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INTERNAL AUDIT POLICY

Preamble

The internal audit requirement arises from the Companies Act, 2013. As per Section 138 therein, read with Rule 13 of the Companies (Accounts) Rules, 2014, the following companies are required to appoint an internal auditor:

- a. Listed Companies
- b. Unlisted Companies

The Internal auditor shall either be a Chartered Accountant, Cost Accountant, or such other professional as may be decided by the Board of the company to conduct an internal audit of the functions of the Company.

The Companies that are required to appoint an internal auditor is as follows:

Companies having paid up Share capital of Rs.50 Crs or above during the preceding financial year or Turnover of Rs. 200 Crs or above during the preceding financial year, or Outstanding loans or borrowings from banks or public financial institutions of Rs.100Crs or above at any point of time during the preceding financial year or outstanding deposit of Rs.25Crs or above at any point of time during the preceding financial year.

Private Company having turnover of Rs. 200 Crs or above during the preceding financial year or Outstanding loan or borrowing from banks or public financial institutions of Rs.100 Crs or above at any point during the preceding financial year.

Further, Rule 13 of the rules, as mentioned earlier, also clarifies that the internal audit may or may not be an employee of the Company.

ISFC is a company incorporated under the Companies Act 2013. It is also a non-deposit accepting non-banking financial services company with a certificate of registration issued by the Reserve Bank of India. The norms governing internal audit for ISFC will also be further subject to the guidelines prescribed by the Reserve Bank of India *inter alia* in terms of Master Direction – Reserve Bank of India

(Non-Banking Financial Company – Scale Based Regulation) Directions, 2023¹. The said guidelines and their amendments or any relevant norms prescribed by the Reserve Bank of India and other regulators from time to time are deemed to be an integral part of this policy. Such norms shall be read along while implementing or interpreting this policy. The said direction specifically states that NBFCs that choose to outsource financial services shall, however, not outsource core management functions, including Internal Audit, Strategic and Compliance functions and decision-making functions such as determining compliance with KYC norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio. However, for NBFCs in a group/conglomerate, these functions may be outsourced within the group subject to compliance as prescribed in the said norms. Further, while the internal audit function itself is a management process, the internal auditors can be on contract. ISFC shall strictly apply the said norm while appointing and managing its internal audit. The internal audit function envisaged here shall also assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the NBFC's compliance with its risk management framework and the requirements of the said directions. The appropriate committee of the board of directors shall monitor the internal audit function envisaged herein. The internal audit will be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the company.

ISFC considers Internal Auditing an independent and objective consulting activity designed to add value and improve the company's operations. It assists the company in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of its governance and risk management, process control, regulatory, and compliance processes. This Policy defines the responsibilities of the Internal Audit function of ISFC. The audit procedure needs to be documented for the different streams of activity.

Objectives

The objectives of internal auditing *inter alia* are:

- (a) To ascertain compliance with statutory and regulatory requirements.
- (b) To ascertain compliance with norms laid down by the company.
- (c) To ascertain whether the quality of assets is as per approved norms.
- (d) To advise the management of any deficiencies in processes, procedures, and functions.
- (e) To determine the integrity, security, and controls in the information system are at acceptable standards; and
- (f) To identify deficiencies in the internal control system and recommend procedures to plug the control gaps.

Scope

¹ https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12550

1. The scope of internal auditing encompasses examining and evaluating the adequacy and effectiveness of the Internal Control System and performance in carrying out assigned responsibilities at the organizational, departmental, and functional levels. It includes:
 - (a) Reviewing the reliability and integrity of financial and operating information.
 - (b) Assessing compliance with policies, plans, and procedures.
 - (c) Assessing compliance with laws and regulations.
 - (d) Reviewing the means of safeguarding assets and verifying the existence of such assets and quality.
 - (e) Verifying the rate of interest offered to customers, underwriting policy norms, cash collection process at branch level by collection team, In-depth verification of branch with highest NPA on quality of approval, cheque bounce analysis, Lending and bouncing ratio, Delegation of powers, and third-party validation.
 - (f) Reviewing and appraising the economy and efficiency with which resources, including IT Resources, are employed.
 - (g) Review established internal control systems to ascertain whether they function as designed.
2. Monitoring and evaluating the effectiveness of the company's operational risk management processes.
3. Examining and reporting on the adequacy of internal controls for all new or significantly modified information systems.
4. Investigating and reporting on violations of policies and procedures, errors, fraud or misuse of company assets.
5. Performing forensic audits when there are red flags that warrant investigation.
6. Reviewing specific operations, programs, functions or activities at the request of the Audit Committee or management, as appropriate.
7. The Internal Audit will provide advice and assistance to the management, when requested, by:
 - (a) Serving as a consulting resource for the review of policies and procedures, financial and administrative systems, organizational structures, and other related administrative activities.
 - (b) Serving as a consulting resource for developing control procedures for new or significantly modified functional areas and computer-based financial and management information systems.

Audit Universe

The audit universe includes all the present and future activities in the company.

Audit Plan

1. A plan duly approved by the Board should be prepared for all audit streams to facilitate the audit activity. Prioritization is based on the level and direction of risk. The areas or activities identified as high, very high or extremely high-risk basis risk matrix may be audited at shorter intervals as compared to medium or low-risk areas, which may be audited at longer intervals subject to regulatory guidelines as applicable.
2. Frequency of audit of an activity/ function should be determined based on the risk perception.
3. However, all activities of the company will be audited at least once a year.

Audit Sampling

1. The internal auditor may perform sample verification where 100% verification is not warranted based on the risk perception.
2. The internal auditor should design and select an audit sample, perform audit procedures on it, and evaluate sample results to provide sufficient appropriate audit evidence to meet the objectives of the internal audit engagement.
3. When designing an audit sample, the internal auditor should consider the specific audit objectives, the population the internal auditor wishes to sample, and the sample size.
4. The internal auditor should select sample items so that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.

Audit Reporting

1. Following the conclusion of each audit, the auditor shall prepare an audit report, which will be finalized after discussion with the head of the department/activity under review.
2. The response should include a time frame for the anticipated completion of the action to be taken for rectifiable irregularities and an explanation for any recommendations that will not be addressed.
3. Timelines for closing audit reports for various audit streams will be laid down by which time all irregularities should be rectified.
4. For non-rectifiable irregularities, appropriate action must be taken within the time prescribed by the operational guidelines, or permission for maintaining the status quo must be obtained from the appropriate authority.
5. The internal auditor will distribute the report, obtain the comments, determine its adequacy and revisit the matter if necessary.

6. The Internal Auditor will report findings to the senior management. Any important points shall be reported to the appropriate committee of the BOD.

Documentation

1. The auditor shall prepare audit documentation based on which he reached his conclusions.
2. The documents may be kept in paper or electronic form. However, electronic documentation methods shall be used as far as possible.
3. The retention period of audit documents will be laid out in the respective manual. The documentation will be recalled in case of any dispute on the audit findings.

Code of Ethics

- Internal Audit staff members are responsible for conducting themselves so that their integrity, objectivity, confidentiality, and competency are not open to question.
- Internal Auditors shall possess the educational background, qualifications and competencies commensurate with their level of responsibility in providing assurance and consulting services to the company.
- Exercise objectivity and diligence in the performance of their duties and responsibilities.
- Exhibit loyalty in all matters pertaining to the company's affairs and refrain from participating in illegal or improper activity.
- Refrain from entering into any activity which may be in conflict with the interest of the company or which would prejudice their ability to carry out their duties objectively.
- Be prudent in using information acquired in the course of their duties. Do not use confidential information for personal gain or in a manner that knowingly would be detrimental to the company's interests.
- Use reasonable care to obtain sufficient factual evidence to support conclusions.
- Reveal such material facts known to them which, if not revealed, could distort the reported results of the audit and
- Continue to strive for improvement in the proficiency and effectiveness of their service.

Access to Information

Internal Audit has the authority to audit all functions of the company. It shall have complete access to all information, programs, databases, records, facilities and personnel relevant to the performance of an audit.

Documents and information given to internal auditors during a review will be handled consistent with company policy and in the same manner as the employees are normally accountable for them.

Auditee Responsibilities

The division/department or activity under review is to provide full cooperation to the Internal Auditor. The audit is planned without prior intimation. The auditee unit shall furnish information to the auditor whenever required.

Review of the Audit policy

The Internal Audit policy shall be reviewed at least once at the beginning of the year.

The Audit Committee/Board is responsible for reviewing and modifying the Internal Audit.