

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF THE FEDERAL BANK LIMITED

Report on the Audit of the Standalone Financial Statements

Opinion

We have audited the accompanying Standalone Financial Statements of **THE FEDERAL BANK LIMITED** ("the Bank"), which comprise the standalone balance sheet as at 31 March 2019, and the standalone profit and loss account, the standalone cash flow statement for the year then ended and notes to the Standalone Financial Statements, including a summary of the significant accounting policies and other explanatory information in which are included the Returns for the year ended on that date audited by the branch auditors of the Bank's branches.

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid Standalone Financial Statements give the information required by the Banking Regulation Act, 1949 ('BR Act') as well as the Companies Act, 2013 ("Act") in the manner so required for 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 31 March 2019, and profit and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Act. Our responsibilities

under those SAs are further described in the *Auditor's Responsibilities for the Audit of the Standalone 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 Standalone 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 opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Standalone Financial Statements of the current period. These matters were addressed in the context of our audit of the Standalone Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Description of Key Audit Matters

Identification of Non-Performing Assets ('NPAs') and Provision on Advances Gross NPA: INR 3,260.68 crore for year ended 31 March 2019 Charge (including write-off): INR 630.55 crore for year ended 31 March 2019 NPA Provision: INR 1,606.32 crore as at 31 March 2019 <i>Refer to the accounting policies in "Schedule 17 to the Standalone Financial Statements: Significant Accounting Policies- Use of estimates and Advances and Note 1.4 and Note 3.1 of Schedule 18 to the Standalone Financial Statements: Advances"</i>	
The key audit matter	How the matter was addressed in our audit
<p>Significant estimate and judgment involved</p> <p>Identification of NPAs is made based on the assessment of various criteria stipulated in the Reserve Bank of India ('RBI') guidelines with regard to the 'Prudential Norms on Income Recognition, Asset Classification and Provisioning'. NPA classification is made borrower wise whereby if one facility to the borrower becomes an NPA then all facilities to such a borrower will be treated as an NPA.</p> <p>Provisions in respect of such NPAs and restructured advances are made based on management's assessment of the degree of impairment of the advances subject to and guided by the minimum provisioning levels prescribed under RBI guidelines, prescribed from time to time. The provision on NPAs are also based on the valuation of the security available. In case of restructured accounts, provision is made for erosion/diminution in fair value of restructured loans, in accordance with the RBI guidelines.</p>	<p>Our key audit procedures included:</p> <p>Design / controls</p> <ul style="list-style-type: none"> Assessing the design, implementation and operating effectiveness of key internal controls over approval, recording and monitoring of loans, monitoring process of overdue loans (including those which became overdue subsequent to the reporting date), measurement of NPA provision, identification of NPA accounts, and assessing the reliability of management information, which included overdue reports. In addition, for corporate loans we tested controls over the internal ratings process, monitoring of stressed accounts including credit file review processes and review controls over the approval of significant individual impairment provisions. Evaluated the design, implementation and operating

The key audit matter	How the matter was addressed in our audit
<p>We identified NPA identification and provision on loans and advances as a key audit matter because of the significant efforts involved by the management in identifying NPAs based on the RBI guidelines, the level of management judgement involved in determining the provision, the valuation of security of the NPAs and on account of the significance of these estimates to the financial statements of the Bank.</p>	<p>effectiveness of key internal controls over the valuation of the securities for NPAs and the Special Mention Accounts ('SMA').</p> <ul style="list-style-type: none"> • Testing of management review controls over identification of NPAs, measurement of provisions and disclosures in financial statements, including auditing management controls on Early Warning System of identifying credit impairment indicators. • Involved our information systems specialist in the audit of this area to obtain evidence and get assurance over data integrity and calculations, including system reconciliations. <p>Substantive tests</p> <ul style="list-style-type: none"> • Test of details for a selection of exposures over calculation of NPA provisions including valuation of collaterals for NPAs as at 31 March 2019; the borrower-wise NPA identification and provisioning determined by the Bank and also testing related disclosures by assessing the completeness, accuracy and relevance of data and to ensure that the same is in compliance with the RBI guidelines with regard to the Prudential Norms on Income Recognition, Asset Classification and Provisioning. • We also selected a number of loans to test potential cases of loans repaid by a customer during the period by fresh disbursement(s) to these higher risk loans. • We selected samples (based on quantitative and qualitative thresholds) of corporate clients where impairment indicators had been identified by management. We obtained management's assessment of the recoverability of these exposures (including individual provisions calculations) and challenged whether individual provisions, or lack of, were appropriate. • This included the following procedures: <ul style="list-style-type: none"> - Reviewing the statement of accounts, approval process, board and credit committees minutes, credit review of customer, review of Special Mention Accounts ('SMA') reports and other related documents to assess recoverability and the classification of the facility; - Assessed external collateral valuer's credentials and comparing external valuations to values used in management's assessments; and - For a risk based sample of corporate loans not identified as displaying indicators of deterioration by management, challenged this assessment by reviewing the historical performance of the customer and assessed whether any impairment indicators were present.

The key audit matter	How the matter was addressed in our audit
<p>Valuation of Financial Instruments (Investments) Gross value of investments: INR 32,224.29 crore as at 31 March 2019 Mark to market: INR 399.82 crore as at 31 March 2019 Net value of investments: INR 31,824.47 crore as at 31 March 2019</p>	
<p><i>Refer to the accounting policies in "Schedule 17 to the Standalone Financial Statements: Significant Accounting Policies- Investments" and "Schedule 8 to the Financial Statements: Investments"</i></p>	
<p>Significant estimate and judgment involved</p> <p>Investments</p> <p>Investments are classified into 'Held for Trading' ('HFT'), 'Available for Sale' ('AFS') and 'Held to Maturity' ('HTM') categories at the time of purchase. Investments, which the Bank intends to hold till maturity are classified as HTM investments.</p> <p>Investments classified as HTM are carried at amortised cost. Where in the opinion of management, a diminution, other than temporary, in the value of investments has taken place, appropriate provisions are made.</p> <p>Investments classified as AFS and HFT are marked- to-market on a periodic basis as per the relevant RBI guidelines.</p> <p>We identified valuation of investments as a key audit matter because of the management judgement involved in determining the value of certain investments (Bonds and Debentures, Pass through certificates) based on the policy and model developed by the Bank, impairment assessment for HTM book and the overall significance to the financial results of the Bank.</p>	<p>Our key audit procedures included:</p> <p>Design / controls</p> <p>We tested the design, implementation and operating effectiveness of management's key internal controls over the valuation process and independent price verification, including the Bank's review and approval of the estimates and assumptions used for the valuation including key authorization and data input controls;</p> <p>We assessed appropriateness of the valuation methodologies with reference to RBI guidelines and Bank's own valuation policy;</p> <p>Read investment agreements / term sheets entered into during the current year, on a sample basis, to understand the relevant investment terms and identify any conditions that were relevant to the valuation of financial instruments.</p> <p>We tested the controls operated at the Bank for ensuring completeness of the investments.</p> <p>Substantive tests</p> <p>We verified the list of investments from eKuber for SLR securities and DP statements for Non-SLR securities.</p> <p>We independently verified the fair valuation of investments on a sample basis with direct observable inputs and external input data such as market value from FBIL, spreads from FIMMDA etc. after considering the requirements of RBI guidelines.</p> <p>We assessed that the financial statement disclosures appropriately reflected the Bank's exposure to investments valuation risks with reference to the requirements of the prevailing accounting standards and the RBI guidelines.</p>
<p>Information technology ('IT') systems</p>	
<p>IT systems and automated controls</p> <p>The Bank's key financial accounting and reporting processes are highly dependent on information systems including automated controls in systems, such that there exists a risk that gaps in the IT control environment could result in the financial accounting and reporting records being materially misstated. Amongst, its multiple IT systems, seven systems are key for its overall financial reporting.</p> <p>In addition, large transaction volumes and the increasing challenges to protect the integrity of the Bank's systems and data, cyber security has become a more significant risk in recent periods.</p> <p>We have identified 'IT systems and automated controls' as key audit matter because of the high level automation, significant number of systems being used by the management and the complexity of the IT architecture.</p>	<p>Our key IT audit procedures included:</p> <ul style="list-style-type: none"> • We focused on user access management, change management, segregation of duties, system reconciliation controls and system application controls over key financial accounting and reporting systems. • We tested a sample of key controls operating over the information technology in relation to financial accounting and reporting systems, including system access and system change management, program development and computer operations. • We tested the design and operating effectiveness of key controls over user access management which includes granting access right, new user creation, removal of user rights and preventative controls designed to enforce segregation of duties.

The key audit matter	How the matter was addressed in our audit
	<ul style="list-style-type: none"> • For a selected group of key controls over financial and reporting system, we have performed procedures to determine that these controls remained unchanged during the year or were changed following the standard change management process. • We have also assessed other areas which includes password policies, security configurations, system interface controls, controls over changes to applications and databases and that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment. • Security configuration review and related tests on certain critical aspects of cyber security on network security management mechanism, operational security of key information infrastructure, data and client information management, monitoring and emergency management.

Information Other than the Standalone Financial Statements and Auditors' Report Thereon

The Bank's management and Board of Directors are responsible for the other information. The other information comprises the information included in the Bank's Annual Report, but does not include the Standalone Financial Statements and our auditors' report thereon. The Bank's Annual report is expected to be made available to us after the date of this auditor's report.

Our opinion on the Standalone 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 Standalone Financial Statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the Standalone Financial Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the Bank's Annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Management's Responsibility for the Standalone Financial Statements

The Bank's management and Board of Directors are responsible for the matters stated in section 134(5) of the Act with respect to the preparation of these Standalone Financial Statements that give a true and fair view of the state of affairs, profit and cash flows of the Bank in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified

under Section 133 of the Act, provisions of Section 29 of the Banking Regulation Act, 1949 ("BR Act") and the circulars, guidelines and directions issued by the 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 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 standalone financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

In preparing the standalone financial statements, management and Board of Directors are 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.

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

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

Our objectives are to obtain reasonable assurance about whether the standalone 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 standalone 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 standalone financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- 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 standalone financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the standalone financial statements, including the disclosures, and whether the standalone financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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 standalone financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' 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

The balance sheet and the profit and loss account have been drawn up in accordance with the provisions of Section 29 of the BR Act, Section 133 of the Act.

- (A) As required by sub section (3) of Section 30 of the BR 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 purpose of our audit ;
 - (b) the transactions of the Bank, which have come to our notice, have been within the powers of the Bank; and
 - (c) since the key operations of the Bank are automated with the key applications integrated to the core banking systems, the audit is carried out centrally as all the necessary records and data required for the purposes of our audit are available therein. However, during the course of our audit we have visited 40 branches. Returns from 1,234 branches were received duly audited by other auditors and were found adequate for the purpose of our audit.
- (B) Further, 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 and have found them to be satisfactory;
 - (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 reports on the accounts of the 1,234 branches of the Bank audited by branch auditors under Section 143(8) of the Act have been forwarded to us and have been properly dealt with by us in preparing this report;
- (d) the standalone balance sheet, the standalone profit and loss account and the standalone cash flow statement dealt with by this Report are in agreement with the books of accounts.
- (e) in our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act to the extent they are not inconsistent with the accounting policies prescribed by the RBI;
- (f) on the basis of the written representations received from the directors as on 31 March 2019 taken on record by the Board of Directors, none of the directors is disqualified as on 31 March 2019 from being appointed as a director in terms of Section 164(2) of the Act;
- (g) with respect to the adequacy of the internal financial controls with reference to financial statements of the Bank and the operating effectiveness of such controls, refer to our separate Report in "Annexure A"; and
- (C) With respect to the other matters to be included in the Auditors' Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, 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 Standalone Financial Statements - Refer Schedule 12 and No.4.7 of Schedule 18 to the Standalone Financial Statements;
 - ii. The Bank has made provision, as required under the applicable law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts- Refer Note 4.12 of Schedule 18 to the Standalone Financial Statements ;
 - iii. There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Bank
 - iv. The disclosures required on holdings as well as dealing in specified bank notes during the period from 8 November 2016 to 30 December 2016 as envisaged in notification

G.S.R. 308(E) dated 30 March 2017 issued by the Ministry of Corporate Affairs is not applicable to the Bank

- (D) With respect to the matter to be included in the Auditors' Report under section 197(16):
- i. The Bank is a banking company as defined under Banking Regulation Act, 1949. Accordingly, the requirements prescribed under Section 197 of the Companies Act, 2013 do not apply.

For B S R & Co. LLP
Chartered Accountants
Firm's Registration No:
101248W / W-100022

For M.M. Nissim & Co.
Chartered Accountants
Firm's Registration No:
107122W

Akeel Master
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Membership No: 046768

Sanjay Khemani
Partner
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Mumbai
May 4, 2019

ANNEXURE A TO THE INDEPENDENT AUDITORS' REPORT ON THE STANDALONE FINANCIAL STATEMENTS OF THE FEDERAL BANK FOR THE YEAR ENDED 31 MARCH 2019.

Report on the internal financial controls with reference to the aforesaid standalone financial statements under Clause (i) of Sub-section 3 of Section 143 of the Companies Act, 2013

(Referred to in paragraph (B)(g) under 'Report on Other Legal and Regulatory Requirements' section of our report of even date)

Opinion

We have audited the internal financial controls with reference to financial statements of The Federal Bank Limited ("the Bank") as of 31 March 2019 in conjunction with our audit of the standalone financial statements of the Bank for the year ended on that date.

In our opinion, the Bank has, in all material respects, adequate internal financial controls with reference to financial statements and such internal financial controls were operating effectively as at 31 March 2019, based on the internal financial controls with reference to financial statements 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 (the "Guidance Note").

Management's Responsibility for Internal Financial Controls

The Bank's management and the Board of Directors are responsible for establishing and maintaining internal financial controls based on the internal financial controls with reference to financial statements criteria established by the Bank considering the essential components of internal control stated in the Guidance Note. These responsibilities include the design, implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the orderly and efficient conduct of its business, including adherence to Bank's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Companies Act, 2013 (hereinafter referred to as "the Act").

Auditors' Responsibility

Our responsibility is to express an opinion on the Bank's internal financial controls with reference to financial statements based on our

audit. We conducted our audit in accordance with the Guidance Note and the Standards on Auditing, prescribed under section 143(10) of the Act, to the extent applicable to an audit of internal financial controls with reference to financial statements. 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 with reference to financial statements were established and maintained and whether 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 with reference to financial statements and their operating effectiveness. Our audit of internal financial controls with reference to financial statements included obtaining an understanding of such internal financial controls, 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 standalone 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 Bank's internal financial controls with reference to financial statements.

Meaning of Internal Financial controls with Reference to Financial Statements

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

material effect on the financial statements.

Inherent Limitations of Internal Financial controls with Reference to Financial Statements

Because of the inherent limitations of internal financial controls with reference to financial statements, 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 with reference to financial statements to future periods are subject to the risk that the internal financial controls with reference to financial statements may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

For B S R & Co. LLP

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May 4, 2019