

# Independent Auditor's Report

## To the Members of AU Small Finance Bank Limited

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the accompanying financial statements of AU Small Finance Bank Limited ("the Bank"), which comprise the Balance sheet as at March 31, 2020, the Profit and Loss Account, the Cash Flow Statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Banking Regulation Act, 1949 and the Companies Act, 2013, as amended ("the Act") in the manner so required for the banking companies and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Bank as at March 31, 2020, its profit and its cash flows for the year ended on that date.

#### Basis for Opinion

We conducted our audit of the financial statements in accordance with the Standards on Auditing (SAs), as specified under section 143(10) of the Act. Our responsibilities under those Standards are further described in the 'Auditor's Responsibilities for the Audit of the Financial Statements' section of our report. We are independent of the Bank in accordance with the 'Code of Ethics' issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Act and the Rules thereunder, and we have fulfilled our other ethical responsibilities

in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the financial statements.

#### Emphasis of Matter

We draw attention to Note 2 of the Schedule 17 to the financial statements, which describes the extent to which the COVID-19 pandemic will impact the Bank's operations and its financial metrics which are dependent on uncertain future developments. Our opinion is not modified in respect of this matter.

#### Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the financial year ended March 31, 2020. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have determined the matters described below to be the key audit matters to be communicated in our report. We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

## Key audit matters

## How our audit addressed the key audit matter

### Identification of Non-Performing Advances and provisioning for Advances (Refer Schedule 17.4 to the financial statements)

Advances constitute a major portion of the Bank's assets and the quality of the Bank's loan portfolio is measured in terms of the proportion of non-performing assets (NPAs) to the total loans and advances. As at March 31, 2020, the Bank has reported total gross advances of ₹ 27,233 crore (March 31, 2019: ₹ 22,994 crore), gross non-performing advances of ₹ 458 crore (March 31, 2019: ₹ 470 crore) and a corresponding provision for non-performing advances of ₹ 240 crore (March 31, 2019: ₹ 176 crore).

Identification and provisioning of advances is governed by the prudential norms and guidelines relating to COVID-19 Regulatory Package issued by the Reserve Bank of India (RBI). These norms prescribe rule based and qualitative criteria for advances to be classified as NPA including overdue aging, moratorium on advances extension of asset classification benefit for specific Advances.

Given the volume and variety of loans, judgement is involved in the application of RBI norms for classification of loans as NPA and in view of the significance of this area to the overall audit of financial statements, it has been considered as a key audit matter.

Our audit procedures included, among others the following:

- Considered the Bank's accounting policies for NPA identification and provisioning and assessing compliance with the prudential norms prescribed by the RBI read with the RBI guidelines relating to COVID-19 Regulatory Package dated March 27, 2020 and April 17, 2020.
  - Tested the operating effectiveness of the controls (including application and IT dependent controls) for borrower-wise classification of loans in the respective asset classes viz., standard, sub-standard, doubtful and loss with reference to IRAC norms.
  - Performed test of details to test whether the provisioning rates applied for respective asset classes were in accordance with the Bank's accounting policies and assessed the reasonableness of the rates used by the management wherever such rates were higher than the minimum rates prescribed by RBI.
  - Performed inquiries with the credit and risk departments to ascertain if there were indicators of stress or an occurrence of an event of default in a particular loan account or any product category which need to be considered as NPA. Examined the early warning reports generated by the Bank's credit team on a monthly basis to identify loan accounts with credit stress.
  - Considered the special mention accounts (SMA) reports submitted by the Bank to the RBI's central repository of information on large credits (CRILC) to assess whether any accounts from such reporting need to be considered as non-performing.
  - Performed analytical procedures on various financial and non-financial parameters to test the completeness of accounts identified as NPA.
  - We made inquiries with management regarding any effects considered on the NPA identification and/or provisioning, resulting from observations raised by the RBI during their annual inspection of the Bank's operations.
  - Tested the arithmetical accuracy of computation of provision for Advances.
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- For testing the IT general controls, application controls and IT dependent manual controls, we included specialized IT auditors as part of our audit team. The specialized team also assisted in testing the accuracy of the information produced by the Bank's IT systems.
  - Tested the design and operating effectiveness of the Bank's IT access controls over the information systems that are critical to financial reporting.
  - Tested IT general controls (logical access, changes management and aspects of IT operational controls). This included testing that requests for access to systems were reviewed and authorized.
  - We considered the control environment relating to various interfaces, configuration and other application controls identified as key to our audit.
  - In addition to the above, we tested the design and operating effectiveness of certain automated controls that were considered as key internal controls over financial reporting.
  - Where deficiencies were identified, we tested compensating controls or performed alternate procedures.

### IT systems and controls

The reliability and security of IT systems plays a key role in the business operations of the Bank. Since large volume of transactions are processed daily, the IT controls are required to ensure that applications process data as expected and that changes are made in an appropriate manner. These systems also play a key role in the financial accounting and reporting process of the Bank.

Due to the pervasive nature and complexity of the IT environment we have ascertained IT systems and controls as a key audit matter.

Our areas of audit focus included user access management, developer access to the production environment and changes to the IT environment. These are key to ensuring IT dependent and application based controls are operating effectively.

### Information Other than the Financial Statements and Auditor's Report Thereon

The Bank's Board of Directors is responsible for the other information. The other information comprises the information included in the Annual report but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether such other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

### Responsibilities of Management and the Board of Directors for the Financial Statements

The Bank's Board of Directors is responsible for the matters stated in section 134(5) of the Act with respect to the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Bank in accordance with the provisions of Section 29 of the Banking Regulation Act, 1949, accounting principles generally accepted in India, including the Accounting Standards specified under section 133 of the Act read with the Companies (Accounts) Rules, 2014 in so far as they apply to the Bank provision of section 29 of the Banking Regulation Act, 1949 and the circulars, guidelines and directions issued by Reserve Bank of India ("RBI") from time to time.

This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Bank and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and the design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those Charged with Governance are also responsible for overseeing the Bank's financial reporting process.

### Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances. Under section 143(3) (i) of the Act, we are also responsible for expressing our opinion on whether the Bank has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements for the financial year ended March 31, 2020 and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

**Report on Other Legal and Regulatory Requirements**

1. The Balance Sheet and the Profit and Loss Account have been drawn up in accordance with the provisions of Section 29 of the Banking Regulation Act, 1949 read with the Companies (Accounting Standards) Rules,

2006 (as amended) specified under section 133 of the Act, read with the Companies (Accounts) Rules, 2014.

2. As required sub section (3) of section 30 of the Banking Regulation Act, 1949 and the appointment letter dated June 03, 2019, we report that:

- a. We have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purpose of our audit and have found them to be satisfactory;
- b. The transactions of the Bank, which have come to our notice, have been within the powers of the Bank; and
- c. The financial accounting systems of the Bank are centralised and therefore, accounting returns for the purpose of preparing financial statements are not required to be submitted by the branches. We performed procedures necessary for the purpose of our walkthrough of processes and test of controls at branches by inspection of documents obtained from branches.

3. As required by Section 143(3) of the Act, we report that:

- a. We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;
- b. In our opinion, proper books of account as required by law have been kept by the Bank so far as it appears from our examination of those books;
- c. The Balance Sheet, the Profit and Loss Account and the Cash Flow Statement dealt with by this Report are in agreement with the books of account;
- d. In our opinion, the aforesaid financial statements comply with the Companies (Accounting Standards) Rules, 2006 (as amended) specified under section 133 of the Act, read with the Companies (Accounts) Rules, 2014 to the extent they are not inconsistent with the accounting policies prescribed by RBI;
- e. On the basis of the written representations received from the directors as on March 31, 2020

- taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 2020 from being appointed as a director in terms of Section 164 (2) of the Act;
- f. With respect to the adequacy of the internal financial controls over financial reporting of the Bank with reference to these financial statements and the operating effectiveness of such controls, refer to our separate Report in "Annexure 1" to this report;
- g. In our opinion, the entity being a banking company, the remuneration to the whole-time director during the year ended March 31, 2020 has been paid by the Bank in accordance with the provisions of Section 35B (1) of the Banking Regulation Act, 1949; and
- h. With respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, as amended in our opinion and to the best of our information and according to the explanations given to us:
- i. The Bank has disclosed the impact of pending litigations on its financial position in its financial statements – Refer Note Schedule 12, Schedule 17.I and Schedule 18A – Note 32 to the financial statements;
- ii. The Bank did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses;
- iii. There were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Bank.

For **S.R. Batliboi & Associates LLP**  
Chartered Accountants  
Firm's Registration No.: 101049W/E300004

**per Sarvesh Warty**  
Partner  
Membership No.: 121411  
UDIN: 20121411AAAABP3586

Place of Signature: Mumbai  
Date: May 2, 2020

# Annexure 1 to the Independent Auditor's Report of Even Date on the Financial Statements of AU Small Finance Bank Limited

## Report on the Internal Financial Controls under Clause (i) of sub-section 3 of Section 143 of the Companies Act, 2013 (the "Act")

To the Members of AU Small Finance Bank Limited

We have audited the internal financial controls over financial reporting of AU Small Finance Bank Limited (the "Bank") as of March 31, 2020 in conjunction with our audit of the financial statements of the Bank for the year ended on that date.

### Management's Responsibility for Internal Financial Controls

The Bank's Management is responsible for establishing and maintaining internal financial controls based on the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India. These responsibilities include the design, implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the orderly and efficient conduct of its business, including adherence to the Bank's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Companies Act, 2013.

### Auditor's Responsibility

Our responsibility is to express an opinion on the Bank's internal financial controls over financial reporting based on our audit. We conducted our audit in accordance with the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (the "Guidance Note") and the Standards on Auditing as specified under section 143(10) of the Companies Act, 2013, to the extent applicable to an audit of internal financial controls, both applicable to an audit of Internal Financial Controls and, both issued by the Institute of Chartered Accountants of India. Those Standards and the Guidance Note require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether adequate

internal financial controls over financial reporting was established and maintained and if such controls operated effectively in all material respects.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the internal financial controls system over financial reporting.

### Meaning of Internal Financial Controls Over Financial Reporting

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

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

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

### **Opinion**

In our opinion, the Bank has, in all material respects, an adequate internal financial controls system over financial reporting and such internal financial controls

over financial reporting were operating effectively as at March 31, 2020, based on the internal control over financial reporting criteria established by the Bank considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India.

For **S.R. Batliboi & Associates LLP**  
Chartered Accountants  
Firm's Registration No.: 101049W/E300004

**per Sarvesh Warty**  
Partner  
Membership No.: 121411

Place: Mumbai  
Date: May 2, 2020