

# **Internal Audit of Mutual Funds and Portfolio Managers**

**CA Vidya Barje**

**M.P. Chitale & Co.**

September 17, 2016



# Internal Audit of Mutual Funds





# Setting the Context



# Regulatory framework governing Mutual Fund Internal Audit

Like provisions 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 the auditors shall check their adequacy on a continuing basis (SEBI Circular on Risk Management)



# Regulatory framework governing Mutual Fund Internal Audit ...

- 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 auditors.
- SEBI Circular No. MFD/CIR/09/014/2000 dated January 5, 2000 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 needs 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, 2000 states that compliance with recording of investment decisions needs to be verified by trustees through independent auditors or internal and/or statutory auditors or other systems developed by them.



# Regulatory framework governing Mutual Fund Internal Audit ...

- To supervise the activities of AMC, trustees appoint internal auditors and specify the scope of audit.
- ICAI has issued Technical Guide on Internal Audit of Mutual Fund which has suggested scope of audit and given detailed checklist (issued in December 2011).



# Preparing for Mutual Fund Internal Audit

- Develop good understanding of 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 market instruments
- Need to understand the Operations at Custodian and Registrar and Transfer Agent
- Typical process of units allotment w.r.t. cut off 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.



# Salient Features of SEBI MF Regulations

- Investor Protection is the paramount objective
- Stringent restrictions compared to PMS, Venture Capital
- Ensures Independence from the sponsor
- All investors to be treated equally
- Elaborate periodic reporting to SEBI
- Regular SEBI inspections





# Internal Audit Scope



# Mutual Fund Internal Audit – Scope

- 1 Investment transactions audit
- 2 Compliance w.r.t. SEBI (MF) Regulations
- 3 Review of SOPs and internal policies and their compliance
- 4 Verification of NAV
- 5 Review of reconciliations
- 6 Risk Management framework
- 7 Review of custody operations
- 8 Review of RTA operations
- 9 AMC Branch Operations
- 10 Distributors
- 11 Compliance with other Fiscal Acts
- 12 Review of Expenses



# Investment Audit



# Investment Audit

- Investment Transactions
- Investments prohibited
- Investments subject to restrictions
- Inter scheme transactions
- Scheme Information Document restrictions
- Limit on Broker-wise Business Distribution
- Cross Investments
- No Borrowing for Investment



# Investment Transactions audit

- Review of front office software system w.r.t.
  - 媏 Maker-checker controls;
  - 媏 Rights are given as per profile;
  - 媏 All SEBI and internal limits are monitored through FOS;
  - 媏 Correctness of masters created
- Verification of internal/external evidences
  - 媏 Contract notes
  - 媏 Counter party confirmations
  - 媏 Offer document of issuer;
  - 媏 Rating letter
- Research reports
  - 媏 For equity as well as debt
  - 媏 For first time purchase of the security;
  - 媏 Format to be approved by the Trustees;
  - 媏 Regular updation of the research report
- Recording of reasons for investment transactions;



# Investments Prohibited

- Investments in non-transferable securities
- Advancing loans
- Unlisted securities of associate/group company
  - 媮 Any security issued by way of private placement by an associate and group company
- Listed securities of group companies of sponsor exceeding 25% of net assets of MF



# Investments subject to restrictions

## ■ Investments in Debt securities

- Single issuer - 10% of NAV at scheme level. With trustee approval 12%.
- Unrated debt 10% at issuer level and total at 25% for scheme level
- Single sector – 25% of NAV. Additional exposure of 10% of NAV for housing finance companies
- Single group – 20% of NAV at scheme level. With trustee approval 25%.

## ■ Investments in Equity securities

- 10% of AUM at scheme level
- 10% of paid up share capital at MF level

## ■ Investments in the units of another scheme of same mutual fund or another mutual fund

- 5% of AUM at MF level

## ■ Investments in Capital Protection schemes

- Only AAA and equivalent securities



# Investments subject to restrictions...

## ■ Investment in Short Term Deposits

媿 Not to exceed 15% in each scheme can be increased to 20%.  
Single bank exposure to 10%

## ■ Investments by Liquid schemes

媿 Residual maturity not to exceed 91 days

## ■ Investment by close ended scheme

媿 No security to mature beyond the maturity date of the scheme





# Investments subject to restrictions...

## ■ Investments in foreign securities

- Overall limit of USD 300 mio per MF
- Limit for investment in overseas ETFs USD 50 mio
- SID to have provision to invest in foreign securities
- All prudential norms specified in seventh schedule are applicable
- Investment only in listed equity securities and debt securities rated above investment grade etc.
- Dedicated Fund Manager has been appointed for overseas investments
- Separate Disclosure in half-yearly portfolio
- AMC and trustees to review performance
- Trustees to comment in their report to SEBI on compliance with these requirements.



# Interscheme Transfers

- Interscheme Transfers are at Market rate
- Funds and security to be actually transferred from one scheme to another within 48 hours (spot basis)
- It should be as per the investment objective of the transferee scheme

Probable violations:

Transfer of Part of the security where securities are in physical form, transfer of securities have been allotted but not received.

Transfer of securities with out considering the market trades



# Investment in Derivatives

**SEBI circular No. Cir/IMD/DF/11/2010 dated August 18, 2010**

- Gross exposure through equity, debt and derivative not to exceed 100% of NAV. Futures exposure = No. of contracts \* lot size \* market price. Option exposure = Option premium paid
- Hedging positions not included in the above mentioned limits.
- Cash and cash equivalents with residual maturity of less than 91 days are not treated as exposure.
- Writing of options not allowed.
- Total exposure related to option premium paid should not exceed 20% of Net Assets.
- Contracts for interest rate swaps can be entered only with market makers. Value of notional principal can not exceed value of underlying asset and exposure to single counterparty can not exceed 10% of NAV.



# Other Investment Restrictions

- Scheme Information Document restrictions
  - 孃 Rebalancing with in a specified period
- Limit on Broker-wise Business Distribution
  - 孃 Reporting to AMC and Trustee Board
- Cross Investments
  - 孃 Needs to be disclosed when 5% limit is touched
- No Borrowing for Investment
  - 孃 Direct or Indirect (i.e. using other schemes funds)



# Compliance of SEBI (MF) Regulations



# Compliance with SEBI (MF) Regulations

- Composition of Board of trustees and AMC;
  - 媏 2/3rd Trustees and 50% in AMC directors to be independent
- Investment restrictions w.r.t. equity, debt securities, PTCs, derivatives, foreign securities etc.;
- Insider trading and Employee dealing policy;
  - 媏 Pre-clearance of investments
  - 媏 Reporting of investments
  - 媏 Restrictions in trading (within 30 days)
- Trustees approval for launch of new scheme 18(4)
- Filing of reports with board of AMC, Trustees, SEBI;
- AMFI/NISM certification of sales and marketing employees;



# Compliance with SEBI (MF) Regulations...

- Minimum number of investors and maximum holding by single investor;

孀 20 investors and not more than 25% AUM to be held by one investor – to be monitored on quarterly average basis.

孀 To be rebalanced with in 45 days.

- Updation of SAI, SID and KIM and Issue of addendums;

孀 KIM and SID updation on yearly basis, addendums to be updated on website and also physically to be sent to distributors/branches etc. as the change occurs

孀 Separate SID/KIM of each scheme needs to be uploaded on website

- Advertisements of Mutual fund

孀 Adherence of Schedule VI advertisement code and circulars issued by SEBI



# Compliance with SEBI (MF) Regulations...

- Product labeling to classify the schemes on the basis of risk involved. This risk disclosure needs to be made in SID/KIM and every advertisement.
- Performance reporting on AMC website in a comparable, downloadable (spreadsheet) and machine readable format
- Disclosure of Executive remuneration on AMC website
- Networth to be maintained by AMC – Rs. 50 Crs.
- AMC/sponsors to invest seed capital in each scheme - 1% of amount raised in NFO/AUM as on May 06, 2014 or Rs. 50 lacs whichever is less
- Minimum AUM to be maintained by each Debt oriented and Balanced scheme – Rs. 20 crs. on half-yearly rolling basis. If not maintained, compulsory winding up of the scheme





# Compliance with SEBI (MF) Regulations...

## ■ Charging of expenses within regulatory limits

孀 Reduced fee in case of Index Fund (1.5%) and Fund of fund scheme (0.75%)

孀 In case of FOF investing in overseas funds, fees charged by overseas and Indian funds not to exceed the limit. Disclosure regarding the same to be made in Annual report.

孀 Additional TER upto 30 bps on scheme AUM in case investment in B15 cities. This additional expenses needs to be clawed back if B15 investor redeems within 1 year from the date of investment.

## ■ Dividend Distribution – distributable surplus, dividend advertisements, trustee approval etc.

孀 Dividend to be paid only out of realised profit and unit premium can not be considered as distributable surplus.



# Compliance with SEBI (MF) Regulations

## ■ Dealing room functioning

媏 Recording of calls,

媏 Restriction on dealing through unrecorded lines (e.g. personal cell phones)

媏 Systems/procedures to review these recordings on a periodical basis and reporting of compliance to Trustees

## ■ Identification of performing and non-performing/doubtful assets;

## ■ Disclosure of votes cast

媏 AMCs to record and disclose specific rationale supporting their voting decision w.r.t. each vote

媏 Disclosure on website on quarterly basis within 10 working days from the end of the quarter.



# Compliance with SEBI (MF) Regulations

Scrutinizer's certificate to be obtained on yearly basis. This certificate to be submitted to trustees and disclosed in Annual report and website.

Boards to review and ensure that AMC has voted on all important decisions

## ■ Investor Education and Awareness

Setting apart 2 bps of daily AUM for investor education and awareness

½ of the funds to be transferred to AMFI

Amount to be spent only on investor education and awareness

MFs to print literature in regional languages and conduct campaigns also in regional languages.



# **Compliance of AMFI circulars/Best practices Guidelines**



# Compliance with AMFI Guidelines

Though not regulatory, SEBI's instructions to follow AMFI Guidelines. AMFI has issued guidelines/given directions in the following areas:

- Laid down criteria for identification of suspicious transactions to be reported by AMCs under PMLA Guidelines
- Given clarifications for complying with SEBI Circular on minimum no. of investors and investor holding more than 25% of AUM
- Valuation of debt securities – to adopt Security level pricing
- Computation of additional expenses to be charged on subscriptions from B15 cities and clawback of expenses and brokerage
- Payment of maximum commission/brokerage to distributors
  - 媿 Upfront brokerage not to exceed 1%
  - 媿 Total brokerage (Upfront and Trail) to be paid within Distributable Total expense ratio (DTER)
  - 媿 Any marketing support expenses (other than specifically allowed) are also to be considered as payment of commission
  - 媿 Payment of brokerage for B15 subscription can be upto B15 expenses accrued



# Compliance with AMFI Guidelines

- Stress testing of liquid and money market schemes, on quarterly basis, risk management policy to be framed
- Guidelines related to investor servicing such as documents to be obtained for change of bank mandate (COB), processing of combined application for COB and redemption, application to indicate Employee identification no. (EUIIN) selling mutual fund units, process for aggregating split transactions for NAV applicability, guidelines for dealing with redemptions/ switch-out prior to realisation of funds, process for identifying and dealing with third party cheques etc.



# SOPs/Internal Policies



# Compliance with SOPs/internal policies

## ■ AMC needs to frame detailed SOPs for

Dealing, Settlement of trades

Cash Flow preparation

NAV computation

Valuation

Reconciliations

Risk Management

Broker empanelment

Compliance with MF Regulations

Compliance with procedures/processes specified in SOP needs to be verified.





# Compliance with SOPs/internal policies...

## ■ Policies framed by AMC

媿 Investment Policy;

媿 Broker empanelment policy;

媿 Distributor/Agent empanelment policy;

媿 Policy for allocation of common expenses over the schemes

媿 Valuation Policy;

媿 Employee and director's Securities Dealing Policy;

媿 Policy on Proxy voting



# NAV Verification



# Significance of NAV in Mutual Fund

- NAV denotes intrinsic value of the scheme and is suppose to represent realisable value of the net assets of the scheme
- All the subscriptions/redemptions /switches are carried out at NAV
- This is the single parameter of the performance measurement for the schemes
- Regulatory restriction on timing of declaration of NAV
- Virtually no margin for error in NAV computation



# Components of NAV

- Total Assets
  - 孃 Investments at market value
  - 孃 Interest/discount accrued till date
  - 孃 Bank balances
  - 孃 Other current assets
- Total liability (excluding Unit Capital) i.e.
  - 孃 Current Liabilities including expenses accrued
- Number of units as on the day end
- NAV of the scheme is (Market Value of Asset – Liability)
- NAV of the unit is Scheme NAV/Number of Units



# Verification of NAV

- Accounting of investment transactions;
- Accounting/accrual of Corporate Benefits;
- Accounting/accrual of income (e.g. interest, discount etc.);
- Marking investments to Market
- Accounting/accrual of recurring expenses;
- Accounting of unit capital;
- Publication of NAV within given timelines



# Sensitivity of Valuation in determining NAV

- The only element in NAV which is debatable and could be subjective is Valuation
- This is the element of NAV prone to errors and could result in significant impact on NAV
- Different theories exist for valuation as it is often said Valuation is not only a Science but also an Art



# Valuation of Investments

## ■ Points to remember:

- Each schemes of the Mutual Fund, it is completely different than the other Scheme of the same Mutual Fund. They are like apples and oranges.
- Conservative approach in the valuation for NAV may not be necessarily prudent
- Always check if the action is fair and equitable for the incoming, continuing and exiting unit holders
- Regulations are different than Acts thus when there is apparent inconsistency, do interpret the regulations to understand the intent.



# Valuation of Investments...

- Reg. 47 specifies that mutual fund shall carry out valuation as per valuation norms specified in Eighth Schedule. Good Faith valuation
- Amendment to Regulations dated February 21, 2012
  - 媏 All investments to be valued at Fair value i.e. Realisable value;
  - 媏 While arriving at the realisable value also ensure securities are to be valued in good faith and in true and fair manner;
  - 媏 Policy needs to be consistent and not the valuation result;
  - 媏 Valuation Rule:
    - ◆ Rule no. 1 is Valuation should be at realisable value.
    - ◆ Rule no. 2 Do not follow any rule other than Rule no. 1.
  - 媏 Schedule VIII and Circulars etc. issued can be used only if it would ensure fair valuation;
  - 媏 Valuation principle should be followed at all times and not necessarily the same methodology;
  - 媏 Aforesaid principle is applicable to all the securities irrespective of the tenure.





# Valuation of Investments...

- Taking cue from this the following are the necessary attributes of valuation of non traded security:
  - Consistency (in method not the result),
  - Transparency,
  - Clear measurability,
  - Defined in the approved valuation policy



# Review of Reconciliations



# Review of Reconciliations

- Securities;
- Bank Accounts – Investment, Redemption, dividend;
- Pending Corporate actions;
- Unit capital – three way reconciliation;  
(RTA, Accounts and Bank)



# Review of Reports



# Review of Reports

## ■ List of reports to be submitted to SEBI/Trustees/RBI:

Name of the report	To be submitted to	Frequency of Submission/ Stipulated Due dates
Monthly Cumulative Report	SEBI	Monthly i.e. by the 3rd business day of the following month
Compliance Test Report	SEBI	Bimonthly i.e. within 21 days of the completion of the two months period
Half-yearly portfolio	SEBI	Half Yearly i.e. 1 month from the end of each half year
Half-yearly un-audited results in new format	SEBI	Half Yearly i.e. within 1 month from the end of each half year



# Review of Reports...

## ■ List of reports to be submitted to SEBI/Trustees/RBI:

Name of the report	To be submitted to	Frequency of Submission/Stipulated Due dates
<b>Bi-monthly Compliance Certificate</b>	<b>Trustees</b>	<b>Bimonthly</b>
<b>Quarterly AMC Activity Report</b>	<b>Trustees</b>	<b>Quarterly</b>
<b>Half-yearly Report from AMC to BoT</b>	<b>Trustees</b>	<b>Half Yearly i.e 1 month from the end of the half year</b>
<b>Half-yearly Report from BoT to SEBI</b>	<b>SEBI</b>	<b>Half Yearly i.e. within 2 months from the end of the half year</b>



# Review of Reports...

## ■ List of reports to be submitted to SEBI/Trustees/RBI:

Name of the report	To be submitted to	Frequency of Submission
<b>Annual Accounts</b>	<b>SEBI/Unit Holders</b>	<b>Within 4 months from the end of the year</b>
<b>Abridged scheme-wise Annual Report</b>	<b>Unit Holders</b>	<b>Within 4 months from the end of the year</b>
<b>Annual Statistical Report</b>	<b>SEBI</b>	<b>Within 30 days from the end of the year</b>
<b>Reconciliation of SGL holdings</b>	<b>RBI</b>	<b>Quarterly</b>
<b>New Scheme Report</b>	<b>SEBI</b>	<b>Within 10 days from the close of the scheme</b>



# Review of Reports...

## ■ Points to be verified:

- 媏 Format and content of report as per SEBI/AMFI circulars
- 媏 Logic in preparation of reports such as dates, securities, transaction types, classification of issuers etc. considered in preparation of the reports in case reports are generated from system
- 媏 Correctness of data used for preparation of reports
- 媏 Filing of reports within due dates





# Registrar & Transfer Agent Function



# Review of RTA operations

- **Transactions audit covering purchases, redemptions, switches, SIP, SWP etc. w.r.t. for transactions received through all sources such as physical application, channel, online etc.**

- 媏 Cut-off time

- 媏 Applicable NAV

- 媏 KYC compliance

- 媏 Charging of load, STT, TDS etc.

- 媏 T15/B15 classification of investors

- 媏 UBO declaration

- 媏 FATCA declaration

- **Verification of Scheme Masters w.r.t.**

- 媏 Minimum subscription and redemption amounts;

- 媏 Lock-in period;

- 媏 Applicability of switch;

- 媏 Marking of lien;

- 媏 Entry/exit load;

- 媏 Brokerage rates etc.



# Review of RTA operations...

- Review of service level requests such as change of address, bank mandate, claims, transmission etc. and the promptness on part of the RTA in handling such cases.
- Review of reconciliation of unit capital, subscription, redemption, switches and dividend bank accounts;
- Correctness of dividend and DDT;
- Review of brokerage w.r.t.
  - 孀 Timely changes in the brokerage rates as per AMC instructions;
  - 孀 Correctness of Brokerage calculation as instructed by AMC;
  - 孀 Deduction and payment of service tax;
- Review of investors complaints received and compliance thereof;
- Review of reports generated by RTA;



# Review of RTA operations...

## ■ Compliance with SEBI (MF) Regulations w.r.t.

- 媏 NAV applicability for transactions amounting to Rs. 2 lakhs and above, split transactions, unclaimed dividend/redemption cases;
- 媏 Timely payment of dividend and redemption;
- 媏 Timely dispatch of Account statement and format of Account Statements
- 媏 Restrictions on redemptions are only as per SEBI circular;
- 媏 Sending reminder letters to returned undelivered cases;
- 媏 Single plan structure



# Review of RTA operations...

- Compliance with AMFI best practices such as
  - 媏 Consideration of T15/B15 locations on the basis of PIN code and not the place of acceptance of application
  - 媏 Cooling off period for Change of bank Mandate and redemption requests received together
  - 媏 Payment of brokerage only to distributors having NISM certification and KYD, has provided self-certification etc.
  - 媏 No payment of brokerage on sponsor investments
  - 媏 Acceptance of third party cheques



# AMC Branch Operations



# Review of AMC Branch Operations

- Compliance with time stamping and KYC norms
- Display of NAV, addendums
- Availability of SAI/SID/KIM
- NISM certification of sales and operations staff dealing with investors
- Reporting of transactions to HO on timely basis
- Requests and complaints handling



# Distributors





# Review of Distributors

- Empanelment process
- KYD compliance
- Due diligence of certain distributors
- Payment of brokerage/incentives
- Review of distributor operations on regular basis by AMC



# Custody Operations



# Review of custody operations

- Controls in place for settlement of trades;
- Compliance with SLA for delivery of various reports on timely basis;
- Reconciliation of securities;
- Reconciliation of outstanding corporate actions
- Physical verification of certificates, if any



# Risk Management



# Review of Risk Management Compliance

SEBI Circular dated September 30, 2002 has laid down the risk management framework to be put in place by the AMC;

## ■ Broadly has three parts

### ■ **Mandatory**

- ◆ Risk officer / Risk Management Committee
- ◆ BCP/DR in place
- ◆ Insurance cover by AMC and its service providers

### ■ **Recommendatory**

- ◆ Integrated front office and back office
- ◆ Cash management system
- ◆ Best execution testing
- ◆ Various ratios as risk measurement tools
- ◆ Anti Money Laundering
- ◆ Liquidity support
- ◆ Stress testing of liquid and money market schemes

### ■ **Industry practices**

- Trustees need to review the framework put in place (through internal audit function) on periodic basis



# **Fiscal Laws compliance**



# Compliance with other Acts

- Deduction and payment of tax at source;
- Payment of Dividend distribution tax;
- Charging and payment of Securities Transaction tax;
- Payment of service tax



# Applicable taxes

- Dividend distribution tax is not payable in respect of income distribution by equity oriented mutual funds but applicable in case of all other schemes.
- TDS on expenses chargeable to Mutual Fund such as printing, courier, AMC fees, professional/audit fees, advertising, marketing expenses etc.
- Capital gain in case of non residential investors.
- STT on unit redemption of equity oriented schemes.





# Expenses' Verification



# Expenses chargeable to scheme

- Marketing and selling expenses including agents' commission
- Brokerage and transaction cost
- RTA fees
- Audit fees
- Custody fees
- Investor communication i.e. printing and stationary expenses of quarterly newsletters, annual reports, addendums etc., courier and postage expenses
- Cost of statutory advertisements
- Winding up expenses
- Service tax on all above expenses



# Expenses not chargeable to scheme...

- Penalties and fines for infraction of laws.
- Interest on delayed payment to the unit holders.
- Legal, marketing, publication and other general expenses not attributable to any scheme(s).
- Expenses on investment management/general management.
- Expenses on general administration, corporate advertising and infrastructure costs.
- Depreciation on fixed assets and software development expenses



# Monitoring of Expenses

## ■ Probable violation:

- 媿 Units held by AMC/FD investments/Investment in MF units not reduced for computing AMC fees chargeable.
- 媿 Mistake in allocation of common expenses across the schemes
- 媿 Expenses of one schemes accounted to another scheme
- 媿 Expenses of general nature attributable to the AMC wrongly charged to schemes



# Internal Audit of Portfolio Managers





# Setting the Context



# Regulatory framework governing Mutual Fund Internal Audit

SEBI Circular No. IMD/PMS/CIR/1/21727/03 dated November 18, 2003 state that :

“There shall be internal audit by a practicing CA or CS so as to judge the quality of internal procedures being followed by the portfolio manager. The report of the internal audit shall be submitted to the Board of the portfolio manager.”

There is no scope or frequency specified for the audit. Generally it is carried out on quarterly or half-yearly basis.



# Preparing for PMS Internal Audit

- Develop good understanding of structure of portfolio management activities and various entities associated with mutual fund
- Develop good understanding of difference in discretionary, non-discretionary and advisory activities carried out by Portfolio Manager
- Develop good understanding about Portfolio Managers Regulations
- Regulatory requirements are limited compared to MF Regulations. Client agreement governs the working of portfolio manager.





# Internal Audit Scope



# PMS Internal Audit – Scope

## 1 Operations audit

- Investment transactions
- Recording of income and expenses
- Valuation
- Reconciliations
- Accounting of corpus
- Fees computation.

## 2 Compliance w.r.t. SEBI (PM) Regulations



# Operations Audit

Scope and methodology is as per Mutual Fund audit. Distinctive features of PMS audit would be:

- Computation of fees: fixed fees and performance fees. Performance fees is hurdle based. High Watermark principal to be applied. High Water Mark is highest value that portfolio has reached. Performance fees can be charged only on increase in portfolio value in excess of the previously achieved high water mark.
- Fees and charges to be disclosed in Disclosure Document and agreement and client needs to sign the fees annexure and add in their own handwriting that they have understood the fees/charge structure.



# Operations Audit...

- Allocation of trades if executed on pool basis to ensure all clients get same rate
- Valuation of securities – No NAV needs to be declared. Valuation needs to be carried to compute correct AUM on the basis of which fees are computed.
- Valuation of corpus-in/out – Value on the date of entering into agreement or on receipt of securities in client's PMS Demat Account whichever is later. In case of corpus-out, value on the date of transfer of securities in client's individual Demat Account or date of cessation of agreement whichever is earlier.



# Compliance Audit

- No investment restrictions specified in Regulations. Need to follow what has been stated in Disclosure Document and Client Agreement. Also need to follow following investment rules –
  - 婣 Not to borrow funds
  - 婣 No leveraging allowed. Investment in derivatives only for hedging purpose.
  - 婣 Not to enter into any speculative transactions.
- Format of Disclosure Document and client agreement needs to be as per Regulations
- Portfolio Manager not to accept funds less than Rs. 25 lakhs. Corpus cannot go below Rs. 25 lakhs except due to reduction in value of assets
- Client can instruct not to invest in particular securities. Not to purchase/sale of securities other than during trading window if instructed by client.



# Compliance Audit...

- Securities – listed as well as unlisted - are kept in separate demat account opened for each client – except investment in Liquid Funds
- Clear segregation of the client funds from Portfolio Manager's funds and funds of separate clients
- Funds to be kept in separate bank account – Not to use funds of one client for another client and regular reconciliations to be carried out.
- Custodian to be appointed if AUM is more than Rs. 500 crs.
- To send audited statement to each client on yearly basis
- Furnishing of periodic reports to clients
- Quarterly reporting to Board of Directors
- Submission of monthly and half-yearly report to SEBI



# Open House



Thank You

