settle pending corporate actions.	
4.5	Verify if the corporate action event has been appropriately created in the scheme books.	
4.6	Review if the blocking and unblocking of securities was performed on a timely basis with appropriate maker-checker authorisation. Blocking and unblocking of securities is performed for securities and corporate actions pending settlement.	

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4.7	Review that there are appropriate procedures available to handle claims arising for unclaimed/ excess securities (i.e. bonus/ dividend received for the period when ownership of physical securities was not with the Mutual Fund schemes) and the same are processed accordingly.	
4.8	Review that timely notification is received from the Custodian for availing of call/ put options and the contract has been executed accordingly as per the decision of the Fund Manager.	
Reporting		
5.1	Review whether the Custodian provides all the reports/ data as per the SLA with the Custodian.	
5.2	Review the accuracy, timeliness, and periodicity of the reports sent by the Custodian.	
Access Rights		
6.1	Review access rights to check if they are in line with the roles and responsibilities of the personnel involved.	
Verification of Securities		
7.1	Verify if client securities held in physical form are verified periodically to identify discrepancy, if any, with records maintained electronically.	
Complaints and Requests		
8.1	Review all outstanding requests/ complaints and verify if those are resolved timely and appropriately.	
Outsourced Agency		
9.1	Review of outsourced agency, if any, used by the Custodian to verify if the Custodian has executed an SLA with the agency and verify if the SLA terms are monitored by the Custodian.	
Identification and Accounting of NPAs/ Securities classified as below investment grade or default		
10.1	Review if identification of NPAs/ securities classified as below investment grade or default is within SEBI norms	

Internal Audit – Custodian Operations

	and appropriate provision has been created for the same.	
Business Continuity Plan and Business Disruption Plan		
11.1	Verify preparedness of the Custodian to support business continuity.	
11.2	Verify their participation in mock BCP/DR drills.	
11.3	Verify if special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
11.4	Verify transactions to determine that business disruption is minimised.	

Chapter 11

Internal Audit – Banking Operations and Reconciliation

Background

11.1 Mutual Funds process a very large number of transactions on a daily basis across multiple schemes and even more numerous plans/ options. These transactions occur over a very wide geographical footprint, and accommodates a wide spectrum of investors, with different banking preferences, using different banking payment platforms/ channels to participate in Mutual Fund investment life cycle.

Mutual Funds, therefore, maintain a large number of bank accounts and often, by design, choose more than one banking partner to enable to better reach across the country and for timely receipt of money from investors for deployment and also payment to the investors on timely basis, as and when required.

Multiplicity of bank accounts, transaction volumes, transaction frequencies, types of transactions and a quick turnaround on financial matters from an investor service perspective, necessitates appropriate oversight over management and operation of bank accounts. A logical outcome of this arrangement is the need for a robust reconciliation process to ensure that monies received/ paid are attributed to the correct investors and deployed to the correct schemes and plans or deployed to the correct vendor/ payee. Bank accounts are operated for the following core Mutual Fund activities:

- Subscriptions, SIPs and Switch-ins (purchases)
- Redemptions, Switch-outs, Systematic Transfer Plans (STPs) and Systematic Withdrawal Plans (SWPs)
- Dividend payments
- Refund processing
- Brokerage pay-outs
- Common Pool
- Operations Bank Account

Internal Audit

11.2 Internal audit of Banking Operations and Reconciliation activities includes the following:

Banking Operations

1. Review of governance mechanisms exercised over bank accounts to ensure:

- Board approvals for opening a bank account along with list of authorised signatories.
- Robust controls for granting/ revoking bank portal access.
- Maker-checker controls for bank payment scheduling and authorization.
- Periodic review of user access to bank accounts and bank portals.
- Periodic review of existing bank accounts for identifying inoperative/ dormant accounts for closure.
- Authentication devices are in use to enhance safeguards over banking operations and their inventory is maintained.
- Control over custody and issuance of physical cheque (leaves) and cancelled cheques, if any.

2. Review of adequacy of controls over bank account management activities to ensure:

- Maintenance of inventory of all bank accounts with their purpose and General Ledger (GL) code mapping the active/ inoperative status of the accounts.
- Documentation provided to banks for opening bank accounts or modifying user access to accounts/ bank portals is properly authorised.
- Compliance requirements are met in relation to opening of bank accounts for NFOs.
- Timely funding of bank accounts.
- Management of the surplus funds available in the bank accounts.

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- Validation of bank charges, monitoring of minimum account balances, transfer of unutilised funds in bank accounts, etc.
 - Controls are exercised over operation of pool accounts, and credit facility with banks, if any is appropriately managed.
 - Exercise of controls over usage of bank portal/ website user login ids
- 3. Review of subscription bank account activities to ensure:**
- Funds sighting for allotment of NAV is performed by RTA/ Operations team.
 - Collections match RTA provided subscription reports to unfunded units or unidentified credits.
 - Maker-checker controls are in place for file uploads and bank transfers.
 - Proper mapping of bank accounts with systems to facilitate fund transfers/ host to host transfers with minimal manual intervention.
 - Proper controls are in place for transfer of funds from collection accounts to pool accounts and from pool accounts to individual scheme accounts and reconciliations for the same are done properly.
- 4. Review of refund processing activities to ensure:**
- Whether instructions for payment of refund, in case of rejected subscriptions are processed timely, to the correct recipients, to the correct bank accounts with adequate maker-checker controls.
- 5. Review of redemption, dividend and brokerage bank account activities to ensure:**
- Files received from RTA follow a proper approval and due diligence process before funding.
 - Pay-out files are processed accurately, to the correct investor accounts to meet regulatory or internal timelines.
 - Instructions for pay-outs are executed with suitable maker-checker controls.
 - Unutilised funds lying in bank accounts are identified and transferred to designated accounts, where necessary.

Bank Reconciliation Operations

1. Review of general controls exercised over the reconciliation process to ensure:

- Existence of a mechanism to identify, report and document reconciliation of transactions occurring in the normal course of business as well as exceptions or transactions outside the normal course.
- Adequacy of processes for identifying stale cheques and their re-validation.
- Action on unclaimed warrants/ pay orders.
- Handling and resolution of unidentified/ unclaimed credits or double payments in the bank accounts.

2. Review of process of reconciliation of redemptions, dividend and brokerage transactions to ensure:

- Reliable and timely exchange of redemption/ dividend/ brokerage files (at investor/ distributor level), accounting and funding files between RTA, Fund Accountant, Treasury and Operations teams.
- Proper reconciliation between redemption/ dividend/ brokerage liability accounted by Fund Accountant and calculated by RTA.
- Dividend reinvestment input files are appropriately and accurately accounted and processed.
- Proper reconciliation with redemption, dividend and brokerage registers received from RTA.
- Proper reconciliation of redemption/ dividend/ brokerage GL balances and identification/ rationale for un-extinguished liability.
- Proper reconciliation of redemption/ dividend/ brokerage bank accounts and identification of investor/ distributor level unclaimed liability.
- Reconciliations are performed at defined intervals and long pending unclaimed items or unidentified/ unreconciled entries are reported.
- Reconciliations identify erroneous/ duplicate entries which are rectified/ resolved.

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- Adequate segregation of duties in case reconciliations are handled in-house.
 - Turnaround time (TAT) is defined, tracked and reported for resolution of differences and exceptions (if any).
- 3. Review of process of reconciliation of subscription transactions to ensure:**
- Robust fund sighting and cross collection identification procedures for allocation of correct NAV
 - Follow-up and timely resolution of unidentified credits
 - Proper reconciliation with subscription registers received from RTA.
 - Errors are timely identified, rectified and reported
 - Whether refunds for rejected subscriptions in respect of NIGO transactions, channel transactions (including online portals of AMC, RTA, MFU, stock exchanges and all digital platforms, such as, PayTM, ET-Money, mobile application, etc.) and HNI/ corporate transactions are handled accurately and timely and refunds are processed to the correct recipient.

Key Risks

Particulars	Risk Type
Unauthorized use of bank accounts leading to incorrect or fraudulent pay-outs	Financial/ Operational/ Compliance/ Reputational
Delay in/ non-funding of bank accounts	Financial/ Operational/ Compliance/ Reputational
Transfer to inaccurate scheme accounts	Financial/ Operational/ Compliance/ Reputational
Inaccurate or untimely transfer to unclaimed dividend/ redemption/ brokerage accounts	Compliance/ Operational/ Reputational
Fraud arising from unauthorized changes to investor bank accounts leading to diversion of payments to unauthorized accounts	Financial/ Operational/ Compliance/ Reputational/ Fraud

Internal Audit – Banking Operations and Reconciliation

Reconciliation is performed by persons/ teams that are not independent of the Banking Operations Team	Financial/ Operational/ Reputational/ Fraud
Unreliable or incomplete Reconciliation MIS leading to incorrect reporting to AMC/ Trustees/ Regulator	Compliance/ Operational/ Reputational
Erroneous reconciliation impacting customer investments and scheme balances	Compliance/ Operational/ Reputational
Denial of redemption to rightful investor due to incorrect matching of subscription credits	Financial/ Operational Reputational/ Compliance
Duplicate payments processed not identified due to incorrect reconciliation	Financial/ Operational/ Reputational

Internal Audit Checklist

Banking Operations

Sr. No.	Particulars	Remarks
Delegation of Authority		
1.1	Whether Authorised Signatory List/ Financial Delegation of Authority (FDOA) is approved by the Board or other appropriate authority authorised by the Board, as and when required.	
1.2	Whether powers granted under the FDOA to such authorised persons include: <ul style="list-style-type: none"> • Opening/ closing of bank accounts. • Addition, deletion, modification to the list of designated authorized signatories. • Providing indemnity letters to facilitate operation of bank accounts via modes, such as, internet banking, fax, etc. 	

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	<ul style="list-style-type: none"> • Cheque book custody and its authorised signatories. • Authorised signatories. • Requirement of dual authorisation for any changes to bank account operations envisaged above. • Restriction on the ability of one user to unilaterally change authorised signatories on the web portal or by way of manual instructions. • Financial/ monetary limits for each user or user level. 	
1.3	Whether process is in place for granting/ revoking access of designated users to the internet banking portal and controls are exercised over usage of bank portal/ website login-ids.	
1.4	Whether process is in place to ensure that bank portal payment authorisation is provided to approved users, under a maker-checker mechanism with approving rights vested with more senior members of the Banking Operations team (including dual authorisation for granting, revoking or modifying Admin access, if such access control is vested with Operations team rather than with the system/ bank administrator).	
1.5	Whether user access management of applications (used by the Banking Operations team or outsourced support staff for their transaction processing activities) is periodically reviewed and documented.	
1.6	Whether authentication device is provided directly to the user based on bank's requirement for Corporate Internet Banking (CIB) login post approval from the authorised signatory.	
1.7	Whether an inventory is maintained of authentication devices issued by the respective banks. Whether records of custody of such devices issued to specific authorised users is maintained.	

Internal Audit – Banking Operations and Reconciliation

1.8	Whether adequate safeguards are in place in case bank account authorised users are granted mobile based bank application access.	
1.9	Whether access to the Secure File Transfer Protocol (SFTP) server is limited to very few users with no responsibility for Banking Operations (required where AMC's bank interface applications are configured to communicate with SFTP servers to deliver encrypted payment instructions in a host to host arrangement).	
1.10	Whether there are robust controls to initiate revocation rights of bank account authorised signatories or persons with access to interface applications used in banking operations when such persons terminate their association with the entity or are transferred to other responsibilities.	
Bank Account Management		
2.1	<p>Whether all the Bank Accounts for Collection, Redemption, Refund, Dividend, Brokerage, Expenses, Unclaimed and Pool Accounts, are properly inventoried in a database.</p> <p>Whether the database includes details, such as, date of requisition received for opening bank account along with the reason for the same, account opening date, purpose, GL accounts to which each bank account is mapped, designated authorities vested with responsibility to operate the account, details of past Bank Accounts which are inoperative or have since been closed, requirement of minimum bank balances (if any), bank charges (if any), active or inactive status of bank accounts, etc.</p>	
2.2	<p>Whether signed approval letter from Board authorised persons along with list of employees with specific view/ authorisation access requests is provided to the bank for opening of the account.</p> <p>Whether bank confirmation is received for account opening (for bank account to be opened for NFO, additional requirements include compliance approval</p>	

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	is in place along with details of SID, KIM, NFO launch date and rationale for opening the bank account).	
2.3	Whether periodic review of bank accounts is done to identify inoperative /dormant accounts to be closed.	
2.4	Whether proper approvals are obtained for closure of the bank account and bank closure letter duly signed by Board authorised officials is provided to the bank.	
2.5	Whether residual balance, if any, is reconciled and transferred to another operative bank account before finalising the bank account closure.	
2.6	Whether appropriate procedures are followed to map newly created bank accounts and un-map closed bank accounts to the schemes.	
2.7	Whether there is a mechanism to track and validate bank charges levied and minimum account balances are being monitored regularly.	
2.8	Whether there is a mechanism to track credit facilities available to the AMC and whether usage is tracked and interest, if any, is validated.	
2.9	Verify preparedness of Banking Operations team to support business continuity.	
2.10	Verify their participation in mock BCP/DR drills.	
2.11	Verify if special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
2.12	Verify transactions to determine that business disruption is minimised.	
2.13	Verify documentation on back-up plan in case Banking Operations team is not available or unable to perform their duties due to exigencies.	

Internal Audit – Banking Operations and Reconciliation

Subscriptions/ SIPs		
3.1	<p>Whether RTA provides:</p> <ul style="list-style-type: none"> • scheme level/ transaction level feed files for transactions on the MFU, stock exchanges, all digital platforms of AMC, RTA and those, such as, PayTM, ET Money, etc. • files for credits matched in Cash Management System (CMS). <ul style="list-style-type: none"> ▪ files for channel collection accounts. ▪ scheme-wise utilization files. ▪ bank statement extracts. 	
3.2	Whether utilization amounts provided by RTA are cross checked with the actual balances in bank accounts before using the files to communicate payment instructions to banks.	
3.3	Whether maker-checker control is in place to oversee correct upload of RTA utilization feeds in the interface application.	
3.4	Whether mapping of bank accounts for host to host (H2H) transfers is reviewed at the time of set-up of accounts to ensure accurate movements from Collection Accounts to Subscription Pool Accounts.	
3.5	Whether dual authorisation on banking website is available for fund movement. Whether the fund transfer/ RTGS instructions to banks are performed using letters signed by two authorised signatories.	
3.6	Whether reconciliation of feed from individual collection accounts vs. actual collection in pool is done before fund movement to schemes at day-end.	
3.7	Whether controls are in place to ensure Collection Pool Accounts function as sweep accounts and are zeroised at day-end.	
Refund Processing		
4.1	Whether subscription transaction rejection file feed provided by RTA is transmitted to Treasury team for funding the Refund Account.	

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4.2	Whether transaction level dump received from RTA is verified to ascertain accuracy of name of investors and bank account numbers. Where such matches do not occur, whether a 100% check for transactions is done by RTA with investor applications to ensure accuracy of bank account before processing refund pay-out.	
4.3	Whether funds are transferred from Collection Account to Refund Account.	
4.4	Whether the pay-outs to individual investors via the banking portal is performed under maker-checker controls.	
4.5	Whether bank reverse feeds are verified to ensure that refunds have hit the correct investor bank accounts and amounts as per RTA Refund file feed.	
Redemptions		
5.1	Whether redemption transaction feed files provided by RTA are transmitted in a timely manner to Treasury team for funding the Redemption Bank Accounts (separate feeds for Direct Credits, NEFTs, RTGS, cheques, etc.).	
5.2	Whether separate bank account is used for funding redemptions by investors using instant redemption facility and that bank account balances are provided daily to the Treasury team to ensure adequate funding in such bank account.	
5.3	Whether redemption bank accounts are funded by Treasury team for the appropriate amount and in a timely manner.	
5.4	Whether the redemption pay-outs to individual investors via the banking portal is performed with maker-checker controls.	
5.5	Whether bank reverse feeds are verified to ensure that redemptions have hit the correct investor bank	

Internal Audit – Banking Operations and Reconciliation

	accounts and amounts as per RTA Redemption file feeds.	
Dividend Processing		
6.1	Whether dividend transaction feed files provided by RTA are transmitted in a timely manner to Treasury team for funding the Dividend Bank Accounts (separate feeds for DCs, NEFTs, RTGS, cheques, etc.).	
6.2	Where investors have selected dividend reinvestment option instead of dividend payment option, whether dividend posting controls are provided by RTA to the Fund Accounting team.	
6.3	Whether Dividend Bank Accounts are funded by Treasury team for the appropriate amount in a timely manner.	
6.4	Whether the dividend pay-outs to individual investors via the banking portal is performed with maker-checker controls.	
6.5	Whether bank reverse feeds are verified to ensure that dividends have hit the correct investor bank accounts and amounts as per RTA dividend file feeds.	
Brokerage Payments		
7.1	Whether brokerage feeds provided by RTA are transmitted in a timely manner to Treasury team for funding the Brokerage Bank Accounts (separate feeds for DCs, NEFTs, RTGS, etc.).	
7.2	Whether Brokerage Bank Accounts are funded by Treasury team for the appropriate amount and in a timely manner.	
7.3	Whether RTA provided brokerage feed files are reverse fed into bank interface application and verified for accuracy.	
7.4	Whether the brokerage pay-outs to individual	

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	distributors via the banking website is performed with maker-checker controls.	
7.5	Whether bank reverse feeds are verified to ensure that brokerage payments have hit the correct distributor bank accounts and amounts as per RTA brokerage file feeds.	

Internal Audit

Bank Account Reconciliation

Bank Account Reconciliation		
8.1	Whether there is an independent reconciliation team not connected with the operations of any bank/ function for which the reconciliation statements are being prepared by the team.	
8.2	Whether the reconciliation team has a comprehensive control over all the bank/ accounts requiring reconciliation and the duly updated control chart is shared with seniors in charge of/ monitoring the reconciliation.	
8.3	Whether there is a process to perform reconciliation of units purchased, redeemed and held in demat form with records maintained by RTA.	
8.4	Whether information is received from the Banking Operations team of all bank accounts opened and closed in a prompt manner which is updated in the control chart of the reconciliation team.	
8.5	Whether timelines have been agreed with other concerned departments for receipt of the required liability/ asset account ledgers and backup of liability/ asset/ payment information and detailed bank statements from the bank (soft copies, if required).	
8.6	Whether timelines have been agreed by the reconciliation team for the preparation and submission of the reconciliations in the agreed formats with documentation/ information in support of the items pending in the reconciliation.	

Internal Audit – Banking Operations and Reconciliation

8.7	Whether there is a process of escalating non-receipt of information for undertaking the reconciliations or for not receiving timely feedbacks to resolve the items pending in the reconciliation.	
Dividend Reconciliation		
9.1	<p>Whether RTA provides accurate total dividend liability to the Banking Operations team (BOT) and Fund Accountant (FA).</p> <p>Note: RTA calculates dividend liability based on information provided by Operations team/ FA on schemes impacted, dividend rate and record date. RTA determines the units and investors as on record date to arrive at dividend liability.</p>	
9.2	<p>Whether RTA provides dividend re-investment liability file to FA for accounting (usually, this is part of the Daily Transaction Report (DTR) provided by RTA to AMC).</p> <p>Note: In such cases, additional units are allotted to investor in lieu of dividend pay-out. This is done when investor opts for dividend re- investment instead of dividend pay-out.</p>	
9.3	<p>Whether RTA provides accurate bank funding files for pay-out to BOT for sharing with Treasury team for facilitating funding in relevant pay-out bank accounts and to FA team for accounting the funding of liability.</p> <p>Whether Treasury team/ BOT confirms to FA once funding is completed.</p>	
9.4	<p>Whether Operations/ RTA/ Outsourced Agency performs dividend reconciliation at the following levels:</p> <ul style="list-style-type: none"> • Reconciliation of liability as accounted in FA system with RTA provided liability file; • Reconciliation of liability GL closing balance/bank balance and rationale for pending pay-out liability; 	

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	<ul style="list-style-type: none"> Reconciliation of bank accounts funded for liability, payouts to investors and pending/unpaid liability (at investor level). 	
9.5	<p>Whether periodicity of reconciliation and reporting frequency of reconciliation is defined.</p> <p>Whether long pending unclaimed items or unidentified/ unreconciled entries are reported at appropriate frequency.</p> <p>Whether maker-checker controls are in place during the performance of reconciliation.</p>	
9.6	Whether bank account reconciliation is reviewed periodically to ensure that underlying entries are properly classified.	
9.7	Whether the reconciliation robustly identifies erroneous double payments to the same investor and procedures exist to attempt recovery of double payment from investor or from RTA.	
9.8	Whether completeness checks are done to ensure reconciliation is performed for all bank accounts including dormant/ inoperative bank accounts.	
9.9	Whether suitable mechanism exists to ensure proper mapping of all dividend bank accounts to relevant GL codes in the accounting system, including additions on account of new bank accounts and un-mapping of dormant/ inoperative bank accounts.	
9.10	Whether arrangements are in place with CMS bankers/ RTA/ outsourced vendor to facilitate auto matching of credits and debits to reduce the incidence of manual efforts in performing reconciliation.	
9.11	Whether bank reconciliation, if in-house, is performed by persons not vested to operate the bank accounts being reconciled. Whether aging of outstanding amounts is done and transferred to appropriate unclaimed account.	
9.12	Whether reconciliation of GL accounts with bank accounts is vested with a separate agency or with an	

Internal Audit – Banking Operations and Reconciliation

	independent team in RTA not responsible for dividend operations.	
9.13	Whether TATs are defined for remediation/ resolution of differences once identified during the reconciliation exercise. Whether MIS with ageing of pending items is provided periodically to AMC Management.	
Redemption Reconciliation		
10.1	For redemption reconciliation, repeat checks as mentioned in Dividend Reconciliation section in S. No. 9.1 & 9.3 above.	
10.2	Whether Operations/ RTA/ outsourced vendor performs redemption reconciliation at the following levels: <ul style="list-style-type: none"> • Reconciliation of redemption liability GL closing balance/bank balance and rationale for pending pay-out liability; • Reconciliation of bank accounts funded for redemption liability, payouts to investors and pending/ unpaid redemption liability (at investor level). 	
Subscription Reconciliation		
11.1	Whether RTA/ outsourced vendor correctly identifies and tags instances where amount has been credited in the scheme's bank account but could not be mapped with the applications received by RTA as "un-reconciled credits".	
11.2	Whether subscription bank account reconciliation is reviewed periodically to ensure that underlying entries are properly classified. Whether mismatches in amounts received and units created are identified.	
11.3	Whether the reconciliation robustly identifies errors and procedures to immediately rectify the errors. Whether cross collections are identified during reconciliation to ensure correct subscription amount	

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	is assigned to correct scheme and allotted with correct NAV.	
11.4	For subscription reconciliation, repeat checks as mentioned in Dividend Reconciliation Section in S. No. 9.5, 9.8, 9.9, and 9.11 to 9.13 above.	
Refund Pay-out Processing		
12.1	<p>Processing and pay-out for refunds generally relate to the following three categories:</p> <ul style="list-style-type: none"> • Refund towards applications which are not in good order (NIGO) - physical transactions • Refund for Channel Partner transactions including all online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET-Money, etc. • Refund requests of Corporate and HNI Investors routed through Sales team 	
12.2	Whether NIGO reports from RTA are complete, i.e. include front office and back office NIGO rejections where applicant money is already credited/ banked.	
12.3	Whether investor-wise funding file provided by RTA matches the NIGO report.	
12.4	Whether checks are in place to sight the funds credited in relevant collection accounts before approving the NIGO refund.	
12.5	Whether procedures are in place to transfer the correct refund amount from respective collection/ pool accounts to fund a designated refund account for pay-out.	
12.6	Whether pay-out from designated refund account is done accurately and the refund account reconciled after amounts are debited.	
12.7	Whether failed refunds or unpaid refunds residing in refund accounts are properly explained and reconciled.	

Internal Audit – Banking Operations and Reconciliation

12.8	Whether daily funding requirement files containing refund request of Channel Partner, online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET-Money, etc., along with underlying data is sent by RTA to BOT.	
12.9	For channel partner reconciliation, repeat checks as mentioned in NIGO Refund Reconciliation section in S.No.12.4 to 12.7.	
12.10	Where Channel Partners are non-banking aggregators, whether the amount of refund is paid into their respective accounts or in the respective investor's bank account as per Channel Partner instructions and properly confirmed and reconciled.	
Brokerage Payments		
13.1	Whether RTA provides accurate total of brokerage liability to the BOT and FA.	
13.2	For brokerage reconciliation, repeat checks as mentioned in Dividend Reconciliation section in S. No. 9.3.	
13.3	Whether Operations team/ RTA/ Outsourced Agency performs brokerage reconciliation at the following levels: <ul style="list-style-type: none"> • Reconciliation of brokerage liability GL closing balance/bank balance and rationale for pending pay-out liability; • Reconciliation of bank accounts funded for brokerage liability, payouts to distributors and pending/ unpaid brokerage liability (at distributor level). 	
13.4	For brokerage reconciliation, repeat steps as mentioned in Dividend Reconciliation section in Points 9.5 to 9.9 and 9.11 to 9.13.	
Miscellaneous General Controls over Reconciliation Process		
14.1	Whether mechanisms exist to identify and report bank transactions and inter-bank transfer not expected in the normal course of business.	

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14.2	Whether adequate documentation is available for such transfers.	
14.3	Whether rules for permitted and unauthorised usage of specific bank accounts are formally documented and exceptions reported at periodic intervals to AMC Management and Trustees along with justification. Whether such reported cases are subsequently ratified by AMC Management/ Trustees.	
14.4	Whether mechanism exists to identify payments made by cheques/ warrants/ pay orders and whether unpaid amounts are transferred to Stale Cheque Account for monitoring after proper identification of the beneficiary (investor, broker).	
14.5	Whether adequate safeguards are exercised to handle stale cheque/ warrants/ pay orders revalidation or new cheque issuance after ensuring that the payee has not received credit via funds transfer. Whether appropriate documents are obtained from such claimant to indemnify the AMC in case of wrongful revalidation caused by the applicant.	
14.6	Whether the AMC has a Mandatory Leave Policy for all critical staff including the Operations team.	

Internal Audit – Registrar and Transfer Agent (RTA) Operations

Background

12.1 Mutual Funds (MFs) receive subscriptions from investors in their various schemes and facilitate redemptions when desired by the investors. In addition, MFs also handle Non-Financial Transactions (NFTs) and investor service requests. Investors are located over a wide geography using various methods for initiating their transactions. For example, they may initiate transactions through:

- Physical forms submitted at specific collection centres designated by the MF designated as official points of acceptance.
- Online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET- Money, mobile application, etc.
- Mutual Fund distributors (channels) using their infrastructure to communicate transaction orders
- Exchanges, such as, BSE, NSE, and ICEX
- Mutual Fund Unit (MFU) facility
- Fax/ telephone/ e-mail (Institutional Investors).

To cater to the needs of investors and to handle the voluminous transaction flow, it requires a robust infrastructure and technology leverage to function efficiently and effectively. While there are lot of parties that work together, RTA is one agency that works in the backdrop doing the last mile (i.e. investor record maintenance and servicing). It is one of the most critical functions that has a country-wide reach both in terms of people and technology to service the investors' needs together with those of the AMCs.

A vast majority of MFs in the country have outsourced their RTA operations. Services provided by RTAs include the following:

- Accepting and processing of investor subscriptions
- Accepting and processing of investor redemptions

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- Registration and processing of specialised transactions, such as, Systematic Investment, Transfer and Withdrawal Plans (SIP, STP and SWP respectively) and switches
- Management of dividend processing
- Acceptance and processing of investor requests and complaints
- Liaising daily with MF Operations for NAV cut-off timing procedures and with Fund Accounting team for sharing unit capital data at day-end
- Liaising with various banks for registration/ de-registration of SIPs, etc.
- Maintaining records of folios and holdings of each investor.
- Processing non-financial transactions e.g. change of bank, change of contact details, processing of transmission requests, registration of lien etc.
- Managing and servicing distributor on-boarding, continuing eligibility, administering and processing of distributor commissions

RTAs are registered SEBI intermediaries. RTA operations are critical component of MF operations and therefore, the audit for this activity requires internal auditors to be very well versed with these operations in order to perform an effective internal audit.

Internal audit of RTA involves a lot of activities. The illustrative list of activities is as follows:

1. KYC compliance including Suspicious Transaction Reporting (STR) monitoring: Compliance with investor due diligence requirements such with KYC, Foreign Account Tax Compliance Act (FATCA), Common Reporting Standards (CRS), tracking of persons on whom sanctions were imposed by United Nations Security Council (UNSC) and Unlawful Activity Prevention Act (UAPA), etc.
2. Compliance with NISM certification for all RTA staff
3. Review of front office procedures for acceptance of investor requests, (financial and non- financial), time stamping, timely and accurate processing, exception management, completeness checks for applications received from AMC branches and distributors
4. Review of applications and transaction requests to evaluate if in good order or not in good order and effective communication to investor/ distributor/ Registered Investment Advisor (RIA)

Internal Audit – Registrar and Transfer Agent (RTA) Operations

5. Review of purchase transactions to ensure:
 - AML/KYC/UBO and FATCA compliance
 - NAV allotment in line with SEBI requirements in particular cut off timing guidelines
 - Segregation of direct/ distributor/ RIA introduced applications
 - Refunds for rejected applications
 - Quality and completeness checks
 - Split transaction compliance
6. Review of NFOs to ensure:
 - Compliance with SEBI requirements
 - Report submission to AMC as envisaged in regulations
 - Refund for un-allotted applications
7. Review of systematic transactions to ensure:
 - Registration of such transactions as per the mandate and scheme documents
 - Triggering and cessation of such transactions as requested by investor or as per business rules
 - Timely communication of acceptance/ rejection of systematic transactions
 - Compliance with all regulatory requirements while processing systematic transactions
 - Proper reconciliation of registered, triggered, failed and rejected systematic transactions
8. Review of channel transactions to ensure that they are properly executed, reconciled and processed.
9. Review redemption requests to ensure:
 - Accurate processing at appropriate NAV
 - Compliance with regulations, such as, TDS and STT, where applicable
 - Interest calculations and payment, where redemption is delayed

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- Safeguards are in place to ensure payment of redemption to correct investor
 - Compliance with SEBI regulations for unclaimed redemptions.
10. Review lien marking process to ensure safeguards are in place to timely create lien and to release lien in compliance with directions of statutory authorities.
11. Review dividend processing to ensure:
- Accuracy of dividend rates applied
 - Timeliness and accuracy of dividend payment to the correct investor
 - Correct deduction of tax at source
 - Non-deduction of tax only on receipt of correct forms (Form 15G, 15H)
 - Compliance with SEBI regulations related to unclaimed dividends.
12. Review distributor commission management processes to ensure:
- Accurate empanelment/ de-empanelment and withholding of brokerage as per AMFI requirements
 - Accurate updates of commission structures, claw backs
 - Proper management of Employee Unique Identification Number (EUID) and Know Your distributor (KYD) processing
 - Controls over commission on distributor's own investments
 - Accuracy of commission calculations and controls to ensure payment of commission to the correct distributor and claw backs, where applicable
 - Proper tagging of investor location as envisaged in SEBI regulations
13. Review Non-Financial Transactions (NFTs) and Investor Servicing related processes to ensure:
- Proper investor authentication and verification
 - Proper classification of NFTs and investor requests
 - Completeness of all NFTs received
 - Timely and accurate processing of NFTs and Investor requests

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- Deployment of additional controls for special NFTs, such as, transmission, change of address, change of bank mandate, etc.
 - Communication of processing of NFT to investor as envisaged in regulations
 - Timely, reliable and complete NFT and Investor Service MIS is provided to AMC management
14. Review access controls granted by users within RTA to ensure no conflict of interest exists and practices, such as, password sharing do not occur.
15. Review whether Stationery (dividend/ redemption warrants, etc.) and PDC management is properly access controlled and issues and receipts are properly documented. Review controls in place for Returned Undelivered (RUD) stationery.
16. Review RTA near site and far site DR arrangements to ensure that its BCP/DR program is adequately robust to continue operations without disruptions in case of exigencies.
17. Review of Information Security Controls (Refer Chapter on Information Technology)
18. Regulatory Reporting, Reconciliations, Investor/ distributor master database (Refer Chapter on Compliance and Risk Management and refer Chapter on Banking Operations and Reconciliation for more details in this regard)

Key Risks

Particulars	Risk Type
Non-compliance with regulations due to incorrect or delayed processing of financial and non-financial transactions	Compliance/Operations/Reputational
Leakage of Investor data by RTA	Compliance/ Reputational
Unreliable or incomplete MIS leading to incorrect reporting to AMC/ Trustees/ Regulator	Compliance/Operations/Reputational
Fraud arising from unauthorized changes to investor bank accounts leading to wrong payments.	Compliance/ Operational/ Financial/ Reputational
Information Security Risk	Compliance/ Financial/ Reputational

Internal Audit Checklist

S. No.	Particulars	Remarks
Registrar & Transfer Agent Operations		
1.1	<p>Verify whether policies and procedures have been laid down or Manuals have been prepared and put in place for:</p> <ul style="list-style-type: none"> ▪ Turnaround time (TAT) for various activities ▪ Maker-checker (manual and/ or system based) for various activities ▪ Creation and modification of Masters: <ul style="list-style-type: none"> ➢ Investor details (including bank accounts) ➢ Distributor details ➢ AMC details ➢ Scheme names and details ➢ AMC approved brokerage rates (including transaction charges for applications) ➢ Scheme-wise rates of dividends, record dates ➢ Rates to be considered for deduction of taxes at source ➢ Rates for STT ➢ Rates for GST ▪ Receipt of applications ▪ Mandatory minimum documents (incl. KYC, if applicable) and information to be received with the applications ▪ Time stamping and procedure to be followed in case of breakdown of time stamping machine ▪ Preliminary review of applications ▪ Observations/ exception reporting ▪ Rejection of applications ▪ Recording of applications and scanning of documents ▪ Receipt, recording and timely banking of 	

Internal Audit – Registrar and Transfer Agent (RTA) Operations

	<p>cheques, in case of receipt of physical instruments (and process of dealing and reporting of exceptions, if any)</p> <ul style="list-style-type: none"> ▪ Policy for receipt, storage, scanning and dispatch of different kinds of documents. ▪ Receipt and delivery of courier and recording of the same including undelivered returns ▪ Functions and activities at the AMC branch/ RTA branch ▪ Inward and outward registers ▪ Printing and stationery register ▪ Fixed assets register ▪ Registers in compliance of statutory requirements (such as, Labour laws, Shops and Establishment Act, etc.) 	
1.2	Verify whether the Manuals and Policies and Procedures are reviewed and updated periodically.	
Investor Services Centre (ISC) - Front Office (AMC Branch/RTA Branch)		
2.1	Verify whether the procedure of receipt of investor application for purchase, redemption, switch, servicing requests, etc. is carried out properly.	
2.2	Verify whether inward entry (affixing of date and time stamp) is available on the application received.	
2.3	Verify whether the applications are pre-screened at ISC prior to their acceptance.	
2.4	Verify whether the process of dispatching of applications is understood and verified.	
2.5	Verify whether all the financial transactions, such as, purchase subscription/ redemption/ switch are duly dated and time stamped (date and time stamp should be mandatory for updation in the system).	
2.6	Verify whether time stamp affixed across locations are correct and consistent and reviewed periodically.	
2.7	<p>Verify whether the following controls are in place:</p> <ul style="list-style-type: none"> ▪ Opening and closing running Date and Time 	

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	<p>Stamping Machine (DTSM) serial numbers are captured and reviewed</p> <ul style="list-style-type: none"> ▪ DTSM machines are kept under safe custody ▪ No application has more than one date and time stamp. 	
2.8	Whether DTSM and any other mode of receiving investor applications are properly configured to provide correct date and time output.	
2.9	Whether instances of break down/ servicing of the DTSM have been recorded by the Front Office.	
2.10	Whether a manual register is maintained to capture the time in case of breakdown of DTSM.	
2.11	Whether the guidelines stipulated by the AMC are duly adhered to in case of breakdown of DTSM at AMC or RTA branches.	
2.12	Whether all mandatory documents are collected at the time of accepting the financial and non-financial application/ requests (a checklist for mandatory documents should be kept at the centers).	
2.13	Whether KYC/ IPV (in-person verification) procedures using eSign and online verification methods comply with SEBI Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/73 dated April 24, 2020.	
2.14	Whether all the applications received across AMC branches/ ISCs are scanned and uploaded into the system after capturing the basic investor details.	
2.15	Whether cheques received are deposited on time for realization.	
2.16	Whether quality checks are performed on applications at Front Office after acceptance at the counter and documented.	
2.17	Whether Front Office rejections are properly recorded and rejected applications are returned to investors.	

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2.18	Whether successful/ rejected applications are duly communicated to investors over the counter, or via e-mail/SMS.	
2.19	Whether complaints received at Front Office are duly acknowledged, recorded, resolved and communicated to investor.	
2.20	Whether all the original documents are dispatched to the RTA Head Office.	
2.21	Whether all the applications reported during the day are reconciled with the number of applications scanned and sent at RTA Head Office.	
Purchases/ Subscription Application		
3.1	Whether documents viz. Application, KYC, cheque copy, bank mandate, documents required for investments based on investor tax status, etc. are available in the RTA system for purchase transactions.	
3.2	Whether RTA systems have appropriate boundary conditions set to accept applications only as per SID of the respective schemes.	
3.3	Whether there is a process of verification of investor signature before processing of purchases/ subscriptions (where physical requests are received)	
3.4	Whether mechanisms/systems exist at RTA to ensure that all KYC/AML guidelines are properly adhered to.	
3.5	Whether allotment of NAVs is ensured as per SEBI Circular (guidelines for NAV for applications above and below Rs. 2 lakh each).	
3.6	Whether refund in respect of rejected applications have been made (where applicable) as per SLA agreed with RTA and interest is paid on delayed refunds in compliance with the regulations.	
3.7	Whether a mechanism is in place to segregate direct investments from those introduced by distributors.	

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3.8	Whether completion checks are carried out for all time stamped transactions on a daily basis.	
3.9	Whether Quality Check process is implemented by RTA to ensure correctness of applications being processed.	
3.10	Whether a process is in place to identify missed transactions for necessary remediation action.	
3.11	Whether a process is in place to: <ul style="list-style-type: none"> ▪ Identify and resolve split transactions ▪ Identify and reject third party payments (i.e. payment for a purchase/ subscription application is made by person other than the applicant) ▪ Identify and reject investments made by minor unless the investment is submitted and executed by the minor's legal/ natural guardian along with relevant documentation. 	
3.12	Whether all purchase transactions initiated on or after July 1, 2020, are subjected to stamp duty (such as one time purchase, SIP, STP-in {including for registrations prior to July 1, 2020), switch-in and dividend reinvestment, dividend transfer plan) Whether stamp duty is at appropriate rates, i.e. at 0.005% on purchase transactions and at 0.015% on transfer of mutual fund units (such as transfers between demat accounts) (Notification No. S.O. 4419(E) dated December 10, 2019, and notification dated March 30, 2020 issued by the Department of Revenue, Ministry of Finance, Government of India).	
New Fund Offer (NFO)		
4.1	Whether NFO applications are processed in adherence with the AMC/SEBI guidelines.	
4.2	Whether reports are submitted to AMC as envisaged in the regulations.	

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4.3	Whether refund for un-allotted units is paid within the timeframe specified in SEBI guidelines, along with interest for delay in payment of refund (if any).	
Systematic Transactions (SIP/ STP/ SWP)		
5.1	Whether SIP/ SWP/ STP registration process complies with SLAs agreed with RTA and in compliance with specific scheme requirements.	
5.2	Whether SIP/ SWP/ STP scheduled transactions are executed as per SLA agreed with the RTA and in compliance with specific scheme requirements.	
5.3	Whether there is a process of verification of investor signature before processing of Systematic transactions (where physical requests are received)	
5.4	Whether cessation of systematic transactions is done in compliance with investor request as well as business rules agreed with the RTA.	
5.5	Whether RTA Front Office/ Back Office have a mechanism to carry out completeness checks on systematic applications received and registered/ executed.	
5.6	Whether remediation files are prepared for deficiencies in the SIP application forms and resolved accordingly.	
5.7	Whether PDC for SIPs provided by investor are entered in the system and maintained in safe custody.	
5.8	Whether ECS SIP mandates are sent to third party for bank registration.	
5.9	Whether RTA exercises all checks necessary to comply with regulatory/ AMC requirements related to SIPs registered for minors.	
5.10	Whether procedures related to SIP Pause requests from investors are processed in the manner and within timelines envisaged in the regulations/ AMC SLAs	

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5.11	Whether SIPs are registered in compliance with eKYC/ PAN Exempted KYC Reference Number (PEKRN) requirements, where applicable.	
5.12	Whether all new systematic transactions reported by ISCs/ AMC branches/ channel partners/ web applications are subjected to reconciliation and completeness checks.	
5.13	Whether stamp duty is levied from July 1, 2020, on all SIP and STP transactions (including for registrations prior to July 1, 2020) and demat account transfers at appropriate rates.	
Channel/ Exchange Transactions		
6.1	Whether bank mandate is separately recorded in the system and sent in original/ scanned copies as per requirement for channel, online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET-Money, etc.	
6.2	Whether reverse feed is obtained from all channel partners/ banks/ service providers and imported in the system. Verify whether there is a check to identify offline transactions replicated channels, online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET-Money, etc.	
6.3	Whether RTA systems ensure communication to investors of acceptance or rejection of SIP.	
6.4	Whether system report on registration with reverse feeds pending is generated and shared with AMC.	
6.5	Whether MFU SIPs with entry date prior to October 01, 2017 are rejected.	
6.6	Whether TATs are defined and adhered to for registration of SIPs through various platforms.	
Redemption		
7.1	Whether redemption request is available in the RTA system.	

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7.2	Whether KYC details are obtained and updated before processing redemption (in case of legacy investors where no PAN/ KYC data is recorded or for cases where KYC was done before the KRA era).	
7.3	Whether correct NAV is considered for all redemptions	
7.4	Whether interest is paid on all delayed redemptions beyond 10 working days in compliance with SEBI guidelines	
7.5	Whether appropriate STT and exit loads have been charged on redemptions.	
7.6	Whether appropriate tax has been deducted at source on redemptions, where applicable.	
7.7	Whether instant redemption transactions are executed as per the regulatory requirements	
7.8	Whether there is a process of verification of investor signature before processing the redemptions (where physical requests are received). Whether safeguards for authorised signatory of corporate investor are exercised to ensure that, in case of redemption requests, it is the same as authorised signatory records maintained by RTA.	
7.9	Whether there is a process to identify the unclaimed redemptions and periodically transfer these to designated unclaimed account.	
7.10	Whether mechanism exists to validate requests for unclaimed redemptions and make payment after proper verifications. Whether redemption instrument revalidation process is in place (where physical cheques are issued).	
Marking/ Removal of Lien		
8.1	Whether lien is marked in a timely manner on receipt of order/ notice from statutory/ regulatory/ government agencies.	

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8.2	Whether lien is marked/ removed in compliance with the business rule and in compliance with the statutory/ regulatory/ government agency communication.	
8.3	Whether there is a maker-checker process of marking and release of lien.	
Dividend Processing		
9.1	Whether proper rates of dividend are administered in the RTA system using appropriate maker-checker mechanisms.	
9.2	Whether mechanisms are in place to process dividend (pay-out as well as dividend reinvestments) in cases where transactions are backdated (missed transaction processing).	
9.3	Whether dividend processed in a timely manner.	
9.4	Whether stamp duty is levied from July 1, 2020, on all dividend reinvestments and dividend transfer plans at appropriate rates. Whether appropriate tax has been deducted at source (TDS), where applicable.	
9.5	Whether the dividend warrant printing and dispatch is properly handled.	
9.6	Whether adequate safeguards are in place for dividend payments to be processed but withheld from release on lien marked/ folios on statutory hold, etc.	
9.7	Whether unclaimed dividend is identified as stipulated in the SEBI guidelines and reports are provided to AMC for movements in unclaimed dividend.	
9.8	Whether mechanism exists to validate requests for unclaimed dividend and make payment after proper verifications. Whether dividend instrument revalidation process is in place (where physical cheques are issued).	

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9.9	Whether delayed dividend payment is made along with interest.	
Distributor Commission		
10.1	Whether mechanism exists for coordination with AMFI to update RTA systems with details of distributors empanelled and the de-empanelled in a timely manner to ensure commission is paid/ withheld appropriately.	
10.2	Whether RTA timely communicates with de-empanelled distributors as and when they are de-empanelled.	
10.3	<p>Whether RTA systems have robust controls to manage:</p> <ul style="list-style-type: none"> ▪ updates to commission structures as communicated by AMC. ▪ claw back of commission as per regulatory requirements and standard business practice. ▪ proper remediation of Employee Unique Identification Number to employees of distributors (i.e. AMFI Registration Number or ARN holders). ▪ documentation and controls for KYD process. ▪ control over commission on distributor's own investments. ▪ process of consolidation/ merger of brokers, ▪ process of identification of transaction charges to be paid, based on distributor's opt-in/ opt-out selection. ▪ withholding of commissions due to non-submission of distributor self-declaration, ARN expiry, etc. 	
10.4	Whether mechanisms are in place to ensure that commission is computed accurately.	
10.5	Whether tagging for T-30 cities is done properly in the RTA system in line with the SEBI/ AMFI guidelines.	

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10.6	Whether controls are in place to ensure that no commission/ transaction charge is paid except where the distributor has selected the opt-in option.	
10.7	Whether the brokerage pay-outs have been properly handled (net of claw backs).	
Non-Financial Transactions (NFTs) & Investor Servicing		
11.1	Whether NFTs are processed as per the requests received and appropriately classified.	
11.2	Whether RTA systems have maker-checker control for processing all non-financial transactions, including proper investor verification and authentication.	
11.3	Whether mechanisms are in place for performing completeness checks on NFTs received from various channels, such as, physical, e-mail, call centers, online portals of AMC, RTA, MFU and all digital platforms, such as, PayTM, ET-Money, etc.	
11.4	Whether transmission requests are subjected to rigorous controls to ensure that they are processed accurately and to prevent risk of fraud or litigation arising from inappropriate processing.	
11.5	Whether revalidation of dividend and redemption is done according to the defined business rule.	
11.6	Whether adequate safeguards are exercised while handling change of bank mandate requests to prevent fraud.	
11.7	Whether proper controls including KYC checks are in place while handling requests for minor attaining majority status.	
11.8	Whether adequate safeguards are in place while accepting requests for changes in investor signature before processing.	
11.9	Whether all NFTs are processed based on mandatory documents listed along with adequate maker-checker controls.	

Internal Audit – Registrar and Transfer Agent (RTA) Operations

11.10	Whether MIS on NFTs is reliable, accurate, complete and shared in a timely manner with AMC management for appropriate review and action.	
Investor Communications		
12.1	<p>Whether adequate controls are in place to ensure that communication is sent to the investors for each request received and processed and all transactions at appropriate stages. For example:</p> <ul style="list-style-type: none"> ▪ All FT and NFT requests at initiation, acceptance, rejection and completion stages. ▪ Special NFTs, such as, transmission at every stage, where an event has occurred from initiation to completion. ▪ Automatic transactions, such as, systematic transactions during registration, acceptance and rejection stages, instalment trigger dates, transaction success or failure status, de-registration and term expiry stages. ▪ Communication on transactions, such as, scheme closure, consolidation, roll over, etc. 	
12.2	Whether Statement of Accounts/ annual statements/ CAS is sent to all investors periodically in line with the regulatory requirements.	
12.3	Where there are returns of the Statement of Accounts (either through email bouncing and/ or through physical returns due to absence of completion of delivery to investor), whether appropriate remedial action is taken for the same and notations of such returns and remedial actions are recorded properly.	
12.4	Whether investor complaint/ service management system is in place.	
12.5	Whether all investor complaints/ requests are received and processed through the investor	

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	complaint/ request management system and resolved correctly.	
12.6	Whether all the service Turnaround Time (TAT) are agreed with AMC and defined in the system.	
12.7	Whether all the necessary documents are obtained before processing the investor complaints/ request.	
Logical Access Management		
13.1	Whether access provided to users on RTA systems as mapped according to the hierarchy, is in line with individual roles and responsibilities and is reviewed periodically.	
13.2	Whether sharing by RTA users of User IDs and Passwords is strictly restricted.	
13.3	Whether there is a process of compulsory change of passwords at periodical intervals.	
Management Information System (MIS)		
14.1	Whether MIS as per the agreed schedule of SLA is sent to the AMC.	
14.2	Whether reports are systemically generated and maker-checker control is built in the system.	
Record Retention & Maintenance		
15.1	Whether all data and documents related to requests and complaints is properly maintained and archived for easy retrieval.	
15.2	Whether all such records are retained for duration in accordance with regulatory requirements.	
15.3	Whether follow-up with front offices is ensured for original documents.	
15.4	Whether there is a procedure for the periodical review of the stored documents and records to ensure its existence, availability and retrieval.	

Internal Audit – Registrar and Transfer Agent (RTA) Operations

Cash Management Service/ PDC Management		
16.1	Whether Post Dated Cheques (PDCs) are stored in a secured manner under lock and key accessible to the assigned users.	
16.2	Whether keys of the safe custody are accessible to designated/ authorised personnel only.	
16.3	Whether agreement is in place with the vendor for collecting and banking the PDC Cheques.	
16.4	Whether mechanism is in place to ensure hand over of PDCs only to persons authorised for instrument pick-up and banking.	
16.5	Whether the acknowledgement received for the PDCs handed over is checked and stored properly for future retrieval, if required.	
16.6	Whether there is a process to ensure periodical verification of PDCs.	
Stationery		
17.1	Whether dividend, redemption, brokerage and purchase return warrants are adequately stored.	
17.2	Whether stock movement reports are maintained and timely updated. Whether stock movement reports are maintained and timely updated.	
17.3	Whether Returned Un-Delivered (RUD) warrants are recorded and stored appropriately and followed-up.	
Business Continuity Planning and Disaster Recovery (BCP and DR) Plan		
18.1	Verify preparedness of Fund Management and Dealing teams to support business continuity.	
18.2	Verify their participation in mock BCP/DR drills.	
18.3	Verify whether special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	

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18.4	Verify transactions to determine that business disruption is minimised.	
18.5	Verify documentation on back-up plan, in case Fund Manager is not available or unable to perform his duties due to exigencies.	
18.6	Whether BCP/ DR policy is defined for RTA operations and records all critical applications and processes.	
18.7	Whether downtime in the event of a disaster is recorded along with plan of action.	
18.8	Whether offsite, near site and far site data storage facilities are in place and are tested for availability periodically.	
18.9	Whether tests are conducted as per defined frequency and results are documented.	
Centralised Processes at RTA		
19.1	<p>Whether RTA has mechanisms and controls in place to:</p> <ul style="list-style-type: none"> ▪ authenticate and validate investor KYC, PAN and UBO (Ultimate Beneficial Owners). ▪ track and report compliance with Foreign Account Tax Compliance Act (FATCA)/ Common Reporting Standard (CRS). ▪ track investors for matches with sanctions listings declared under United Nations Security Council (UNSC)/ Unlawful Activities Prevention Act (UAPA). ▪ report suspicious transactions and persons matching the sanctions list. ▪ train its personnel. ▪ track whether NISM trainings/certifications are monitored for personnel handling RTA operations. 	

Internal Audit – Investor Servicing

Background

13.1 Investor servicing or customer servicing means the support provided to investors or customers before and after they invest in or buy products. In the past, choice of products was based on type of products offered and the performance of products. However, now the overall customer experience is also a consideration for deciding the product to buy. A good customer support makes a wonderful customer experience. Customer support is looked at as a business strategy as it is expected to give the customer satisfaction, ensure brand loyalty and word of mouth marketing.

Investor satisfaction in any business plays a vital role in the success and growth of the company. Investor servicing in a mutual fund business starts when the investor shows interest to invest in a mutual fund scheme. Investor servicing involves providing investors with an accurate account of mutual fund products, its operations, etc. This helps the retail and institutional investors to make an informed decision on whether to invest in the Mutual Fund. Investors can find the name of the contact person in the SID, of the Mutual Fund or in the branches or on the website of AMC whom they can approach in case of queries, complaints or grievances. If the complaints remain unresolved, the investors may approach SEBI for facilitating redressal of the complaints. SEBI also offers a platform which investors can access online to record their complaints or grievances. This platform is called SEBI Complaints Redressal System (SCORES). SEBI takes up the matter with the concerned Mutual Fund to provide adequate redressal of investor complaints.

Following are the various media through which investors can contact the Mutual Fund House:

- Walk-in at any Branch
- Sending e-mails to the e-mail address specified on website, SID, etc.
- Sending letters to the address available on website, SID, etc.
- Telephonic calls to the corporate office or branches or call center. Mutual Fund house may also use RTA's call center services for investor servicing.

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- Write to the Mutual Fund House by connecting through social media platforms.
- Use digital technologies, such as, web portal or applications, chat bots, google assistants, whatsapp, text, messaging services, if any, provided by the AMC.

Activities in Investor Servicing

13.2 Activities as covered in Investor servicing are as following:

- Maintaining a comprehensive web portal of the AMC/ mutual fund covering various aspects such as, corporate profile, information on key personnel, financial reports, forms, factsheets giving fund information, addendums, NAVs, policies to be disclosed, such as, privacy policy, voting policy, other regulatory disclosures, ways to invest, how to register, information about mutual fund schemes, compliance requirements, such as, Foreign Account Tax Compliance Act (FATCA), Ultimate Beneficial Owner (UBO), KYC requirements, etc., SIDs, contact details of the AMC, etc.
- Co-ordination with RTA to ensure processing of financial and non-financial transactions within the agreed turn-around time (TAT).
- Attend to investors and understand their queries, requests, grievances and complaints and handle investor queries, requests, etc. received through AMC branches, call centers, social media platforms.
- Report the number of customer complaints received and ageing of those complaints including resolution to SEBI.
- Send appropriate and timely communications, such as, physical letters, electronic communication, such as, e-mail, SMS, etc. to investors
- Conduct investor awareness programs to attract prospective investors to invest in mutual funds.
- Maintain records of the investor queries, requests, grievances, complaints, etc. with proper classification.
- Follow-up and resolve investor queries, grievances, complaints, etc

Internal Audit – Investor Servicing

Key Risks

Particulars	Risk Type
Inadequate disclosure of information relating to investor servicing	Compliance/Operational/Reputational/Financial
Absence of documented procedures to appropriately handle investor servicing	Operational
Investor servicing staff do not hold valid NISM certification	Compliance/Operational
Absence of recording/ audit trail of investor requests, queries, grievances, complaints, etc.	Compliance/Operational/Reputational/Financial
Delay in resolving investor queries and complaints	Compliance/Operational/Reputational
Absence of investor awareness programs	Compliance/Operational
Lack of co-ordination with RTA for appropriate resolution of queries and complaints	Compliance/Operational/Reputational/Financial
Absence of appropriate and timely communication to investors	Compliance/Operational/Reputational

Internal Audit Checklist

Sr. No.	Particulars	Management Comments
Investor Service Manual		
1.1	Verify whether investor service manual is in place and approved by designated authority and reviewed on a periodic basis.	
1.2	Verify whether the manual is version controlled and available to all the staff members of the Investor Service department including those at branches.	

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Review of SLAs		
2.1	Verify adherence with terms mentioned in SLA with the service provider, such as, call center with specific reference to agreed deliverables, turnaround time, fees charged, etc. for investor servicing.	
Investor Servicing through Digital Technology and Branch		
3.1	Verify whether the digital technologies of the AMC provide the required information including information relating to AMC officials, financial reports, ways to invest, etc.	
Handling Customer Requests		
4.1	Verify whether the investor requests, queries, grievances, complaints, etc. (including those received through SEBI SCORES platform) are appropriately recorded.	
4.2	Verify whether appropriate and timely follow-up is done with RTA in order to ensure resolution of investor requests within TAT. Verify whether timely escalations are performed for TAT delays.	
4.3	Verify whether investor requests, complaints etc. (including those received through SEBI SCORES platform) are appropriately classified and resolved timely.	
4.4	Verify whether legal cases, if any, are handled appropriately in co-ordination with the Legal team.	
4.5	Review whether appropriate instructions are provided to the RTA for restricting operations in investor account to comply with a legal notice received from Court or from any statutory authority.	
4.6	Verify whether appropriate procedures are in place to monitor the monthly reports received from RTA on customer queries, requests, complaints etc. and to report to senior management at a set frequency.	

Internal Audit – Investor Servicing

4.7	Verify whether Trustees periodically review investor complaints and the redressal of the same by the AMC.	
Compliance with Regulatory Requirements		
5.1	Verify whether investor servicing staff at corporate office or at branches or at call center possess valid NISM certification.	
5.2	Verify whether expiry of NISM certification for employees is monitored by the AMC and such employees are accordingly notified in advance to renew the same.	
5.3	Verify whether appropriate disclosures including details of investor complaints are made as required by SEBI for investor servicing.	
Investor Communication/ Awareness Programs		
6.1	Verify whether timely and appropriate investor communication (electronic or physical) is sent to investors. Note: Generally, investor communication is taken care of by AMC (if invested using AMC's online platforms) or through RTA. (Refer Chapter on RTA Operations for details.)	
6.2	Verify whether investor awareness programs are conducted for educating investors about mutual fund products.	
Business Continuity Planning (BCP) and Disaster Recovery (DR) Plan		
7.1	Verify preparedness of Investor Servicing department to support business continuity.	
7.2	Verify their participation if any in mock BCP/DR drills.	
7.3	Verify if special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
7.4	Verify transactions to determine that business disruption is minimised.	

Chapter 14

Internal Audit – Compliance & Risk Management

Background

Compliance

14.1 The key role of a compliance team is to help to mitigate compliance risks, including material loss, financial loss, or loss of reputation that a Company may suffer as a result of its failure to comply with laws, regulations, rules, industry standards and codes of conduct applicable to its activities. Compliance is everyone's responsibility.

The 2008 financial crisis led to increase in regulatory scrutiny and regulations. This caused financial sector to increase the role of the compliance department from advisory to risk management and monitoring.

Compliance Officers in Compliance department are responsible for working with management and staff to identify and manage regulatory risk. Their objective is to ensure that an organization has effective internal controls that adequately measure and manage the risks it faces. Compliance officers provide an in-house service that effectively supports business areas in their duty to comply with relevant laws and regulations and internal procedures.

Compliance team is independent of any commercial or administrative function. Compliance team is provided full access to company's systems, employees, books and records that they deem fit necessary to carry out their duties. Other staff is expected to cooperate with the Compliance department in an open and honest way and not to obstruct compliance staff in their work. Compliance Department has the right to start an investigation at its own and escalate material issues to management and the Boards.

Risk Management

14.2 SEBI Circular No. MFD/CIR/15/19133/2002 dated September 30, 2002 requires Mutual Funds to implement the Risk Management System, progress of which is to be reviewed by the Board of AMC and Trustees. Further, the review of Risk Management Systems shall be a part of internal audit and a report thereon shall be placed before the Board of AMC and

Internal Audit – Compliance & Risk Management

Trustees who shall make comments on the adequacy of systems quarterly and half-yearly. Compliance reports may be filed with SEBI.

Key Internal Audit Areas

14.3 Following are key areas involved in the internal audit of Compliances and Risk Management functions for mutual fund:

1. Adherences to Mutual Fund Regulations, circulars, AMFI guidelines and internal norms.
2. Employee Trading Guidelines:
 - Monitoring of employee dealing guidelines; reporting to trustees any deviations as per Regulation 25(9) of (Mutual Fund) Regulation 1996.
 - Review of the process and records for designation of staff as “Access” and “Designated” persons in accordance with the SEBI guidelines.
 - Compliance of applicable policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades by connected/ covered persons in their personal capacity and the implementation of the SEBI Guidelines.
 - Periodical reports to the Board of Directors of AMC and Trustee Company at such frequency as may be decided by the Boards but not less than once in a year.
 - Approval and review of compliance of these guidelines by the Board of AMC and Trustee Companies.
 - Reporting of violations by any connected/ covered Person to Board of AMC, Trustee Companies and SEBI.
 - Prior approval from the Compliance Officer to be obtained by the Access Persons and Designated Persons for sale/purchase of securities other than for those exempted.
 - Review of details of transactions in investments covered under the Guidelines to be reported by all Covered Persons within 7 calendar days from the date of transaction.
 - Compliance by AMC staff with the requirement of annual certification of broker accounts, holdings and policy certification.

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- The Compliance Officer shall report to the Trustees all transactions done by the trustees or the employees or directors of the AMC or the trustee company in the investee companies (Regulation 49T of SEBI MF Regulations).
3. Adherence to Compliance and Risk Manuals and SOPs; review of SLA terms with various service providers.
 4. Review of Investment restrictions (Seventh Schedule of MF Regulations), investment decision-making, and recording of investment decisions.
 5. KYC norms and applicability of Prevention of Anti Money Laundering Act, 2002; submission of Cash Transaction Report (CTR) and Suspicious Transaction Report (STR).
 6. Compliance Manuals:
 - Approval of Manuals and Policies by appropriate authorities.
 - Compliance Manual, Operation Manual, Advertisement Manual, IT System Manual, Customer Service Manual, Dealing Room Access and Monitoring Policy, Voice Call Recording and Monitoring Policy Risk Management Manual, Investment Policy, Valuation Policy, Employee Dealing Policy, etc. should be approved by the appropriate authorities.
 - Conduct yearly updates of SOPs which should be approved/ noted by appropriate authorities.
 7. Investment Committee: Members and Constitution, Number of Meetings, Recording of Minutes and Recommendations.
 8. Delegation of authority to be approved by the Board of AMC.
 9. Amendments to the Company policies, if any, as approved by Board or noted by Board or in any manner as authorized by the Board/ Audit Committee.
 10. Front Office and Back Office segregation of duties (including deployment of requisite skilled manpower, investment system and infrastructure to Back Office commensurate with Front Office).
 11. Adherences to the Advertisement Code; AMC and all intermediaries of the fund abide by the Code of Conduct.
 12. Employees engaged in marketing and distribution should have obtained appropriate certification from AMFI as required by SEBI.

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13. Risk Management System as per SEBI Circular MFD/CIR/15/19133/2002 dated September 30, 2002. It includes risk policy approvals by the AMC and Trustee Board, e.g., risk procedures for investment, operational and business risks assessments, DR/BCP set ups; risk/ investment committee set ups and meetings; reporting to Board/ Audit committee; other compliance with risk management, circular of SEBI and ongoing updation.
14. Verifying whether the company is carrying out appropriate and adequate investor profiling.
15. Verifying the maintenance and adequacy of data security system.
16. Verifying whether source codes for software are maintained and updated.
17. Verifying whether the company has access/available to the data lying with RTA and Custodian.
18. Whether outstanding observations of previous audit reports from the SEBI Inspections or any other external reviews by regulators or external parties are followed up and implemented.
19. Empanelment of brokers (by Back Office):
 - Procedures/ criteria (as stipulated in Investment Policy) for Broker appointment by Back Office, dealing with Front Office and Review/ monitoring by Mid-Office.
 - Business-wise spreads, ceiling per broker (as stipulated in MF Regulations).
 - Executing of Legal Agreement with Brokers for empanelment covering terms and conditions of brokerage business (in a standard format).
 - Suspension of brokers based on action taken by regulator and exchanges.
20. Inter-scheme transfers:
 - Recording rates and times of Inter-scheme transactions.
 - Approval and authorization.
 - Reporting to trustees.

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21. Verification of periodic reports for accuracy, content, format and timeliness before submission to Trustees and Regulators.

22. Submission of information and reports sought by regulators from time to time which includes:

S.No.	Nature of Report	Frequency
1.	Monthly Compliance Report (MCR)	Monthly
2.	Deployment of Funds Mobilized	Monthly
3.	Bank's contribution to AUM	Monthly
4.	Monthly data request: <ul style="list-style-type: none"> • Percentage of AUM of your fund invested in securities issued by banks. • Percentage of AUM of your fund held by Institutions/ Corporates/ HNIs/ Retail Investors/ Banks. • AUM of debt oriented funds and downgrades. (Due date reduced from 9 days to 5 days from Dec 2015 onwards) 	Monthly
5.	Data on Branches, Investor Education and Cash Investments	Monthly
6.	Data on SIPs, B-30 AUM and Direct Investments	Monthly
7.	New Scheme Report in soft format	Monthly
8.	Compliance Report by AMC to Trustees	Bi-Monthly
9.	Compliance Test Report (CTR)	Bi-Monthly
10.	Investments by Sponsors/ Associates/ Group Companies	Quarterly
11.	Percentage of Assets Under Management (AUM) from City Clusters	Quarterly
12.	Ageing Analysis of Assets by AUM	Quarterly
13.	Number of Branches	Quarterly
14.	IMF Data Gap Initiatives-FSI data on OFCs	Quarterly
15.	Half Yearly Financial	Half Yearly

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16.	Half Yearly Financial (new format for publishing) New Format also to be displayed on website.	Half Yearly
17.	Details of Scheme-wise portfolio to be sent to all unit holders - Not to be sent if published with above Filing with SEBI	Half Yearly
18.	Advertisement of half yearly financial results (new format) in 1 English daily & in a newspaper in the language of the region where the Head Office of the MF is situated	Half Yearly
19.	Change in interest of directors in other companies	Half Yearly
20.	Annual Statistical Report	Yearly
21.	Annual Service Fees	Yearly
22.	Filing fees for SID and placement memoranda: 0.005% per cent of the amount raised in the new fund offer or by way of private placement, as the case may be, subject to a minimum of rupees two lakh (to be paid at the time of filing draft SID) and a maximum of rupees fifty lakhs.	As and when required
23.	Filing of Annual Report including details of investments and deposits and scheme-wise portfolio of the Mutual Funds.	Yearly
24.	New scheme report	As and when required
25.	Mutual Funds, exposure data in debt segment	Monthly
26.	System Audit Report	Annually
27.	Reporting for Artificial Intelligence (AI) and Machine Learning (ML) applications and systems	Quarterly
28.	Information on cyber trends	Quarterly

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Key Risks

Particulars	Risk Type
Non-compliance with regulatory requirements	Compliance Risk/ Reputational Risk
The Compliance Risk Assessment and Monitoring Program is not commensurate with the size and nature of business of the entity resulting in regulatory compliance failures and penal fines/ censure.	Compliance Risk/ Reputational Risk
Compliance breaches, serious incidents, complaints are not identified, escalated and reported in a timely manner.	Compliance Risk
Delays or errors in regulatory reporting or internal reporting to Board of Directors/Trustees/Senior management	Compliance Risk
Lack of qualification, experience, adequate training, independence, authority and/ or access to information/ resources to enable the Compliance team to perform their functions	Compliance Risk
Lack of guidance due to incomplete/outdated compliance manuals.	Compliance Risk/ Reputational Risk

Internal Audit Checklist

S.No.	Particulars	Remarks
Employee Trading Guidelines		
1.1	Verify whether Compliance Officer has been appointed and his/her role and responsibilities have been documented to ensure compliance with the Guidelines on Personal Investments/ Trading in Securities by Employees.	

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1.2	Verify whether employee dealing policy, code of conduct, do's and don'ts to prevent conflict of interest between the transactions of the employees and the mutual fund are in place; whether these cover atleast the minimum guidelines laid down by SEBI in respect of investment/ trading in securities by employees of AMCs and Mutual Fund Trustee Companies and these have been approved by the Board of AMC and the Trustee Company.	
1.3	Verify whether the employee dealing policy contains Chinese wall procedures.	
1.4	Verify whether the employee dealing policy is shared with the employees (including contract staff, if applicable) and adequate training provided at regular periodicity as decided by the Management.	
1.5	Access and Designated Persons: Verify whether the employees are correctly identified and classified as "Access" and "Designated Person" as per the Guidelines.	
1.6	Verify compliance with the employee dealing policy.	
1.7	Verify whether Compliance Department is maintaining records of all pre-clearance requests, approvals, reports, holding statements and declarations connected with the Employee Dealing Policy.	
1.8	Verify whether prior approval is obtained from Compliance Officer by the Access and Designated Persons for sale/ purchase of applicable securities by submitting a preclearance request in a prescribed format. Verify whether the trades done by the Compliance Officer or his immediate relatives, as insiders are	

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	approved by the approved authority i.e. board of directors of the company/ Head of the AMC.	
1.9	<p>Contra Trades:</p> <ul style="list-style-type: none"> ▪ Verify whether the code of conduct specifies the period, which in any event shall not be less than six months, within which a designated person who is permitted to trade shall not execute a contra trade. ▪ Verify whether compliance officer is empowered to grant relaxation from strict application of such restriction, reasons for granting relaxations are recorded in writing provided that such relaxation does not violate these regulations. ▪ Verify whether a contra trade is executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade is liable to be retained for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the SEBI Act. <p>Note: Contra trade may be construed as opposite trading or reversal of the actual position.</p>	
1.10	Verify whether shares have not been pledged by the employees or companies to ensure compliance with SEBI (Prohibition of Insider Trading) Regulations, 2015.	
1.11	Confirm that the waiver requests are accompanied by adequate explanations as permitted by the guidelines and waivers are approved as per internal policies. Also confirm that the waivers have been reported to the Board/ Trustees and the actual transactions are reported by the employees within 7 calendar days.	
1.12	Verify whether any penalty has been imposed on	

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	employees during the period in case of insider trading.											
1.13	Verify whether the violations by any connected/ covered person are timely reported to the Board of Directors of the AMC.											
1.14	Verify whether the Boards of the AMC and Trustee companies review compliance of the guidelines in their respective meetings, while reviewing the existing procedures and recommending changes, if required.											
1.15	Ensure that a periodic disclosure is submitted to the Compliance Officer/ Department for the following:											
	<table border="1"> <thead> <tr> <th>Transaction</th> <th>Due date for reporting</th> </tr> </thead> <tbody> <tr> <td>a) Purchase/ Sale of securities including Mutual Fund Units (excluding units of money market mutual fund schemes) (SIP to be reported only at the time of the first installment).</td> <td>7 calendar days from transaction</td> </tr> <tr> <td>b) Transactions in rights entitlements through the secondary market.</td> <td>7 calendar days from transaction</td> </tr> <tr> <td>c) Details of allotment received in Public/ Rights issue.</td> <td>7 calendar days from the receipt of allotment advice</td> </tr> <tr> <td>d) Annual Broker Accounts Certification.</td> <td>April 30</td> </tr> </tbody> </table>	Transaction	Due date for reporting	a) Purchase/ Sale of securities including Mutual Fund Units (excluding units of money market mutual fund schemes) (SIP to be reported only at the time of the first installment).	7 calendar days from transaction	b) Transactions in rights entitlements through the secondary market.	7 calendar days from transaction	c) Details of allotment received in Public/ Rights issue.	7 calendar days from the receipt of allotment advice	d) Annual Broker Accounts Certification.	April 30	
Transaction	Due date for reporting											
a) Purchase/ Sale of securities including Mutual Fund Units (excluding units of money market mutual fund schemes) (SIP to be reported only at the time of the first installment).	7 calendar days from transaction											
b) Transactions in rights entitlements through the secondary market.	7 calendar days from transaction											
c) Details of allotment received in Public/ Rights issue.	7 calendar days from the receipt of allotment advice											
d) Annual Broker Accounts Certification.	April 30											

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	e) Annual Holdings Certification.	April 30		
	f) Annual Policy Certification on front running, contra trades, etc.	April 30		
Investment Compliance Checks				
2.1	Verify whether all the investment restrictions prescribed under the SEBI (Mutual Funds) Regulations, 1996 ('the Regulation') and SID have been set-up in the front-end trading system and on a timely basis. If the limits are not set-up in the front-end trading system, verify how these limits are being monitored by Compliance to ensure that all the investments are within the maximum limits specified under Seventh Schedule of SEBI (Mutual Fund) Regulations, 1996.			
2.2	Verify whether four eye control is in place to ensure that the regulatory and internal investment limits prescribed by Investment Committee or Board of Directors are accurately and timely set-up or updated in the front-end trading system for monitoring purposes.			
2.3	Verify whether a periodic user access review is performed to ensure that the access rights to set-up and update the existing investment limits in front-end trading system is restricted to Compliance team members responsible for monitoring the investment restrictions.			
2.4	Verify whether the system controls are operating effectively as designed to ensure that the regulatory limits set-up in the front-end trading system cannot be breached and overridden unilaterally.			
2.5	Verify whether a close-ended debt scheme has			

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	invested in a security, which matures on or before the date of the maturity of the scheme.	
2.6	Verify whether the active and passive breaches in the investment limits are duly reported to the Board of Directors of AMC and Trustees, Investment Committee and SEBI Regulator on a timely basis.	
Borrowings		
3.1	Verify whether schemes have borrowed money only to meet the temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders in accordance with Chapter VI of SEBI (Mutual Fund) Regulations, 1996.	
3.2	Verify whether borrowings are within the prescribed limits i.e. not more than 20% of the net assets of the scheme and verify if prior SEBI approval has been obtained for raising the borrowing limit in exceptional circumstances.	
3.3	Verify that the duration of such a borrowing shall not exceed a period of six months.	
3.4	Verify that the trustees have ensured that the borrowing is used as a measure of last resort and disclose in SID whether the mutual fund could borrow.	
3.5	Verify whether an agreement duly signed by the authorized signatories is available for all 'lines of credit' arrangements entered into by the AMC.	
3.6	Verify whether the cost of borrowings (interest) is borne by the Scheme to the extent of not exceeding the portfolio yield of the scheme and borrowing cost exceeding portfolio yield is borne by the AMC. (SEBI/HO/IMD/DF2/CIR/P/ 2019/42 dated March 25, 2019).	
3.7	Disclosure Requirements: <ul style="list-style-type: none"> ▪ Verify whether the scheme-wise balance sheet 	

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	<p>discloses the details of borrowings by the scheme with amount, rate of borrowings, rate of interest, source and other terms shown separately, source-wise.</p> <ul style="list-style-type: none"> ▪ Verify whether borrowings, if any, above 10 per cent of the net assets of any scheme of a mutual fund is disclosed in the 'notes to accounts' of the Half-Yearly Financial Statements. 	
Advertisement Policy		
4.1	<p>Verify whether Advertisement Policy is in place and the same is approved/ noted by appropriate authority within Sales and Marketing department and verify whether the same is in compliance with the Advertisement Code specified in Sixth Schedule of SEBI (Mutual Funds) Regulations, 1996.</p> <p>Prior to the release of advertisement, verify whether the advertisement material is reviewed and approved by the Compliance officer.</p>	
4.2	<p>Ensure that advertisement materials are not misleading or contain any incorrect or false opinion.</p>	
4.3	<p>Verify whether the Advertisement Policy is adhered to in all the cases.</p>	
4.4	<p>Verify whether adequate controls exist to ensure that marketing materials released are in compliance with the Advertisement Policy.</p>	
4.5	<p>Verify whether advertisements in respect of real estate and infrastructure debt mutual fund schemes conform to such guidelines as may be specified by the Board.</p>	
4.6	<p>Verify whether there are any celebrity endorsements and if yes, whether they comply with the guidelines issued in relation to celebrity endorsements.</p>	
4.7	<p>In case of advertisements, verify:</p> <ul style="list-style-type: none"> ▪ Pay out of dividends, 	

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	<ul style="list-style-type: none"> ▪ Returns by assuming reinvestment of dividends, ▪ Disclosure of performance related information. 	
4.8	Verify whether the SEBI guidelines have been complied with.	
Broker Appointment and Controls		
5.1	<p>Whether norms have been laid down for:</p> <ul style="list-style-type: none"> • empanelment of brokers • a process of periodic review to ensure that the brokers continue to meet the criteria of empanelment (like sending of audited financials and/ or net worth certificates every year) • Removal of brokers from the panel for not complying with the empanelment norms or in case of adverse market reports of the broker, involvement of the broker in malpractices, absence of proper service, etc. 	
5.2	Verify whether brokers are empanelled as per the norms approved by Investment Committee and minutes of the meetings retained.	
5.3	Verify whether if the trustees have laid down the criteria for empanelment of real estate brokers for the real estate mutual funds.	
5.4	Verify whether there are clear agreements with brokers on the brokerage percentage payable for the securities transactions.	
5.5	Verify whether a record is maintained of all the empanelled brokers with the checklist of the documents provided for empanelment and the approved rates of brokerage.	
5.6	Verify whether there is a process of monitoring securities transactions with the brokers and avoiding undue concentration of business with any broker.	

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5.7	Verify whether the approved brokerage rates have been correctly updated in the system for the purpose of acceptance of trades from the brokers.	
5.8	<p>Verify whether:</p> <ul style="list-style-type: none"> ▪ an AMC, has not, through any broker associated with the sponsor, purchased or sold securities, which is average of 5 percent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes for a block of any three months. ▪ an AMC, has not, through any broker (other than the broker referred to above) purchased or sold securities, which is average of 5 percent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes for a block of any three months unless the AMC has recorded in writing the justification for exceeding the limit of 5 percent and reports of all such investments are sent to the trustees and AMC Board of Directors on quarterly basis. 	
5.9	Review whether disclosures on brokerage paid to associates/ related parties/ group companies of sponsor/ AMC have been made in the unaudited half yearly financial results, the abridged scheme wise annual report and the SAI, in the format as prescribed (Regulation 25(8) and SEBI Circulars).	
5.10	Verify whether brokerage for services are paid to or payable to any entity in which the AMC or its major shareholders have a substantial interest (being not less than 10% of the equity capital), verify whether the amounts debited to the revenue account or amounts treated as cost of investments in respect of such services have been separately disclosed together with details of the interest of the AMC or its major shareholders.	

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Inter-Scheme Transactions		
6.1	Verify whether Inter-Schemes are done as per MF regulations and approved framework.	
6.2	Verify that inter-schemes are done at spot price or previous day market price as per MF Regulations.	
6.3	Verify that inter-scheme deals are approved by fund manager or dealer of both the schemes. If both schemes are handled by same fund manager then whether CIO has approved the Inter-Scheme deals.	
6.4	Check if the transferor scheme and transferee scheme have same investment objectives and documentation of rationale for valuation including inter scheme transfers shall be maintained and preserved by the AMC as per regulation 50 of these regulations to enable audit trail.	
6.5	Verify whether inter scheme deals are approved by Compliance Officer/ Compliance team.	
6.6	Verify that no brokerage or commission is paid by the schemes in connection with inter-scheme transactions.	
6.7	Verify whether all inter-scheme transactions as reported in bi-monthly Compliance certificates are submitted to the Boards of AMC and Trustees.	
6.8	Verify whether all Mutual Funds provide transaction details, including inter scheme transfers, of money market and debt securities on a daily basis to the agency entrusted for providing benchmarking yield/ matrix of spread over risk free benchmarking yield.	
6.9	Verify whether AMC discloses all details of debt and money market securities transacted (including inter scheme transfers) in its schemes' portfolio on its website and the same is forwarded to AMFI for consolidation and dissemination as per prescribed format.	

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Compliance Processes		
7.1	<p>Verify whether a Compliance Officer has been appointed by AMC to ensure that all Rules, Regulations, Guideline, Notifications, Circulars etc. issued by SEBI, the Government of India, and other Regulatory bodies are complied with internally. Also, ensure that the name of the Compliance Officer so appointed has been intimated to SEBI with details like telephone number, fax number and address on which he/she would be available.</p> <p>Verify whether Compliance function of AMC is adequately staffed to enable Compliance Officer to discharge his/her roles and responsibilities.</p>	
7.2	<p>Verify whether Compliance and Risk Manuals and SOPs are documented and periodically reviewed to ensure that current processes and controls are adequate. The SOPs should be properly recorded and stored at a central location for ease of reference by AMC/ Compliance staff.</p>	
7.3	<p>Verify whether a SLA is entered with various service providers providing the compliance monitoring functions and risk management functions and the SLA are periodically reviewed and renewed.</p>	
7.4	<p>Verify whether the Compliance team has:</p> <ul style="list-style-type: none"> ▪ A Compliance Monitoring Plan in place which lays down the key regulatory requirements, controls in place within various Business Units to meet these requirements and the relevant testing steps and frequency of testing by Compliance to monitor these controls. ▪ All evidence of testing by the Compliance team members or appointed external service provider is retained by Compliance and the progress against the Plan is tracked periodically. ▪ The results of the compliance monitoring and status of the compliance plan are reviewed 	

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	and reported to the Compliance Committee, AMC and Trustee Company's Board of Directors.	
7.5	Verify whether the Compliance teams maintain a Complaints Log (collated from multiple channels of communication, such as, e-mail, letters, SCORES, etc.) and track, report and liaise with Business Units in resolving any complaint/ serious incidents reported to compliance or identified by compliance as part of their monitoring activities.	
7.6	Verify whether the Compliance department maintains a regulatory reporting calendar, which details the reports to be submitted to various regulatory bodies and the timelines during the year. It also includes key reports to be submitted to the BOD and the Trustees and timeline and frequency of such reporting.	
7.7	Verify that all Compliance reports, like, Compliance Test Report, New Scheme Report, HY and Quarterly Trustee to SEBI Report, etc. submitted/ published on AMC website/ AMFI/ SEBI website/ in Newspapers/ filed with SEBI within stipulated time limits and contain correct data and in correct format and verify whether a maker-checker control is evidenced.	
7.8	Verify whether the Compliance department presents all recent regulatory updates related to the Board of Directors of AMC and Trustees on a regular basis and also to senior management/ regulatory committee members, if any, either by email or during any meetings scheduled for the Committee.	
Risk Management Processes		
8.1	Verify whether Policy for Risk Management activities as per the SEBI circular MFD/CIR/15/19133/2002 dated September 30, 2002	

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	is in place and is approved by the Board of AMC and Trustees.	
8.2	Verify whether the Risk Management Policy is being adhered to on a regular basis.	
8.3	Verify whether the Risk Committee or Risk Officer reviews the compliance with the policy on a periodical basis.	
8.4	Verify whether the key risks have been identified for all the departments (including third-party risks) across three areas viz. Policies and Procedures, Systems and Organisation and also verify if a department-wise Risk Register is maintained to track the key risks on a periodic basis.	
8.5	Verify whether the Risk Management Committee reports the risk management policies, framework, the risk log and any risk management related issues to the Board of AMC and Trustees periodically.	
8.6	Verify whether the auditors shall check on an ongoing basis about the adequacy of risk management systems and whether their reports are placed before the Boards of AMCs and trustees who shall make comments on the adequacy of systems in the quarterly and half-yearly compliance reports filed with SEBI.	
8.7	<p>Disaster Recovery (DR) and Business Contingency Plans (BCP):</p> <ul style="list-style-type: none"> ▪ Plan is documented for all key business areas to confirm that it is comprehensive and should cover information technology, infrastructure and personnel requirements. Such a contingency plan should allow the AMC to perform, at the bare minimum, the critical functions of mutual fund operations prior to the commencement; ▪ Verify whether special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS 	

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	<p>and Global Pandemics, such as, Covid-19; and</p> <ul style="list-style-type: none">▪ The DR and BCPs are tested and evaluated on a regular basis.	
8.8	<p>Insurance:</p> <ul style="list-style-type: none">▪ Verify that the funds, RTA and custodians have adequate insurance cover against third party losses arising from errors and omissions.▪ Verify whether the level and type of cover is determined by the Trustees, subject to a minimum level of Rs. 5 crore. However, Mutual Funds with assets of less than Rs. 100 crore may take insurance cover for an amount of less than Rs. 5 crore as determined by their trustees.▪ Verify whether the premium for this cover is paid in accordance with Chapter VII, Regulation 52(4)(b)(x) of the Securities and Exchange Board of India (Mutual Fund) Regulations, 1996, also verify whether separate cover has been taken for errors and omissions..	

Chapter 15

Internal Audit – Anti-Money Laundering (AML) and KYC Norms

Background

Anti-Money Laundering (AML)

15.1 Anti-Money Laundering (AML) refers to a set of laws, regulations, and procedures intended to prevent criminals from disguising illegally obtained funds as legitimate income. Though anti-money-laundering laws cover a relatively limited range of transactions and criminal behaviors, their implications are far-reaching. AML initiatives rose to global prominence in 1989, when a group of countries and organizations around the world formed the Financial Action Task Force (FATF).

The process of money laundering, normally, goes through three stages:

- Placement: The purchase of assets/ shares/ investments using the 'dirty' money, perhaps mixed it with 'clean' money;
- Layering: The movement of the money between different financial investments/ institutions to confuse the trail for the authorities;
- Integration: The movement of the money into another economy or business venture to give the money appearance as it is legitimate.

Combating the Financing of Terrorism (CFT)

CFT includes teaching financial investigative techniques to law enforcement, teaching prosecutors to win money laundering cases, and training financial supervisory and regulatory authorities to identify suspicious activity. CFT is also known as Counter Financing of Terrorism.

Suspicious Transaction

The Rules notified under the PMLA defines a "suspicious transaction" as a transaction whether or not made in cash to a person acting in good faith:

- Gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime.

Internal Audit – Anti-Money Laundering (AML) and KYC Norms

- Appears to be made in circumstances of unusual or unjustified complexity.
- Appears to have no economic rationale or bona-fide purpose.

The key applicable AML rules and regulations are as follows (collectively referred to as the 'AML Laws'):

- Prevention of Money Laundering Act (PMLA), 2002, issued by the Finance Ministry of India in consultation with the Reserve Bank of India (RBI) and amendments thereto;
- Prevention of Money Laundering Rules, 2005 and amendments thereto;
- Securities and Exchange Board of India (SEBI) Master Circular on AML and Combating Financing of Terrorism (CFT)/ Obligations of Securities Market Intermediaries under the PMLA, 2002 and Rules framed there-under, issued on October 15, 2019 and other circulars/ notification issued by SEBI from time to time (SEBI/ HO/ MIRSD/ DOP/ CIR/ P/ 2019/113); and
- AMFI guidance on AML, KYC procedures and suspicious transactions reporting and other circulars/ notifications issued by AMFI from time to time.

The significant regulatory requirements under the AML laws are as follows:

- Adoption of written policies and procedures for prevention of money laundering;
- Procedures for identifying and acceptance of new investors (including KYC procedures) and a risk sensitive investor due diligence process for clients of special category (High net worth Investors, Politically Exposed Persons (PEP) etc.) and identification of beneficial owner of securities accounts and transactions;
- A detailed risk assessment procedure to identify, assess and take effective measures to mitigate its money laundering and terrorist financing risk with respect to its clients, countries or geographical areas, nature and volume of transactions and payment methods used by clients.
- Record keeping and retention with respect to investor details and transactions entered;

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- Monitoring of investor's transactions and reporting of any suspicious transactions to Financial Intelligence Unit – India (FIU - IND);
- Designating individuals (as Principal Officer (PO) and Designated Director) and defining their roles and responsibilities;
- Adequate hiring policies and trainings to employees regarding AML laws and requirements; and
- Creating investor awareness on AML laws and requirements.

To avoid duplication of the KYC process of an investor with each of the intermediaries with which investor transacts, SEBI vide circular dated Dec 2, 2011 notified the KYC Registration Agency (KRA) Regulations. A KRA is a Company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under these regulations.

Aadhaar based e-KYC

The Unique Identification Authority of India (UIDAI) provides unique identity (Aadhaar) to all Residents of India. UIDAI also offers e-KYC service which enables online authentication of Aadhaar holder's identity. SEBI circulars have allowed effective usage of UIDAI's e-KYC Services during KYC verification process and accept this electronic information as a proof of both customer identity and address. Following entities shall undertake Aadhaar Authentication service of UIDAI subject to compliance of the conditions as laid down in this regard:

- Bombay Stock Exchange Limited
- National Securities Depository Limited
- Central Depository Services (India) Limited
- CDSL Ventures Limited
- NSDL Database Management Limited
- NSE Data and Analytics Limited
- CAMS Investor Services Private Limited
- Computer Age Management Services Private Limited

These entities are registered with UIDAI as KYC User Agency (KUAs). The SEBI registered intermediaries/ mutual fund distributors can enter into an agreement with KUAs and get themselves registered with UIDAI as sub-

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KUAs. KUAs and Sub KUAs are expected to follow the process prescribed by the SEBI Circular dated November 5, 2019 for Aadhaar e- KYC of the investors in the securities market.

Risk Mitigating Factors

The Money Laundering (ML)/ Terrorist Financing (TF) risk for MFs in India is, generally, mitigated mainly due to the following factors:

- MFs have established detailed KYC procedures.
- Third-party payment is not allowed.
- MFs do not accept payment coming from shell banks/establish relationship with shell banks.
- No account shall be opened or maintained in a fictitious name or on an anonymous basis.
- MFs are allowed to accept subscriptions in cash up to Rs. 50000/-. However, it is generally not accepted by MFs.

Key Risks

Particulars	Risk Type
Non-compliance with AML laws due to inadequate oversight and lack of communication of changes to AML regulations to relevant Business Units, resulting in penalties/ fines/ censures/reputational damage	Compliance Risk/ Reputational Risk
Transactions processed without adequate KYC procedures performed in accordance with regulatory requirements.	Compliance Risk/ Reputational Risk/ Operational Risk
Inadequate record retention in support of KYC verification performed, as required by regulations.	Compliance Risk
Lack of guidance on AML laws due to inadequate training and	Compliance Risk/ Operational Risk

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incomplete/ outdated reference material – AML Handbook/ Training materials etc.	
The appointment and responsibilities of the PO may not be in accordance with regulatory requirements.	Compliance Risk
Regulatory reporting, including suspicious transactions reporting may not be appropriate, timely and in accordance with regulatory requirements	Compliance Risk

Internal Audit Checklist

S.No.	Particulars	Remarks
AML Policy/ Handbook		
1.1	<p>Verify whether there is a duly approved AML Policy for Prevention of Money Laundering (ML) and Terrorist Financing (TF) which ensures:</p> <ul style="list-style-type: none"> ▪ Proper understanding of the contents of the policy by all staff and personnel concerned and developing staff awareness through a continuous training process of the same. ▪ Effectiveness of the Policy. ▪ Adoption of appropriate client acceptance policies. ▪ Undertaking of appropriate and proper client due diligence measures. ▪ Establishment of proper systems to identify, monitor and report suspected ML or TF transactions to the Regulatory authorities and cooperation with the authorities as and when required. ▪ Maintenance of records as per Regulatory time frames indicated. ▪ An independent oversight function to ensure compliance with the policies, procedures and 	

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	<p>controls relating to the prevention of ML and TF, including testing system/ process effectiveness in identifying, evaluating and reporting suspected ML transactions.</p> <ul style="list-style-type: none"> ▪ Details of the Principal Officer and the Designated Director. ▪ Roles and responsibilities of senior management, Principal Officer, Designated Director, Operations Business Units/Department and AML committee, if any. ▪ Role of internal audit or compliance function to ensure compliance with policies, procedures and controls relating to prevention of money laundering and terrorist financing, including the testing of the system for detecting suspicious money laundering transactions. 	
1.2	Verify whether there is a process in place to periodically update the AML Policy to ensure reflection of all current statutory and regulatory requirements in the Policy at all times.	
1.3	Check whether the AMC has appointed a “Principal Officer” and a 'Designated Director' and the Director FIU - IND has been informed of such appointments.	
1.4	Verify whether the AML Risk Assessment is performed and documented by AMC to identify, assess and take effective measures to mitigate its money laundering and terrorist financing risk with respect to its clients, countries or geographical areas, nature and volume of transactions and payment methods used by clients and its compliance with the requirements prescribed by SEBI. Also verify whether the AML Risk Assessment has been periodically reviewed by the senior management.	
Customer Due Diligence and Know Your Customers		
2.1	Verify whether the Customer Due Diligence processes covers the following as per the AML	

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	<p>Regulations:</p> <ul style="list-style-type: none"> ▪ Policy for acceptance of Clients. ▪ Procedures for identifying persons who beneficially own or control the securities accounts. ▪ Application of due diligence process based on the risk profile of the client. 	
2.2	Review the process of ensuring compliance with the minimum KYC documents (including E-Permanent Account Number (PAN), if available) as required by the regulations.	
2.3	Verify whether the applications are processed only for the KYC compliant investors, i.e., investors with valid KYC status as assigned by the KRAs based on their review of KYC documents submitted by investors.	
2.4	Verify whether guidelines for ensuring compliance for disclosure of details of Controlling Person (CP)/ Ultimate Beneficial Owner (UBO) (for investors other than Individuals) and for submission of proof of identity of such CPs/ UBOs have been laid down.	
2.5	<p>Verify whether a valid PAN or PEKRN is provided by the investor before processing any financial transactions (subscription and redemptions).</p> <p>Note: Certain categories of investors can provide other approved proofs of identity in lieu of PAN and are allotted PAN-exempt KYC reference number (PEKRN).</p>	
2.6	Verify whether a process is in place to ensure re-KYC is performed for minor investors turning major i.e. age of 18 years before processing any financial transactions.	
2.7	Verify compliance with AML regulations noted in the SEBI consolidated operational guidelines (IMD/FPI&C/ CIR/ P/ 2019/ 124 dated Nov. 5, 2019)	

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	for Foreign Portfolio Investors (FPIs) registered under SEBI (Foreign Portfolio Investors) Regulations, 2019 (“the Regulations”). [Refer SEBI circular CIR/IMD/FPIC/CIR/P/2018/131 dated September 21, 2018]	
2.8	Verify whether a process is in place for AMC/RTA to follow-up with investors to collect the email ID and mobile numbers of the sole/first holder via KYC Change Request Form by sending periodic reminders – at least annually. [AMFI Best Practice Guidelines Circular No. 77/ 2018-2019 dated March 20, 2019]	
2.9	Verify whether a Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) self-declaration is obtained from the investors (new and existing) either online or offline. Note: FATCA declaration requires investors to confirm if they are a US citizen or a green cardholder (Effective from January 2016) and CRS declaration covers taxpayers from over 90 countries, as opposed to FATCA, which is applicable only for the US taxpayers.	
2.10	Verify whether the company has controls and checks over the prohibition of accepting third-party payments for financial applications received.	
Enhanced and Ongoing Customer Due Diligence		
3.1	Review the process of identifying high/ extreme risk customers and applying enhanced customer due diligence to such customers like: <ul style="list-style-type: none"> ▪ Non-resident clients ▪ High Net Worth clients ▪ Trusts, Charities, Non-Governmental Organisations (NGOs) and Organisations receiving donations ▪ Companies having close family shareholdings or beneficial ownership 	

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	<ul style="list-style-type: none"> ▪ Politically Exposed Persons (PEPs) (including close family members or close relatives of PEPs) ▪ Companies offering foreign exchange offerings ▪ Clients in high risk countries/ jurisdictions ▪ Non face to face clients ▪ Clients with dubious reputation as per public information available etc. ▪ Those transacting under certain circumstances which may be in the nature of suspicious transactions. 	
3.2	When an investor or beneficial owner is identified as high/extreme risk or Politically Exposed Person (PEP) or suspicion has arisen, verify if the reporting entity has undertaken Enhanced Customer Due-Diligence (ECDD) measures.	
3.3	Review whether the criteria for identifying suspicious transactions in mutual funds as prescribed by the AMC/ FIU/ SEBI/ AMFI have been correctly considered/ communicated.	
3.4	Verify whether the suspicious transaction monitoring and investor screening activities against various sanction lists is performed on an ongoing basis.	
3.5	Verify whether the suspicious transactions noted during the monitoring of transactions are subject to further detailed investigation, the Principal Officer has recorded the reasons for treating any transaction or a series of transactions as suspicious and the internal reporting process followed before submission of the final Suspicious Transaction Report to the Director, FIU-IND.	
3.6	Where Technology is used for KYC (as per SEBI Circular SEBI/ HO/ MIRSD/ DOP/CIR/P/2020/73 of April 24, 2020), verify whether:	

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	<ul style="list-style-type: none"> ▪ The processes for online KYC are being followed. ▪ The online KYC App has been/ is subject to software and security audit and validation with additional safety and security features. ▪ Aadhaar number of the investor is not saved in the System. <p>The Video In Person Verification (VIPV) is digitally saved in a safe, secure and tamper-proof, easily retrievable manner and bears the date and time stamping</p>	
Reporting – Review of Timeliness and Accuracy of Filing		
4.1	Verify whether the Cash Transaction Report (CTR) (wherever applicable) for each month has been submitted to FIU-IND by 15 th of the succeeding month.	
4.2	Verify whether the Suspicious Transaction Report (STR) has been submitted within 7 days of arriving at a conclusion based on the reasonable grounds to believe that the transactions (irrespective of the amount of the transaction, whether cash or non-cash) involve proceeds of crime.	
4.3	Verify whether the Non-Profit Organization Transaction Reports (NTRs) for each month shall be submitted to FIU-IND by 15 th of the succeeding month.	
Record Keeping and Retention		
5.1	<p>Verify whether the under-mentioned information for the accounts of their clients retained:</p> <ul style="list-style-type: none"> ▪ Beneficial owner of account ▪ Volume of funds flowing through the account ▪ For selected transactions, the origin of funds, the form in which funds were offered or withdrawn, identity of the person undertaking 	

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	the transaction, destination of funds and the form of instruction and authority.	
5.2	<p>Verify whether records are maintained of the under-mentioned transactions:</p> <ul style="list-style-type: none"> ▪ Cash transaction of more than Rs. 10 lakhs or the equivalent in foreign currency ▪ Series of cash transactions of more than Rs. 10 lakhs or the equivalent in foreign currency in a month ▪ Cash transactions where forgery is involved ▪ All suspicious transactions 	
5.3	<p>Verify whether information is maintained and preserved detailing the:</p> <ul style="list-style-type: none"> ▪ Nature of transactions ▪ Amount of the transaction and the currency in which it is denominated ▪ Date on which the transaction/s was conducted ▪ Parties to the transaction 	
5.4	<p>Verify whether:</p> <ul style="list-style-type: none"> ▪ All records of transactions are maintained for at least for the minimum period as prescribed by the Statutory Authorities ▪ All documents relating to the identity of the clients and beneficial owners as well as account files and business correspondence are retained for a minimum period of five years following the cessation of business relationship 	
Training and Awareness		
6.1	<p>Verify whether appropriate measures are in place for providing periodic AML trainings to the staff to ensure that all staff are aware of their responsibilities and approach to deter money-laundering and the financing of terrorism and evidences retained for the periodic AML training provided to staff.</p>	

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	Training requirements shall have specific focuses for frontline staff, back office staff, compliance staff, risk management staff and staff dealing with new clients. Training should ensure awareness and vigilance to guard against the Money Laundering and Terrorist Financing.	
6.2	Review the AML Training presentation/ materials to ensure that the training materials includes the key ML/TF regulatory topics such as: <ul style="list-style-type: none">• KYC procedures• ML/ TF Policy and Risk Assessment• Periodic investor screening• Suspicious transaction monitoring and reporting• Penalties/ fines for non-compliances with AML laws and regulations, etc.	

Chapter 16

Internal Audit – AMC Branch Operations

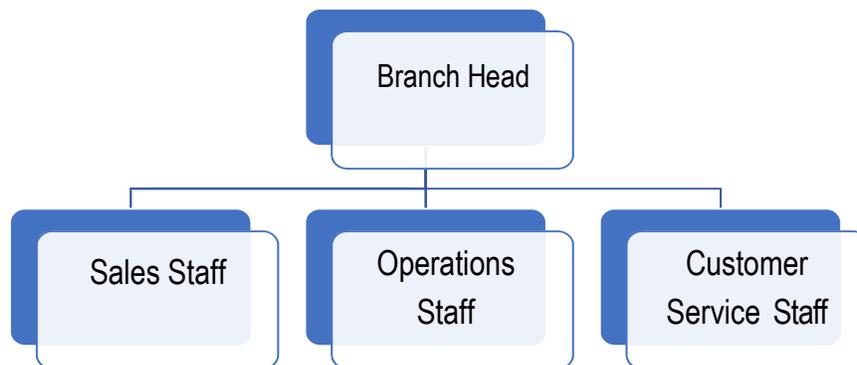
Background

16.1 A branch office is a useful way for large companies to establish relation with customers and locally service customer needs.

AMC of a Mutual Fund has its Branch offices located in different states, districts and areas. The number of Branches of AMC depends on the size of business, long term plans and short term goals of AMC to be attained and concentration on type of targeted customers (which includes both investors and distributors). Many customers prefer a local representative who can be easily accessed for business or investment solutions or for handling grievances or queries. AMC Branch Office performs services, such as, sales promotion, marketing, operations including transaction processing, dealing with local offices of Registrar and Transfer Agents (RTA), customer service, etc.

AMC Branch can have both AMC staff and contract staff. The number of staff members at the AMC Branch depends on business model, size of business, concentration of business, etc.

Structure of AMC Branch



Internal Audit – AMC Branch Operations

Sales staff contacts customers to bring business, operations staff process transactions, customer service staff serves walk-in Branch customers and attends service calls received at Branches.

Processes covered in AMC Branches:

1. Sales and business promotion:
 - Identify prospective investors, contact them.
 - Understand expectations and provide required information investors.
 - Understand the investment objectives of the investors and recommend suggest suitable products.
2. Receipt of financial transactions application along with supporting documents:
 - Receive KYC application and/ or transaction applications from investors.
 - Perform preliminary scrutiny of applications/ documents received including KYC application (where applicable) to identify accuracy of information before acceptance.
 - Time-stamp the application/ documents with a running serial number and ensure SEBI compliances related to time-stamp machine.
 - Inward applications, update information as per the process set by the AMC and deposit the cheques in bank, if any.
 - Perform daily reconciliation of applications time stamped with those submitted to the local RTA office and the MIS sent.
3. Report 'High Value' transactions (transactions with application amount of more than Rs. 2 lakh) to Corporate Office.
4. Handling investor queries and complaints:
 - Handle walk-in customers; existing and prospective.
 - Provide relevant information to resolve queries.
 - Record investor queries and complaints for further processing.
 - Co-ordinate with RTA/ Compliance/ Legal for handling and resolving investor queries, grievances and disputes.
5. Handle couriers/ instruments/ documents returned undelivered.

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6. Receipt and processing of non-financial transaction applications, such as, applications for change of PAN, change of bank account details, addition/ deletion of joint holders, etc.
7. Display of notices, addendums and other regulatory and statutory requirements on notice board.
8. Tracking/ maintaining attendance being recorded for AMC staff and contract staff.
9. Maintenance of records of the assets at the Branch.
10. Ensuring compliance with applicable local statutory requirements.

Key Risks

Particulars	Risk Type
Non-compliance requirements with regulatory/ statutory	Compliance
Mis-selling of mutual fund units	Compliance/Financial/Reputational/Operational
Financial and Non-Financial transactions being missed from being processed	Operational/Financial
No records maintained for investor queries and complaints. No follow-up done to ensure successful and timely resolution of investor queries and complaints.	Compliance/Financial/Reputational/Operational
Absence of time stamping on receipt of applications leading to incorrect allotment of NAV (non-compliance with regulations)	Compliance/Reputational/Operational
Absence of reporting of high value transactions to AMC	Financial/ Operational

Internal Audit Checklist

Sr. No.	Particulars	Remarks
Branch Standard Operating Procedures (SOPs)		
1.1	Review if Branch SOP is in place, approved by the designated authority and reviewed periodically. Also, review if Branch SOP covers the following: <ul style="list-style-type: none"> ▪ Roles and responsibilities of staff at Branches ▪ Time stamping process (including manual) and record maintenance ▪ Good sales practices ▪ Banking of cheques ▪ Liaising with RTA ▪ Handling customer queries and complaints ▪ Accepting and processing financial and non-financial transactions ▪ MIS to AMC/ RTA ▪ Management of sales collaterals/ brochures etc. 	
1.2	Review whether the Branch SOP is version controlled and available on intranet for all staff of the Branch.	
Roles and Responsibilities		
2.1	Review the number of AMC staff and contract staff at the Branch and the roles assigned to each of them.	
2.2	Review whether the rights available in the systems and applications being used are in line with defined roles and responsibilities.	
Maintenance of Time-stamp Machines		
3.1	Identify safe keeping procedures of time stamp machines. Verify if the practice of dual key custody is followed to access locker for safe keeping of time stamp machine.	
3.2	Verify that a register is maintained for opening and closing time stamp running serial number.	

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3.3	Verify that all time stamp machines at the Branch are in working condition and the time is aligned with Indian Standard Time (IST).	
3.4	Verify that breakdown of time stamp machines is informed to the Corporate Office and rectified timely.	
3.5	Verify that manual time stamping procedures are followed if the time stamp machine available at the Branch breaks down. Verify that applications are time stamped by local office of RTA in the absence of manual time stamping procedure.	
Receipt, Scrutiny and Processing of Applications		
4.1	Verify whether on receipt, applications are scrutinized for accuracy and completeness, third party checks, KYC checks, etc. Also, verify that applications are not time stamped multiple times with different serial numbers. Applications if overwritten/ correction ink applied are countersigned by the investor.	
4.2	Verify whether financial transaction applications are time stamped on receipt, whether received physically or through post or through fax or e-mail.	
4.3	Verify whether the date stamp is affixed on non-financial transaction applications on receipt.	
4.4	Verify whether only account payee cheques are accepted for investment.	
4.5	Verify whether inward entry is created for applications, all cheques received are deposited in bank and applications are handed over to RTA office for further processing. Verify that appropriate and timely intimations are sent to investors and back office department at the Corporate Office for cheque bounce cases.	
4.6	Review that reconciliation is performed on a daily basis for financial and non-financial applications time/	

Internal Audit – AMC Branch Operations

	date stamped, inward entry created and those submitted to RTA office.	
4.7	Verify whether appropriate procedures (control over cash, reconciliation, etc.) are followed for investment applications where payment is received in cash up to Rs. 50,000/ -.	
Sales and Business Promotion		
5.1	Verify that appropriate business practices are followed by the Branch in promoting sales of Mutual Fund schemes.	
5.2	Verify whether marketing material used (such as letter head, envelopes or a pen stand, etc.) for business promotion at Branches is approved by the Compliance team at the Corporate Office.	
5.3	Verify whether appropriate procedures are followed at Branches for destruction/ disposal of the old and unused marketing material.	
Compliance Requirements		
6.1	Review that Branch employees (AMC and Contract staff) in sales and customer facing roles hold the certification as mandated by SEBI (i.e. National Institute of Securities Market - NISM). (Please refer Chapter 7K on 'Sales, Marketing and Distribution' for details)	
6.2	Verify whether the Branch Office is licensed under Shops and Establishment Act of the respective State.	
6.3	Verify whether the daily NAVs of schemes are displayed at the Branches. Verify that on Monday, NAV of Sunday for liquid scheme is displayed.	
6.5	Verify that all regulatory and statutory requirement including latest SID, SAI and KIM, NAV, etc. are displayed on the notice board.	
6.6	Verify whether information about the key personnel and contact for grievance redressal is prominently displayed at the Branch.	

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6.7	Verify whether the name and address of the registered office of AMC is displayed outside the Branch premises in a conspicuous position, in legible letters in adherence to Companies Act requirement.	
Customer Service		
7.1	Verify whether appropriate procedures are followed in handling customer request, complaints, and grievances. Also, verify whether customer request etc. are appropriately and timely responded and resolved.	
7.2	Verify that a record of customer complaints/ grievances/ request is maintained manually or in the system with appropriate classification.	
7.3	Review whether appropriate register is maintained with updated status of return undelivered warrants.	
7.4	Verify that appropriate procedures are followed for communicating customer's requirements (brokerage rate, service standards etc.) to the Corporate Office.	
7.5	Verify whether periodic trainings are provided to Customer service staff at the Branch.	
Reporting		
8.1	Verify whether high value transactions are reported to AMC to facilitate sighting of funds in the bank statement and timely utilisation.	
8.2	Review whether appropriate attendance and leave records are maintained for AMC staff and contract staff and accessible to the Corporate Office. Verify that appropriate procedures exist and attendance and leave records are submitted timely to Corporate Office by Branches (if maintained manually).	
8.3	Verify whether a summary of transactions along with transaction applications received and time stamped during the day (before cut-off time for NAV applicability) are reported to local office of RTA (Daily transaction reporting (DTR)).	

Internal Audit – AMC Branch Operations

8.4	Verify that KYC applications received at Branches along with supporting documents are submitted to local KYC Registration Agency for further processing.	
8.5	Verify that sales (area-wise, branch-wise, state-wise, etc.) are reported to the Corporate Office at a set frequency i.e. daily, weekly, monthly, etc.	
8.6	Verify that customer complaints are appropriately and timely reported to the Corporate Office.	
8.7	Verify that all reports as mandated by the Corporate Office are submitted timely.	
Legal Matters		
9.1	Verify whether agreements with vendors engaged locally at Branches are vetted by Compliance and Legal department at the Corporate Office.	
9.2	Verify whether intimation about court cases or notices received from the statutory authorities, if any is forwarded to the Corporate Office on a timely basis.	
Asset/ Expense Management		
10.1	Verify that records and supporting for local expenses are timely submitted to the Corporate Office.	
10.2	Verify that physical verification of assets at the Branch is performed periodically. Discrepancies, if any, are communicated to the Corporate Office	
10.3	Verify whether asset transfers, if any, within Branches are communicated to the Corporate Office on a timely basis.	
10.4	Verify whether appropriate procedures are followed for dealing with petty cash and petty cash expenses. Also, verify whether appropriate checks and balances are in place over petty cash maintenance.	
Physical and Logical Security		
11.1	Verify whether investor access is restricted to the	

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	reception at the Branch and no unauthorised access is allowed to the area where transactions are processed further.	
11.2	Review whether the organisation's policy for securing the IT environment (where applicable for Branches) is uniformly followed.	
Others		
12.1	Verify that fire safety measures are available and these are tested periodically.	
12.2	Verify whether suggestion box is installed at a conspicuous place in the Branch for investor feedbacks. Also, enquire and verify if investor feedbacks (if any received) in the suggestion box are timely sent to the Corporate Office.	
12.3	Verify whether appropriate approvals are obtained from designated officials for conducting investor education and distributor education programmes.	
Business Continuity (BCP) and Disaster Recovery Plan (DR Plan)		
13.1	Verify preparedness of AMC Branches to support business continuity.	
13.2	Verify their participation, if any, in mock BCP/DR drills.	
13.3	Verify whether special procedures are defined to work from home in extra ordinary situations E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
13.4	Verify transactions to determine that business disruption is minimised.	

Note: As AMC Branches handle areas relating to Mutual Fund operations and AMC operations, the above checklist covers both.

Chapter 17

Internal Audit – Sales, Marketing & Distribution

Background

Sales and Marketing

17.1 The Sales and Marketing team of an AMC is primarily responsible for selling mutual fund products registered in India and managed by the AMC to the retail as well as institutional clients either directly or through distributors in compliance with SEBI regulations i.e. without any unethical means. Offering a Mutual Fund scheme that is not suitable for the investor, would qualify as “mis-selling”, which is an offence as per SEBI regulations.

The Sales team is, generally, bifurcated into two frontline divisions:

- (i) Institutional Sales Team; and
- (ii) Retail Sales Team.

However, some AMCs may have different Sales structure based on its business size and geographical presence.

The front-line Sales Team, which is client interfacing is, generally, further divided into four geographical regions viz. West, East, North and South Regions. The Regions are further divided into Clusters, which have the final level of Sales force – the physical sales location residing in them.

The Marketing team of the AMC is responsible for the creation, development, and implementation of specific marketing and communication materials/ campaigns in compliance with SEBI regulations which enables the Sales team to drive and create profitable new business.

Information to the clients/ distributors is made available in the form of brochures/ flyers, fact sheets, mutual fund reports, offer documents, weekly market views, newsletters, portfolio managers' views, etc. through e-mails and physical delivery of the documents. Information is also available on the Company's website.

Now-a-days, mutual funds extensively use digital marketing techniques and

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social media platforms to sell mutual fund units to the new investors and also to generate awareness and interest in mutual funds.

Key Risks

Particulars	Risk Type
Mis-selling of MF units to investors	Compliance/ Reputational Operational/ Financial
Loss of business reputation and damage to poor to business relationship due management.	Financial/ Operational/ Reputation
Loss of business due to incomplete/ inaccurate/ misleading/ out of date advertising & marketing material.	Compliance/ Operational/ Reputation
Inappropriate/ excessive sales and marketing expenses	Financial/ Fraud

Internal audit of Sales should cover at least the following aspects:

- Client Relationship Management and Client Reporting.
- Marketing materials (including development, approval and maintenance).
- Marketing strategy and its implementation.
- Sales management (monitoring of Sales Campaigns, Gift and Entertainment Policy, Commissions to Sales staff, investor education and awareness).
- Product promotion.

Distribution

17.2 The retail business of the AMC/ MFs and some parts of the institutional business are driven through the Distribution Channel. The SEBI regulations prescribe that any entity wishing to sell/ distribute/ advise Mutual Funds to their clients should have fulfil all the norms as prescribed by the AMFI, should have a valid NISM Registration and an AMFI Registration Number (ARN Code).

Distributors charge commission for providing MF distribution services based on the agreed rate structure and the Scheme's AUM generated by them.

Internal Audit – Sales, Marketing & Distribution

There are mainly two types of commissions:

- Trail commission, and
- One-time transaction charge

In addition, various AMC's have incentive programs and internal grading system for the distributors.

Channel Partners is the arrangement that is being established by mutual agreement (SLAs), which AMC's signs with the prospective Channel Partners who helps in promoting/ marketing of mutual fund products to their customers. Channel Partners can be a Banking entity; a Mutual fund or a Non-Banking entity.

Note:

- **Upfront Commission:** SEBI circular SEBI/HO/IMD/DF2/CIR/P/2018/137 dated October 22, 2018 mandated MFs/ AMC's to adopt full trail model of commission in all schemes, without payment of any upfront commission or upfronting of any trail commission, directly or indirectly, in cash or kind, through sponsorships, or any other route. However, upfronting of trail commission is allowed only in case of inflows through Systematic Investment Plans (SIPs).
- **Transaction Charges:** SEBI, vide its circular no. CIR/IMD/DF/13/2011 dated August 22, 2011 has introduced regulations regarding Mutual Funds. One of the regulations was relating to transaction charges in respect of Investments sourced by Distributors. SEBI vide its circular no CIR/IMD/DF/21/2012 dated September 13, 2012 has, in partial modification to SEBI circular no. CIR/IMD/DF/13/2011 dated August 22, 2011, advised that distributors shall have also the option to either opt in or opt out of levying transaction charge based on type of the product.

There are, broadly three different types of Mutual Funds Distributors:

- **National Distributors (NDs):** These are distribution outfits that have branches throughout the country. Some national distributors specialize in regions, like, western and northern India.
- **Independent Financial Advisors (IFAs):** IFAs are set of distributors by the name which denotes that they are not aligned to any particular organization, they operate largely as an individual but some of them operate as a corporate entity. The IFAs are also known as the Retail Distributors.

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- **Registered Investment Advisors (RIA):** A Registered Investment Advisor (RIA) is an advisor or firm engaged in the investment advisory business and registered with the SEBI. RIAs have a fundamental obligation to provide suitable investment advice and always act in their clients' best interests.

Key Risks

Particulars	Risk Type
New distributors are registered with inadequate documents/ incorrect details or without approval. Non-compliance with SEBI/ AMFI guidelines with respect to empanelment and monitoring of distributors resulting in penal fines/ censures.	Compliance/ Operational/ Reputational
Incorrect computation of commissions due to error in setting up/ updating commission structure/ commissions structures for MF distributors not being approved by Sales Management.	Compliance/ Operational/ Reputational

Internal audit of Distributor should cover at least the following aspects:

- Empanelment of distributors, activation and review.
- Distributor Due-Diligence Process.
- Compliance with Code of Conduct prescribed by AMFI.
- Certification Programme for selling and marketing of mutual fund units
- Commissions and service agreements.
- Subscriptions and redemptions.

Internal Audit Checklist

Sr.No.	Particulars	Remarks																																																		
Distribution – Empanelment, Activation & Review																																																				
1.1	Verify whether the procedures have been documented for distributor empanelment and it includes all the regulatory requirements.																																																			
1.2	Verify whether the matrix has been documented within the AMC for approving distributor empanelment and such approvals are evidenced.																																																			
1.3	Verify whether following minimum documents are obtained at the time of distributor onboarding along with a duly signed Distributor Empanelment Form:																																																			
	<table border="1"> <thead> <tr> <th>Documents</th> <th>IFA</th> <th>Partnership Firm</th> <th>Company</th> <th>HUF</th> </tr> </thead> <tbody> <tr> <td>Copy of the AMFI Certificate</td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> </tr> <tr> <td>Copy of the ARN Card</td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> </tr> <tr> <td>PAN Card Copy</td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> </tr> <tr> <td>Cancelled Cheque Copy</td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> </tr> <tr> <td>Memorandum and Article of Association</td> <td align="center"><input type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> </tr> <tr> <td>Authorised Signatory List</td> <td align="center"><input type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> </tr> <tr> <td>Partnership Deed & Resolution</td> <td align="center"><input type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> </tr> <tr> <td>Board Resolution</td> <td align="center"><input type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input type="checkbox"/></td> </tr> <tr> <td>KYD Acknowledgment</td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> <td align="center"><input checked="" type="checkbox"/></td> </tr> </tbody> </table>	Documents	IFA	Partnership Firm	Company	HUF	Copy of the AMFI Certificate	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	Copy of the ARN Card	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	PAN Card Copy	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	Cancelled Cheque Copy	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	Memorandum and Article of Association	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Authorised Signatory List	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Partnership Deed & Resolution	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Board Resolution	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	KYD Acknowledgment	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	
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1.4	Verify whether the MF distributors have completed Know Your Distributor (KYD) compliant certification process introduced by AMFI and the KYD compliance acknowledgment is obtained by MF/ AMC.																																																			
1.5	Verify whether at the time of empaneling distributors and during the period, i.e., review process, Mutual Funds/ AMCs undertakes a due diligence process to satisfy 'fit and proper' criteria.																																																			
1.6	<p>Due Diligence:</p> <ul style="list-style-type: none"> Whether the MFs/AMCs regulate the distributors by putting in place a due diligence framework/ policy and this responsibility has not been delegated to any agency. 																																																			

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	<ul style="list-style-type: none"> ▪ Whether appropriate evaluation, risk assessment and action plan is taken by MFs with each of the distributor based on the due diligence reports circulated by AMFI to respective mutual funds in India who have empaneled these distributors. <p>Note: AMFI facilitates obtaining information from all mutual funds in India (per the 4 criteria mentioned in circular) and appoint independent audit firms to perform due diligence of the distributors and issue their reports to AMFI. The due diligence process shall be initially applicable for distributors satisfying one or more of the following criteria specified by SEBI in addition to the specific criteria within different MFs:</p> <ul style="list-style-type: none"> ▪ Multiple point presence (More than 20 locations) ▪ AUM raised over Rs. 100 crore across industry in the non- institutional category but including high net-worth individuals (HNIs) ▪ Commission received of over Rs. 1 crore p.a. across industry ▪ Commission received of over Rs. 50 lakh from a single Mutual Fund. <p>It has also been clarified that since AMFI registration is not required by SEBI in respect of overseas distributors, AMFI would not be carrying out due diligence of such distributors on behalf of the Mutual Fund industry. AMCs will be fully responsible for any SEBI related requirements on these distributors. (AMFI CIR/ARN-16/13-14 dated August 20, 2013).</p>	
1.7	<p>Code of Conduct:</p> <ul style="list-style-type: none"> ▪ Verify whether Mutual Fund/ AMC has a process in place to monitor and ensure that a Code of Conduct for Mutual Fund Intermediaries prescribed by AMFI is strictly 	

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	<p>followed and the intermediaries do not indulge in any practice contravening it directly or indirectly by obtaining a self-declaration from its distributors on a regular basis.</p> <ul style="list-style-type: none"> ▪ Verify whether any non-compliance with the Code of Conduct is duly reported by the Mutual Funds to the Board and AMFI. Further, no Mutual Fund shall deal with intermediaries contravening the prescribed Code of Conduct. 	
1.8	<p>Review whether the MF/ AMC has a process in place to ensure compliance with the certification requirement for distributors (including new cadre of distributors specified by SEBI regulations) conducted by the National Institute of Securities Markets (NISM) by obtaining the copy of the NISM exam passing certificate at the time of empanelment and on a periodic basis. Whether the MF/AMC has a process to keep track of validity of (a) NISM certification and (b) AMFI registration/ EUIN of the employees of distributors engaged in selling mutual funds and of their sub-distributors.</p> <p>If the said associated person (i.e. distributors, agents or any persons to be employed or engaged in the sale and/or distribution of mutual fund products) possesses a valid AMFI Mutual Fund (Advisors) Module Certificate obtained before June 1, 2010, he shall be exempted from the requirement of the above mentioned NISM Certification Examination.</p>	
1.9	<p>Verify whether the distributor is registered with AMFI by obtaining AMFI Registration Number (ARN) for the distributor. Also, verify if the Employee Unique Identification Number (EUIN) has been obtained while receiving the transaction applications from investors.</p> <p>Note: AMFI Registration for Overseas Distributor AMFI vide circular No. CIR/ ARN-14/12-13 dated</p>	

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	<p>July 13, 2012 and AMFI CIR/ ARN-16/13-14 dated August 20, 2013, has notified that overseas distributors are not required to obtain NISM certification or AMFI Registration as per SEBI guidelines and are also not required to comply with KYD process. However, AMCs are required to ensure compliance by the overseas distributors with the extant laws, rules and regulations of jurisdictions where they carry out their operations in the capacity of distributors while empaneling them.</p> <p>Further, the overseas distributors need to complete a basic level registration with AMFI for various purposes, including tracking and MIS.</p> <p>Note: Refer to Chapter on Registrar and Transfer Agent for detailed processes and controls</p>	
1.10	<p>Verify whether a change in distributor (ARN code) is effected as per AMFI Best Practices Guidelines Circular No. 78/2018-2019. Some of the key requirements are as follows:</p> <ul style="list-style-type: none"> ▪ Change is initiated only in circumstances, such as, merger/ acquisition/ consolidation/ transfer of business, transfer of AUM/Consolidation, etc. ▪ Change is initiated only for distributors with valid ARNs and after all requisite self-certification is furnished. ▪ No objection is received from the clients. 	
1.11	<p>Review whether a maker-checker control is in place for setting-up or updating distributor information on RTA systems/ applications.</p>	
1.12	<p>Verify whether there is any categorization of the empaneled distributors, what are the parameters for such categorization, frequency of review of the parameters and whether these distributors are subject to any upgrade/ downgrade.</p>	

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	Verify whether the distributor category upgrade/downgrade is being duly approved by appropriate authority within MF/AMC.	
1.13	<p>Verify whether AMC has controls in place to monitor and timely de-empanel any distributors who are de-registered as the ultimate censure for the following reasons:</p> <ul style="list-style-type: none"> ▪ Violation of the code of conduct. ▪ Being indicted for serious offences by a Regulatory Authority ▪ / Judicial Authority. ▪ Complaints of gross negligence upheld by a consumer court. Also, verify that the AMFI is notified about the de-empanelment on a timely basis. <p>Refer AMFI Guidelines & Norms for Intermediaries ("AGNI")</p> <p>Verify whether AMCs have their internal parameters defined in the procedures failing which AMCs would de-empanel any distributors after obtaining appropriate internal approvals.</p>	
Distribution – Commissions & Service Agreements		
2.1	Review the process for negotiation of commissions/ brokerages with empaneled distributors and the records maintained for the same.	
2.2	<ul style="list-style-type: none"> ▪ Review whether the AMC/MF has an approved commission/brokerage rate structure in place based on the volume of business/ sales. ▪ Review the authority of the approving authorities within AMCs/MFs to decide the commission to be offered to each distributor. ▪ Review the process for delegation of authority and whether Regional Heads are offered budgets and if yes, details thereof. 	

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2.3	Review the procedure for processing exceptions and whether proper documentation is maintained for the same.	
2.4	Verify whether distribution agreements have been entered with the distributors/channel partners with all the necessary terms and conditions (liabilities, including commission details and SLAs) noted therein and whether the agreement is duly reviewed by Legal/ Compliance and signed by appropriate authorities of both parties.	
2.5	Verify whether record of communications for the distribution terms (distribution category upgrade or downgrade, commission rates) through emails or letters have been dispatched on time to the distributors.	
2.6	Verify, whether AMCs withholds the distributors' commission payments due to factors like claw back, pending of ARN (AMFI Registered Number) renewals and incomplete KYC of folios.	
2.7	Review the process of communication of the changes to the brokerage are communicated to the Registrar & Transfer Agent.	
2.8	<p>Verify if the Option Letter for being an "Opt In" distributor (Opt Out being default) in the specified format has been submitted to the CAMS - Point of Service (POS), the list of which is available on AMFI Website.</p> <p>Notes:</p> <ul style="list-style-type: none"> ▪ Opt-in/Opt-out letters submitted by corporate ARN holders (except proprietary concerns, Partnership Firms and HUFs) should be submitted on Corporate Letter head and should be signed by Authorised Signatories as registered with AMFI. ▪ The option exercised for a particular product 	

Internal Audit – Sales, Marketing & Distribution

	<p>category will be valid across all Mutual Funds.</p> <ul style="list-style-type: none"> ▪ To enable the ARN holders to change their status (Opt in/Opt out), it has been decided to keep two half yearly windows available i.e. between March 1st to March 25th and September 1st to September 25th. The new status change will be applicable from the immediately succeeding month. 	
Product Promotions		
3.1	Review the process for launch of New Fund Offer (NFO) or promotion of an existing product.	
3.2	Verify whether sales promotion/ contest/ campaign/ media advertisements have been launched for incentivizing sales.	
3.3	Review the process followed for internal approvals of contest/ campaigns.	
3.4	Verify whether contest brochures and other materials have been pre-approved by compliance.	
3.5	Review whether contest/ campaign costing has been approved internally and back-up papers are available for the same.	
3.6	Review whether there is a process in place to perform post-contest/ campaign evaluation and if the results are shared with senior management on a regular basis.	
3.7	Review whether there is a process in place to perform a post- analysis evaluation of the factors responsible for success and failure of NFO promotion activities and if the results are shared with senior management in a timely manner.	
Marketing Materials		
4.1	Obtain and review the procedures documented for developing and marketing materials for products.	
4.2	Verify whether a list or log of all marketing materials (product presentation, one pager, flyers,	

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	banners, posters, etc.) developed and released is maintained.	
4.3	Review whether appropriate reviews and approvals are obtained within Sales and Marketing management prior to presenting the materials for Compliance review.	
4.4	Verify whether the marketing material is pre-cleared with Compliance function for adherence to the SEBI Advertisement Code and other SEBI guidelines before the marketing material is released in public/ printed/ disseminated.	
4.5	Verify whether periodic reviews are being performed to ensure that the marketing materials or contents available on company's public website are current/ up-to-date and outdated/obsolete marketing materials are timely removed.	
Sales Management		
5.1	Verify distribution of sales force region-wise/ manager-wise.	
5.2	Review whether all members of the sales team are AMFI certified as required by SEBI and verify if there is a process in place to ensure compliance with this requirement.	
5.3	Review whether the process for roll out of annual targets and communication of annual goals has been followed.	
5.4	Verify the process for communication of sales strategy, annual budgets and details of delegation to Regional Heads.	
5.5	Verify the incentives launched for internal sales force and verify details of the plan and approval process followed for the same.	
5.6	Verify details of MIS generated for sales numbers and the review/ monitoring mechanism for the same.	

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5.7	Verify process for recording meetings - meeting tracker, call reports, usage of Customer Relationship Management (CRM) system, etc. Verify whether there is a distributor contact program drawn up which specifics content and frequency of contact.	
5.8	Review the internal controls in place to ensure that no written or electronic communication is sent out to investors without prior approval from Compliance	
5.9	Verify the AMC plan and calendar for providing regular training to distributors and Sales staff. Also, verify frequency and quality of training of Sales staff/distributors and adequate record maintained for trainings attended.	
5.10	Review the process of deciding the KRAs of the Sales Team Members, Regional Heads and Sales Head.	
5.11	Review the methodology adopted for digging and prospecting for new leads/ distributors/ investors.	
5.12	Review the internal control mechanisms for controlling mis-selling of products. Review the investor complaints, redressal mechanism for the same.	
5.13	Verify whether there is a process in place for reviewing the post implementation performance by the Marketing team for all the significant marketing campaigns and the results are shared with the Senior management.	
5.14	Verify whether the expenses for MF distributors that are charged to the funds are in compliance with SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/137 dated October 22, 2018.	
5.15	Review whether the Sales management provide a	

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	periodic update to AMC and Trustee Board of Directors regarding the activities of the Sales and Marketing teams.	
5.16	<p>Verify whether all the expenses incurred by Sales and Marketing teams are:</p> <ul style="list-style-type: none"> ▪ supported with appropriate bills, invoices, agreement, etc. to ensure expenses incurred are for the official purposes only; and ▪ expenses are duly reviewed and approved by authorized personnel within Sales and Marketing management. 	
5.17	Review whether MF/ AMCs have been conducting Investor Awareness Program (IAP) in different cities regularly to create awareness about Mutual Funds, and benefits of investing in mutual funds among public, various Mutual Fund and all AMCs provide the program schedule for each fortnight in advance, which is displayed on AMFI's website and evidences are maintained for such initiatives including attendance records.	
Subscriptions & Redemptions		
6.1	Review the process of tracking of sales and redemptions by Sales management.	
6.2	Verify whether there is a distributor/ investor contact program in case of large redemptions.	
6.3	Review the investor retention initiatives.	
6.4	Review the cross-sell initiatives.	
6.5	Documentation for applications/ redemptions – Review the roles of sales and investor service to check whether roles and responsibilities are clearly defined.	
6.6	Verify matrix for escalation in case of deficiency in investor documentation.	

Chapter 18

Internal Audit – Information Technology

Background

18.1 Information Technology (IT) supports the organisation functions. IT infrastructure comprises of computer systems, networks, server, other devices in order to process, store, retrieve, exchange, produce and analyse information electronically. In today's scenario, IT enables the growth of mutual fund business. The Information Technology Act, 2000, provides legal recognition to electronic transactions to bring the same at par with paper-based transactions.

Presently, mutual fund business in India is technology driven right from the stage of investor onboarding, sales and investment, till the stage of redemption and customer servicing. Client experience can be enhanced with the use of the right kind of technology. Various digital platforms of AMC, distributor, registrar and transfer agent, exchange facilitate online transactions in mutual funds. Investors can also check the latest NAV, status of their accounts, request for Non-Financial transactions and check scheme performances using technology.

In the wake of growing COVID 19 pandemic threat, AMFI vide its circular dated March 22, 2020 instructed MFs to allow transactions only through electronic mode till the social distancing advisory is withdrawn.

Mutual Funds have been extensively using digital and social media platforms to increase their reach and communicate effectively. Digital and social media platforms are also being used by AMCs to understand market needs and designs products to cater to it. AMCs have been marketing their products on digital and social media platforms in order to create awareness, engage customers (investors and distributors), resolve their queries, complaints, grievances etc.

Chat Bots, i.e., the virtual assistants are being looked at as a possible solution to address customer grievances and queries and understand their needs.

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SEBI Intermediaries, i.e., the persons who act as mediators between investors and SEBI are interconnected with technology. SEBI intermediaries are the persons, such as, stock brokers, sub brokers, investor advisors, merchant banker, underwriter, portfolio manager, share transfer agent, registrar to an issue, depositories, custodian of securities, foreign institutional investors, AMC etc. who are associated with securities market. SEBI has issued guidelines on Data Sharing Policy for seeking data. SEBI has allowed the flow of information within intermediaries to meet the variety of requirements, such as, for inter- usability of data for business, analytics, research etc. Data seekers must ensure the confidentiality of data and prevent its misuse and unauthorised access.

CKYC is a process where information on KYC of the investors is shared within the financial sector with uniform KYC norms and inter-usability of the KYC records. This process aims to reduce the burden of producing KYC documents and getting those verified every time a new relationship is created by the investor with a financial entity.

Technology plays a key role in transmission of data in a secured way across SEBI intermediaries and financial sector. Hence, it becomes imperative to safeguard overall IT environment from physical damage, loss or theft of data etc.

IT Risks

IT risks cover IT related events which could potentially impact business. It is the potential that a given threat can exploit vulnerabilities of an asset or group of assets that causes harm to the organisation. IT risk spans a range of business critical areas which are as follows:

- security e.g. compromised business data due to unauthorised access
- availability e.g. inability to access IT systems required for business operations
- performance e.g. reduced productivity due to slow or delayed access to IT systems
- compliance e.g. failure to follow applicable laws and regulations

Identification of IT risks are important to reduce or manage risks and to develop a response plan in the event of and IT crisis.

IT risks can include loss of IT assets, data leakage or theft, downtime of IT service, capacity management failures, non-compliance related risks, failures

of infrastructures, such as, networks, power, internet, security vulnerabilities etc.

Some of the key IT risks are mentioned below:

Cyber Security Risk

Cyber security is the protection of internet-connected systems, such as, hardware, software and data from cyber-threats. Cyber security covers everything that pertains to protecting the sensitive data, personally identifiable information (PII), protected health information (PHI), intellectual property, data, and governmental and industry information systems from theft and damage attempted by criminals.

Cyber security risks relate to a probable exposure or loss or harm to electronic systems, networks, applications, information, servers, etc. resulting from cyber-risks/ cyber-crime. The Courts in India have recognised cyber-crime to mean 'the offences that are committed with a criminal motive to intentionally harm the reputation of the victim or cause harm or loss to the victim, directly or indirectly using modern telecommunication networks, such as, internet and mobile phones. Cyber security risks encompass deliberate attacks from disgruntled employees or outside parties, inadvertent compromises of the information infrastructure due to user errors, equipment failures and natural disasters.

As businesses are driven by technology and global connectivity with the help of internet, organisations are becoming vulnerable to cyber security risks.

Following are the common trends which give chance to cyber-crime:

- Massive growth of internet population with lack of uniformity in devices and software used
- Increasing number of electronic transactions, data transfers and storage
- Use of smarter technology devices, such as, smart phones, applications and web portals. These devices increase connectivity but also gives a chance to cyber criminals to get unauthorised entry into the corporate network
- Ease of using malicious software programs, such as, viruses, spyware, ransom ware, malware, etc. to intrude the privacy of computer systems

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and networks. Phishing is the act of sending out fake emails to collect data in an unauthorised way.

Information Security Risks

Today's business scenario is more demanding in terms of enhanced data protection. Investors want to make sure that their information is secured. If the Mutual Fund fails to secure confidential information, it can result in loss of business/ penalty, etc. Information security refers to processes designed to protect the information in any form i.e. print, electronic, etc. from unauthorised access, use, misuse, disclosure, modification or disruption.

Information security risks relate to threats or harm to the information systems of the organisation. Information security aims to focus on confidentiality of data (blocking of unauthorised access), availability (ease of access to authorised personnel) and integrity of information (unauthorised modification).

Following are some of the common measures taken to address information security risks:

- **Technical Measures:** Focuses protection of data through hardware and software by using techniques, such as, encryption, firewall, etc.
- **Organisational Measures:** Creation of a department/ a unit which has information security as the key responsibility
- **Human Measures:** Imparting regular trainings to users on correct information security practices
- **Physical Measures:** Controlling access to the office locations including data centres, etc.

Other Risks in Information Technology (IT)

There are other risks relating to Information Technology, such as, strategic risk (aligning IT policies with organisational strategies), operational risk (execution and implementation of IT policies), IT infrastructure risk (relates to design deficiencies, vulnerabilities), business continuity and disaster management (relates to back-up plans in the event of disaster or natural calamities or pandemic situations), etc.

Legal Framework for IT Security in India

- **Information Technology (IT) Act, 2000:** Information Technology Act, 2000 defines cyber security to mean protecting information, equipment, devices computers, computer resources, communication devices and information stored therein from unauthorised access, use, disclosure, disruption, modification or destruction. The IT Act, 2000 deals with tampering with computer source code, hacking and computer offences and tampering of electronic records.
- **Copyright Act, 1957:** It provides that any person who knowingly makes use of an illegal copy of computer program shall be punishable.
- **SEBI Guidelines (Latest guidelines are mentioned below):**
 - Cyber Security and Cyber Resilience Framework provided by SEBI Circular dated January 10, 2019. The circular mandates the AMC to have a robust cyber security and cyber resilience framework in order to maintain integrity of data and guard against breaches of privacy.
 - Systems Audit mandated by SEBI Circular dated April 11, 2019.
- **National Cyber Security Policy, 2013:** This policy addresses the growth of information technology, increasing number of cyber - crimes and plans for social transformation.
- **Data Protection Bill, 2019:** This intends to provide a legal framework for data protection in India. The bill will regulate data usage in all sectors of economic activity and establishes new compliance requirements for the business at large.

Key Risks

Particulars	Risk Type
Absence of robust IT Infrastructure	IT
Absence of capacity planning of systems/ networks/ servers. Absence of load balancer for IT network leading to failure of systems	IT
Loss/ theft of IT assets	Information Security/ Financial

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Absence of business continuity plan including failure to keep networks, systems, processes and applications up and running owing to disasters, such as, flood, cyclone, earthquake, fire, epidemics, pandemics, etc. Absence of disaster recovery drills	IT/ Financial/ Reputational
Absence of policies and procedures for IT Environment (such as IT Policy, Change Management Policy, Information Security Policy, etc.)	Cyber Security and Information Security
Absence of performance monitoring tools for IT infrastructure	Operational/ IT/ Financial
Design gaps in IT systems and/ or processes	Compliance/Operational/Reputational/ Fraud
Using systems and processes for unauthorized use of data	Financial/ Cyber Security and Information Security/ Reputational
Security related risks, such as, malware attacks, trojan horse attacks, hackers trying to gain unauthorized access to systems, etc.	Cyber Security and Information Security
Weak passwords/ software vulnerabilities	Operational/ Compliance/ Financial
Data theft/ breach of data/ data leakage	Cyber Security and Information Security
Third party related risk (i.e. it fails to meet obligations)	Operational/ Reputational/ Financial
Non-compliance with applicable regulatory requirements	Compliance/ Cyber Security and Information Security/ Financial/ Reputational

Internal Audit Checklist

S.No.	Particulars	Remarks
Policies and Procedures		
1.1	<p>Review whether following IT policies are in place and approved by designated authority on a periodic basis:</p> <ul style="list-style-type: none"> ▪ IT Policy including Patch Management Policy, IT Asset Management Policy, Password Policy ▪ Information Security Policy ▪ Change Management Policy ▪ BCP and DR ▪ Incident Management Policy ▪ Patch Management Policy ▪ IT Asset Management Policy ▪ Privacy Policy ▪ Cyber Security and Cyber Resilience ▪ Systems Audit Framework Policy ▪ Information Privacy Policy ▪ Record Maintenance Policy ▪ Risk Management Policy ▪ Process for digital technologies ▪ Systems Development Life Cycle Policy ▪ Standard Operating Procedure for practices followed in IT department. 	
1.2	Review whether the policies are reviewed periodically and updated.	
1.3	Review whether the policies are version controlled and available on intranet for all staff of the AMC.	
1.4	Verify whether the policies are complete and procedures followed are aligned with policy framework.	

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Entity Level Controls		
2.1	Review whether IT risks are identified, recorded and relevant controls are mapped against it.	
2.2.	Review configuration of IT infrastructure (covering hardware, software, servers including production server, proxy server, user acceptance test (UAT) server, data centers etc.) network architecture and applications to assess the effectiveness of controls over security of the IT environment.	
2.3	Verify whether the AMC adheres to applicable IT governance framework including the following: <ul style="list-style-type: none"> ▪ IT Steering Committee to review the IT strategic plans, oversee activities, etc. ▪ Technology Committee of Board comprising of an expert proficient in technology to review the implementation of cyber security and cyber resilience framework 	
2.4	Review that licensed version of the operating systems, applications, etc. are being used and the same is monitored on an ongoing basis.	
2.5	Review the details on current operating system in use, geographical physical presence of the organisation, data centre, cloud storage if any, facilities on mobility, etc. to assess the technology landscape of the organisation.	
Access Management		
3.1	Review whether there is a set process to grant and revoke access to systems, applications, web portals etc. and verify the same.	
3.2	Review the Control Matrix verify the same if is Access and approved.	
3.3	Verify whether user access to applications, networks, servers, etc. have been aligned with individual job roles and responsibilities and reviewed periodically.	

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3.4	Review whether AMCs maintain list of users who have been provided privilege access for the systems. Review if AMC has deployed strong controls over such access i.e. restrict the number of privileged users, periodic review, disallow privileged users from accessing logs in which their activities are being recorded, etc.	
3.5	Review if there exists a process of review of user access and access logs for IT environment at a defined frequency. Verify if the results of the review have been shared with department heads and Risk team/ Information Security team, where applicable.	
3.6	Review the process of providing the remote access to corporate network, controls surrounding the same and periodic review of remote access. Review if remote access authentication is available on such access. Also, review that such rights have been appropriately revoked where not required.	
3.7	Review whether employees have rights to access their personal email account/ social media/ chat service platforms using corporate network. Verify if such access is given after taking approvals from authorised officials. Review that appropriate controls are in place to restrict unauthorised access on cloud storage.	
3.8	Review whether access to connect external devices including mobile devices to corporate network is restricted. Also, review whether adequate control mechanisms are in place to protect the company data from storage devices, such as, Compact Disks (CDs), Universal Serial Bus (USB), external hard drives, etc.	
3.9	Verify whether there is any tool available to protect the data leakage or theft of data. Also, verify that the tool provides real time alerts for any such data leakage.	

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3.10	Review the security controls (such as system hardening, Firewalls, Anti-Virus etc.) and the operational effectiveness of such controls to safeguard the corporate network and applications from unauthorised access.	
3.11	Review whether the AMC has installed Intrusion Detection system (IDS) and Intrusion Prevention System (IPS) to monitor security threats (such as probable unauthorised network access or malicious act or violations of security protocols) to network.	
User Management		
4.1	Review whether all users are identified to the system/ applications by a unique User ID.	
4.2	Review the list of users added/ deleted in Active Directory (AD). Also, identify if there are duplicate users in AD. Further, check applications where the user is authenticated with AD.	
4.3	Review whether User ID is disabled after a fixed number of failed log-in attempts and which is documented in the Password Policy. Also, review the process of failed log-in review mechanism is in place at a defined frequency.	
4.4	Review whether the Password Policy is made applicable on all systems, applications and web portals, etc.	
4.5	Verify whether the users are required to change passwords periodically and AMCs have implemented strong password controls (minimum length, history, change of password on first log-on) to access systems, applications, web portals, etc. Passwords are directly communicated to the user in the event of account recovery.	
4.6	Review whether at least two-factor authentication at log-in is implemented for all users on systems, applications, web portals, etc.	

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4.7	Review whether User IDs are disabled after a defined period of inactivity and termination of service of the staff.	
4.8	Review whether passwords to log-in in the systems, applications, web portals are not displayed on the screen in the clear text.	
Physical and Logical Security		
5.1	Verify whether physical and logical access to critical systems and processes or areas (such as data center, servers, etc.) are restricted, subject to enhanced controls and suitably monitored by use of security guards, CCTVs, card access system, review of activity logs, etc.	
5.2	Verify whether the safety of the critical systems and processes is ensured by installation and operating effectiveness of fire alarms, smoke detection devices.	
5.3	Verify whether the automatic fire safety facilities are tested on a periodic basis.	
5.4	Verify whether the data center or server rooms have temperature control systems installed and its operational effectiveness are monitored on an ongoing basis.	
5.5	Verify whether Uninterrupted Power Supply (UPS) back-up is installed for servers, data centers and systems.	
5.6	Review whether back-ups media are stored at off-site location.	
5.7	Review whether movement of back-up media (if any) are tracked and monitored.	
5.8	Review whether the process of effectiveness of back-ups to restrict failed back-ups and monitor the same on an ongoing basis.	
5.9	Review whether the restoration of back-up tapes is verified at defined intervals.	

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5.10	Review whether the access to back-up is restricted to authorized personnel only.	
5.11	Review process, if any, available to destroy physical copies of the confidential information.	
5.12	Verify whether adequate controls surrounding data encryption or password protection are available for transfer of files containing business critical information to a network outside the corporate network.	
Change Management		
6.1	Review whether the AMC uses any tool for change management. Whether all relevant documents involved in the process of change are recorded and stored in the change management tool.	
6.2	Review whether all changes pass through an appropriate maker checker mechanism.	
Incident Management		
7.1	Review whether a log is maintained of all incidents occurred with details of root cause analysis and resolution. Such log also mentions the future course of action to be taken to avoid the recurrence of such incidence in future.	
7.2	Incidents noted are tracked to closure and appropriately notified to senior management and Board of Directors of AMC and Trustees and Audit Committee.	
Patch Management		
8.1	Verify whether the list of patches released, and version number of the applications is maintained.	
8.2	Review whether appropriate and adequate tests were performed before the patches were released in production environment.	

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8.3	Review whether the patches released cover the security concerns or improves the performance of the system or application or web portal.	
IT Asset Management		
9.1	Verify whether the AMC maintains an up-to-date inventory of its hardware, software and information systems (internal and external), details of its network resources, connections to its network and data flows.	
9.2	Review whether the audit trail for asset procurement, disposal and transfer is maintained.	
9.3	Verify that physical verification is performed for IT assets and discrepancies if any are resolved appropriately.	
9.4	Verify whether the IT assets are insured to cover the losses arising out of risks associated.	
Information Security		
10.1	Verify whether the data in motion and critical data at rest are encrypted.	
10.2	Review whether vulnerability assessment and penetration testing (VAPT) is performed for applications and networks at a defined frequency.	
10.3	Review whether open vulnerabilities are monitored for closure and closed within defined timelines.	
10.4	Verify whether alerts for abnormal or unauthorised system activities are monitored with the help of Security Operations Centre (SOC) technology, responded timely and reported to Senior Management.	
10.5	Verify whether periodic trainings are provided on information security breaches and 'Do's' and 'Don'ts' to safeguard against it.	

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Vendor Management		
11.1	Review the SLA in place with the vendor with a specific clause on non-disclosure requirement.	
11.2	Review whether the vendor performance is monitored with the terms of the SLA.	
11.3	Verify whether the exchange of information with the vendor is encrypted/ password protected. Appropriate approvals are in place for deviations. Note: Implementation of this control point is dependent on vendor preferences and capability of vendor systems. Vendors may not accept/ provide encrypted or password protected files	
11.4	Review whether Secured File Transfer Protocol (SFTP) is used for exchange of information with the vendor.	
Digital Technologies		
12.1	Verify whether AMC has a documented process to develop/ acquire and implement digital technologies including mobile applications, web-based portals, websites, cloud storage, etc.	
12.2	Verify whether Digital technologies have been implemented after performing adequate risk assessment and testing. Note: All other check points applicable for IT technologies are applicable for Digital technologies	
12.3	Review whether there are adequate controls to secure cloud facility used.	
12.4	Review whether appropriate controls, such as, Secure Shell (SSH) are put in place to ensure safe exchange of data through email.	
Cyber Security and Resilience Framework (SEBI Circular dated January 10, 2019) (over and above those covered above)		
13.1	Verify whether the AMC has a documented Cyber Security and Cyber Resilience Policy and the same is reviewed on a quarterly basis.	

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13.2	Verify whether the AMC has incorporated best practices from standards, such as, ISO27001, ISO27002, COBIT 5, etc.	
13.4	Review whether the AMC has devised a policy to monitor and regulate the use of internet and internet-based services, such as, social media sites, cloud-based internet storage sites, etc.	
13.5	Review whether the AMC has monitored capacity utilisation of its critical systems and networks.	
13.6	Verify whether regression testing is performed before implementation of a new and modified computer system.	
13.7	Review whether trainings are conducted for employees, outsourced vendors on Cyber security.	
13.8	Review whether the cyber insurance covers the loss of associated risks.	
Business Continuity Plan (BCP) and Disaster Recovery (DR) Plan		
14.1	Verify whether preparedness of the IT team to support business continuity.	
14.2	Verify their participation in mock BCP/DR drills.	
14.3	Verify whether special procedures are defined to work from home in extra ordinary situations. E.g. Epidemics, such as, SARS and MERS and Global Pandemics, such as, Covid-19.	
14.4	Verify transactions to determine that business disruption is minimised.	

Regulatory Updates

List of circulars issued from July 1, 2020 onwards are provided in the table below (Cut-off date for this document is June 30, 2020.):

I. List of SEBI Circulars

Date	Particulars
21 July 2020	Review of Stress Testing Methodology for Positions with Early Pay-in
10 August 2020	Resources for Trustees of Mutual Funds
13 August 2020	Investor grievances redressal mechanism – Handling of SCORES complaints by stock exchanges and Standard Operating Procedure for non-redressal of grievances by listed companies
24 August 2020	Master Circular for Mutual Funds
1 September 2020	Review of debt and money market securities transactions disclosure
8 September 2020	Entities permitted to undertake e-KYC Aadhaar Authentication service of UIDAI in Securities Market – Addition of NSE to the list
11 September 2020	Circular on Asset Allocation of Multi Cap Funds
17 September 2020	Circular on Mutual Funds
5 October 2020	Circular on Product Labeling in Mutual Fund schemes – Risk-o-meter
5 October 2020	Circular on Review of Dividend option(s)/ Plan(s) in case of Mutual Fund Schemes
8 October 2020	Circular on Guidelines on Inter Scheme Transfers of Securities
22 October 2020	Investor grievances redressal mechanism – Handling of SCORES complaints by stock exchanges and Standard Operating Procedure for non-redressal of grievances by listed companies.

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5 November 2020	Circular on Enhancement of Overseas Investment limits for Mutual Funds
6 November 2020	Circular on Norms regarding holding of liquid assets in open ended debt schemes & stress testing of open-ended debt schemes
6 November 2020	Circular on Introduction of “Flexi Cap Fund” as a new category under Equity Schemes
6 November 2020	Investor Grievance Redressal Mechanism

II. List of AMFI Circulars

Date	Particulars
26 June 2020	Updated Guidelines on Transmission of Units and standard formats of Transmission Request Forms supporting documents to be uniformly adopted by all AMCs Annexure
16 July 2020	Revision in the Guidelines on Transfer of AUM from one MF Distributor to another & Transfer of AUM of a deceased ARN holder to the ARN of the nominee/ legal heir of the deceased
16 July 2020	Updated Guidelines reg. Minors' Accounts and Change of status from Minor to Major
July 30, 2020	Additional disclosures in monthly Fact Sheets
August 28, 2020	Outlier criteria for Polling process
October 20, 2020	AMFI Guidance on MFD nomenclature in respect of SEBI (Investment Advisers) Regulations, 2013