SUPPLEMENTARY AUDIT QUALITY REVIEW REPORT

(SAQRR)

AUDITOR: DELOITTE HASKINS AND SELLS LLP (FIRM REGISTRATION NO.: 117366W/W-100018) AUDITEE: IL&FS FINANCIAL SERVICES LTD. FINANCIAL YEAR: 2017-18

REPORT NO 3/2020 DATED: 07/12/2020

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Table of Contents

Annexures

Note: Page 107 comprises of 6 number of pages which are numbered as page 107(i) to 107(vi).

List of Abbreviations

AQR	Audit Quality Review
AGM	Annual General Meeting
BOD	Board of Directors
CRAR	Capital to Risk Assets Ratio
CAM	Credit Appraisal Memorandum
CCDs	Compulsorily Convertible Debentures
DAQRR	Draft Audit Quality Review Report
DSAQRR	Draft Supplementary Audit Quality Review Report
DTTI LLP	Deloitte Touche Tohmatsu India LLP
DHS LLP or DHS	Deloitte Haskins & Sells LLP
EFVS	External Fair Value Specialist
EQCR	Engagement Quality Control Review
EP	Engagement Partner
ET	Engagement Team
FY	Financial Year
GCP	General Contingency Provisions
GRICL	Gujarat Road & Infrastructure Company Limited
ICAI	Institute of Chartered Accountants of India
ICRA	Investment Information and Credit Rating Agency
IECCL	IL&FS Engineering and Construction Company Limited
IEDL	IL&FS Energy Development Ltd
IFIN	IL&FS Financial Services Limited
IFVS	Internal Fair Value Specialist
IL&FS Ltd	Infrastructure Leasing & Financial Services Limited
ITNL	IL&FS Transportation Networks Limited
IT	Information Technology
Ind AS	Indian Accounting Standards
MSEI	Metropolitan Stock Exchange of India Limited - Formerly MCX Stock Exchange Limited
NBFC	Non- Banking Financial Company
NFRA	National Financial Reporting Authority
NOF	Net Owned Funds
NPA	Non- Performing Asset
PBT	Profit Before Tax
PBTCO	Profit Before Tax from Continuing Operation
PRCL	Pipavav Railway Corporation Limited
PY	Previous Year
RBI	Reserve Bank of India
ROMM	Risk of Material Misstatement

SAQRR	Supplementary Audit Quality Review Report
SQC	Standard on Quality Control
SA	Standards on Auditing
SI	Systemically Important
SCN	Show Cause Notice
TCWG	Those Charged with Governance
WP or AWP	Working Paper or Audit Working Paper

Chapter 1: Introduction

1.1. Section 132(2)(b) of the Companies Act, 2013, requires the National Financial Reporting Authority (**NFRA**) to, inter-alia, monitor and enforce compliance with accounting standards and auditing standards in such manner as may be prescribed.

1.2. Rule 8 of the **NFRA** Rules, 2018, provides that, for the purpose of monitoring and enforcing compliance with auditing standards under the Act, the **NFRA** may –

(a) review WPs (including audit plan and other documents) and communications related to the audit;

(b) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

(c) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

1.3. Pursuant to the duty cast upon the **NFRA**, and the mandate given in this connection, the **NFRA** had taken up the AQR of the Statutory Audit of IFIN for the FY 2017-18 (the **"Engagement")** carried out by **Deloitte Haskins & Sells LLP (Firm Registration No. 117366W/W-100018) ("Audit Firm").** The **AQR** has the objective of verifying compliance with the Requirements of Standards on

Auditing (SAs) by the **Audit Firm** relevant to the performance of the **Engagement.** The AQR also has the objective of assessing the Quality Control System of the **Audit Firm** and the extent to which the same has been complied with in the performance of the Engagement.

1.4. The AQR process was started by asking the **Audit Firm** to provide to **NFRA** the **Audit File** (as defined by Para 6(b) of SA 230). Thereafter, the Audit Firm was issued a questionnaire on 2nd May, 2019. The Audit Firm provided its response to the questionnaire on 13th May, 2019, detailing therein the relevant sections of the **Audit File** pertaining to the several questions. The matters raised in the initial questionnaire of the **NFRA** dated 2nd May, 2019, were examined by referring to the portion of the **Audit File** relevant thereto as pointed out by the Audit Firm. Subsequently, the **NFRA** conveyed its prima facie observations/comments/ conclusions on the various issues in the questionnaire to the Audit Firm vide its letter dated 28th June, 2019. The Audit Firm provided its detailed response to the NFRA's prima facie observations/comments/conclusions vide its letter dated 3rd August, 2019. A **Draft Audit Quality Review Report (DAQRR)** was issued on 25th September, 2019. The **Audit Firm** made a presentation in response to the DAQRR to the **NFRA** on 30th October, 2019, and followed it up by submitting their written response to the DAQRR on 4th November, 2019. This was examined and an Audit Quality Review Report (AQRR) was issued on 12th December, 2019.

1.5. **NFRA** had examined only some select issues arising out of the Statutory Audit of IFIN for 2017-18 in detail in the **AQRR issued on 12th December, 2019**. It reserved its right to follow up on the issues that had not been covered in the AQRR by a Supplementary Report. **NFRA** had issued an additional questionnaire on 21st October, 2019. The Audit Firm provided its response to the questionnaire on 15thNovember, 2019, detailing therein the relevant sections of the **Audit File** pertaining to the questions. NFRA examined the responses in detail and issued a Draft Supplementary AQR report dated 1st May, 2020 for which the Audit Firm provided their replies on 25th July, 2020. Later a presentation has been made by the Audit Firm on 28th October, 2020 followed by a clarification letter dated 11th November, 2020. NFRA has examined in detail all these submissions and issues

this Supplementary AQR report which covers issues raised in **NFRA**'s letter dated 21st October, 2019, and other issues which were not covered in the AQRR dated 12th December, 2019.

1.6. A detailed chronology of the events mentioned in the above paragraph as well as the references to the earlier findings of the **NFRA** in this case is placed at **Annexure B**. All this material would need to be consulted to provide the background to the present **SAQRR**, and, when found necessary, to support the reasoning in the present **SAQRR** in respect of any issue. The detailed discussions on the several issues covered in the AQRR are not repeated here in the interests of conciseness.

Chapter 2: NFRA's Conclusions

2.1 General

2.1.1 The NFRA has gone through the responses of the Audit Firm sent vide their letter dated 3rd August, 2019, and 15th November, 2019, along with all its enclosures, and has concluded as in the subsequent sections of this Report in respect of the several issues raised by NFRA.

2.1.2 While the discussion in this **SAQRR** on individual issues refer to SAs most directly bearing on the issues/facts under consideration, it needs to be borne in mind that certain generally applicable requirements of the SAs, such as the need to exercise professional skepticism, the need to obtain sufficient appropriate Audit Evidence, performance of procedures to address the assessed risks etc., would have to be read as integral parts of all individual issues, though not specifically included therein.

2.1.3 NFRA has found that the appointment of DHS as the statutory auditors of IFIN for FY 18 was prima facie illegal, and therefore void *ab initio*, for violation of Sections 141(3)(e) and 141(3)(i) of the Companies Act, 2013. The certificate provided by the Audit Firm to comply with the proviso to Sec 139(1) is also held to have been given fraudulently. Notwithstanding these conclusions, NFRA has proceeded to examine the nature of the substantive compliance by the Audit Firm with the applicable SAs and has detailed its findings in subsequent sections of this SAQRR. NFRA's findings with regard to compliance with the SAs need to be read subject to its findings on the illegality of the appointment of DHS as statutory auditors of IFIN, and without in any way derogating from such findings.

2.1.4 The instances discussed below of failure to comply with the requirements of the SAs are of such significance that it appears to the NFRA that the **Audit Firm** did not have adequate justification for issuing the Audit Report asserting

that the audit was conducted in accordance with the SAs. In this connection, the NFRA wishes to draw attention to Response 12 in the ICAI's Implementation Guide on Reporting Standards (November 2010 edition) that says that "**A key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs**"; and that **"If during a subsequent review of the audit process,**

it is found that some of the Audit Procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could be very serious indeed" (emphasis added). It bears emphasis that the very serious consequences referred to would ensue irrespective of whether such non- compliance was or was not associated with a proved financial reporting misstatement. Failure to comply with any of the Requirements of applicable SAs indicates that the **Audit Firm** has failed to achieve the central purpose of the audit, and that there was not an adequate basis to issue the report that it did.

2.2 Compliance with Independence Requirements

2.2.1 In its AQRR dated 12th December, 2019, NFRA concluded as follows pertaining to the independence of the **Audit Firm**:

a) The **Audit Firm** has grossly violated the provisions of Section 144 of the Companies Act, 2013;

b) The **Audit Firm** has been in serious breach of the Code of Ethics;

c) There has been a violation of the RBI Master Directions pertaining to mandatory rotation of the EP;

d) The above violations had undoubtedly fatally compromised the independence in mind required of the **Audit Firm**. The total fee for the 15 engagements listed in Annexure I was ₹666. 63 lakhs in comparison to the Audit Fee for the year 2017-18 of ₹401 lakhs for both the auditors. It was noted that these 15 Engagements were from IL&FS Ltd, the holding company of the group, or directly from IFIN, and did not include any of the several Engagements given by other Associates and Group Companies of IL&FS Group.

e) Independence in appearance stood completely destroyed since no unbiased person could conclude, on an objective assessment of the circumstances, that there had been no abridgement of the auditor's independence; and

f) The **Audit Firm**'s QC Policies and Practice relating to independence had been shown to be severely inadequate and not fit for purpose.

2.2.2 Besides the above, NFRA made the following further observations and asked the Audit Firm to respond to them:

a) Section 141 of the Companies Act, 2013, provides for eligibility, qualifications, and disqualifications of Auditors. Section 141(3) gives a list of various persons who shall not be eligible for appointment as an auditor of a company. Section 141(3)(i) (before the Companies Amendment Act, 2017) states that "any person whose subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting and specialized services as provided in Section 144".

Besides, Section 141(3)(e) of the Companies Act, 2013, prohibits the appointment as auditor of any person or firm who, whether directly or indirectly, has business relationship with the Company or its subsidiary,

or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed. For this purpose, "business relationship" is defined by Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014. Read together, this means that provision of non-audit services that are prohibited by Section 144 would not be exempt business relationships, and the provision of such non-audit services that violate Section 144, such violation including the absence of approval of The Audit Committee for the provision of such non-audit services, would render the appointment of an **Audit Firm** as auditor of the Company ab initio null and void.

At this stage, we need to highlight a vital distinction between Section 141(3)(e) and Section 144. While the prohibition under Section 144 is limited to provision of **non-audit services** to either a **subsidiary company or the holding company** of the Auditee Company, or the Auditee Company itself, Section 141(3)(e) prohibits **business relationships** including with associate companies, and subsidiaries of either the holding company or associate company. Such a business relationship would bar acceptance of an Audit Engagement at the threshold; further, any such business relationship that arises during the Audit Engagement would, by operation of Section 141(4), lead to automatic vacation of the office of auditor, and result in a casual vacancy in the office of auditor.

b) The abridged details of the Non-Audit Fee, as provided by the **Audit Firm**, are as follows:

Table 1

S. No.	Non-Audit Service providing Firm	Client Company	Financial Year	Amount (₹)
1.	DTTI LLP	IL&FS Ltd.	2018-19	15,00,000

2.	DTTI LLP	IFIN	2017-18	1,50,00,000
3.	DHS LLP	IFIN	2017-18	44,00,000
4.	DHS LLP	IL&FS Ltd. and its affiliates	2017-18	55,00,000
5.	DHS LLP	IFIN	2017-18	25,00,000
6.	DHS LLP	IL&FS Ltd.	2017-18	78,00,000
7.	DHS LLP	IL&FS Ltd. and its subsidiaries and affiliates	2017-18	61,12,500
8.	DHS- Mumbai LLP	IFIN	2016-17	11,00,000
9.	DTT India Pvt. Ltd.	IL&FS Ltd.	2015-16	72,00,000
10.	DTT India Pvt. Ltd.	IL&FS Ltd.	2015-16	9,00,000
11.	DTT India Pvt. Ltd.	IFIN	2014-15	37,00,000
12.	DHS- Mumbai LLP	IL&FS Ltd.	2014-15	12,50,000
13.	DHS- Mumbai LLP	IL&FS Ltd.	2014-15	9,00,000
14.	DTT India Pvt. Ltd.	IL&FS Ltd.	2014-15	40,00,000
15.	DTT India Pvt. Ltd.	IL&FS Ltd.	2014-15	38,00,000
TOTAL				6,56,62,500

It can be observed from the above table that:-

i. the **Audit Firm** provided non- audit services during the tenure of their appointment as the Statutory Auditor of the Company for the FY 2017-18;

ii. the **Audit Firm** was into the practice of providing non-audit

services to the IL&FS Group from the past many years;

iii. the above revenue does not include services provided by the **Audit Firm** and its Affiliates to other group companies of the Auditee Company; and hence,

iv. this brings out the **business relationships** of the **Audit Firm** with the client group.

As such, clearly, the appointment of the **Audit Firm** as Statutory Auditor of IFIN was ab initio illegal and void for violation of Section 143(3)(e) and Section 143(3)(i) of the Act. The declaration of eligibility submitted by the **Audit Firm**, under Section 139(1) of the Companies Act, 2013, is therefore, also, fraudulent.

c) The **Audit Firm's** compliance with the fundamental principles of independence was also completely compromised by the self-interest threat

which occurred due to the **business relationships, financial interest** and dependence on fees as stated above.

2.2.3 On consideration of all the above evidence, the NFRA had concluded in the DSAQRR that:

a) The reappointment of the **Audit Firm** as Statutory Auditor of IFIN for the FY 2017-18 was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act.

b) The declaration of eligibility submitted by the **Audit Firm** in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constituted fraudulent conduct on the part of the **Audit Firm**.

c) The **Audit Firm's** compliance with the fundamental principles of the

Code of Ethics was threatened by the self-interest threat.

d) The **Audit Firm**, its EP, and the EQCR Partner were all guilty of professional misconduct arising out of gross violations of the law and the Code of Ethics.

2.2.4 The **Audit Firm** submitted in their reply to the DSAQRR that:-

a) Since Section 144 of the Companies Act, 2013, does not define the term "management services", NFRA cannot now seek to define the term of its own accord. The Audit Firm's interpretation of "management services" is the appropriate interpretation as it was based on a thoughtful and reasoned evaluation of the relevant professional and regulatory literature available at the time of audit. In the absence of a single literal meaning, or definition of "management services" under the law, the auditor exercised professional judgment in determining which services are prohibited. The Audit Firm interpreted the term based on-

- the international code i.e., IESBA Code of Ethics based on which ICAI Code of Ethics is issued,
- the history of legislation (including relevant provisions of Sarbanes Oxley Act 2002 and Rules),
- application of mind, after due legal consultation, to make a professional judgment.

b) After the above stated analysis, the Audit Firm states that "In particular, a "management service" is an act or set of acts usually performed by the actual management of an entity, including planning, direction, and control activities. The primary test to identify prohibited non audit services is to ascertain whether rendering the non-audit service in question would result in a situation of self-review threat or self-interest threat". The Audit Firm in their professional judgment, interpreted the term 'management services' to include services ordinarily provided by management but performed instead by an Audit Firm. The Audit Firm's

services were limited to providing recommendations to the management for their consideration and action and is consistent with applicable guidance and practice. The Audit Firm did not engage in any decision making, direction setting or policy decisions for IFIN. No engagement was carried out which was in the nature of "management responsibilities", and would in any manner constitute "management services", and hence complied with section 144 of the Companies Act, 2013. Therefor there is no violation of section 141(3)(i) also. There is no violation of section 141(3)(e) as permissible services are exempted from the scope of business relationships. Consequently, the declaration of eligibility submitted by the Firm in terms of Proviso to Section 139(1) of the said Act read with Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014, was also valid.

c) The comparison of fees creates an inaccurate impression because it relies on differing and inconsistent time frames. It uses different entity scopes for each piece of data. The comparison includes fees for non-audit services provided not only to IFIN, but also to other companies such as IL&FS Limited. The fees paid to the Audit Firm and its affiliate entities for non-audit services from the respective entity did not exceed the audit fees for that entity in each year. The Audit Firm is in compliance with the ICAI Code of Ethics.

2.2.5 NFRA has examined in detail the submissions of the **Audit Firm**. NFRA notes that the statements made by the Audit Firm reveal a complete absence of professionalism. The statements also reveal an attempt to try and force a meaning into the relevant section of the law that would support the action already taken, notwithstanding the fact that such interpretation is completely violative of the principles of interpretation of statutes. It is also seen that reading such forced meanings into the Act is completely destructive of the spirit of the Code of Ethics, and completely casts aside the lofty idealism that permeates the Code of Ethics. NFRA has reached these conclusions on the following grounds.

a) NFRA wishes to draw attention at this stage to the following:

- The Guidance Note on Independence of the Auditors issued by the ICAI states as follows:

"It is not possible to define "independence" precisely. Rules of professional conduct dealing with independence are framed primarily with a certain objective. The rules themselves cannot create or ensure the existence of independence. ***Independence is a condition of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered".*** (emphasis supplied). The Audit Firm seems to have not been able to avoid the confusion that the ICAI has warned against.

b) The cardinal rule of construction of a statute is to read it literally, which means by giving to the words used by the legislature their ordinary, natural, and grammatical meaning. The implication of this principle is that extraneous material or considerations should not be imported into the wording of statutes in order to arrive at their meaning. Based on the above principles, NFRA concluded in the AQRR that "the definition of "management services", read in the context in which the term has been used in the statute, can be only understood to mean "services performed by the statutory auditor" for the management, either (a) in the form of doing actions/functions that would otherwise have to be done/undertaken by the management; or (b) providing any kind of support (inclusive of analysis, research, advice etc.) that is required by the management for the performance of those actions/functions".

c) The **Audit Firm's** methodology of interpreting the term "management service" does not follow these fundamentals of reading a law. Instead they say that "on matters of auditor independence (such as definition / meaning of the term "management services") for which clear and specific guidance is not provided under such law" a professional accountant "has three options: (i) first, to refer to the international code

i.e., IESBA Code of Ethics based on which ICAI Code of Ethics is issued; (ii) second, to refer to the history of legislation (including relevant provisions of Sarbanes Oxley Act 2002 and Rules); and (iii) third, to apply one's own mind after due legal consultation to make a professional judgment". As explained in detail while examining the Audit Firm's arguments in the AQRR, all the above are entirely extraneous material that have no place in the interpretation of the statute. To avoid repetition, all that material is not traversed again here.

d) The **Audit Firm** ignores the fundamental fact that the Companies Act, 2013, is an Act of Parliament, unlike the ICAI Code of Ethics. The latter in no way can have the effect of changing the language of the Act and it cannot either curtail or expand the ambit of the sections of the Act. Thus, the prohibition of "management responsibilities" in the Code of Ethics has to be read independently, and in addition to or supplemental to the provisions of the Act, and only to the extent that it is not repugnant to the express provisions and language of the Act. If the advisory services and recommendations to assist management etc. are permitted as per the Code of Ethics, such permission can in no way be extended to define the explicit provisions of the Companies Act, 2013, in so far as the Companies Act does not permit such an interpretation. Such a permission in the Code of Ethics only means that the term "management responsibility" as used in the Code does not include such services.

e) This is further explicit from para R600.8 of the Code of Ethics 2019 which provides that "**Subject to applicable restrictions under Companies Act, 2013**, to avoid assuming a management responsibility when providing any non-assurance service to an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management" (Emphasis supplied).

f) By a plain reading of section 144 of the Companies Act, 2013, as done by NFRA in the AQRR, the literal meaning of the words management

services includes any services provided by the Audit Firm to/for the management. The dictionary meanings of the word service is "providing something" and the term management means "the act of running and controlling a business or similar organization" and/or "the people who run and control a business or similar organization" [Reference: Oxford Dictionary]. The prohibition in Sec 144 of the provision of the specified services is absolute, and there is no warrant in the language of the section to contend, as the Audit Firm has done, that "The primary test to identify prohibited non audit services is to ascertain whether rendering the non-audit service in question would result in a situation of self-review threat or self-interest threat". While interpreting the scope of the prohibited services listed in Section 144 of the Companies Act, 2013, the interpretation must be biased to the broadest view possible of the scope of such prohibited services, keeping in view the mischief sought to be remedied by the section, viz., the need to achieve independence both in mind, and in appearance. The listed services suffer from an absolute and unconditional prohibition, and there cannot be any requirement imposed to prove the existence of any of the threat categories as a pre-condition to their prohibition.

g) The interpretation of the Audit Firm that only "management responsibilities" (*controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources)* is what is comprehended by "management services" is a total misinterpretation of "management services". Similarly, to say that "management service" is "an act or set of acts usually performed by the actual management of an entity, including planning, direction, and control activities" is to stand the words on their head. The legislation talks about services that are ordinarily performed by an Auditor. Interpreting such services as the functions performed by the management is illogical and makes the statute absolutely meaningless.

h) During the presentation made on 28th October, 2020, the Audit Firm

reiterated its written arguments. "If **NFRA's interpretation that 'management services' would cover all services to management**, then the need to list the services included in the section as prohibited would not arise, since **in any case these services would have also been to the management** and therefore would have been covered under 'management services' as interpreted by NFRA" and "NFRA's interpretation would imply that even **assurance services (like tax audit services) cannot be rendered** by the auditor since they too are services to the management" (Emphasis added). In addition, the Audit Firm in in para 6.1 of its written clarifications dated November 11, 2020 submits that "Schedule III to the Companies Act, 2013 in which in the 'General instructions for preparation of statement of profit and loss' in clause 5A (i) (j) (d), a company is required to disclose fees paid to auditors for 'management services'. The explicit recognition that such fees will be paid and should be disclosed makes it apparent that not all 'management services' are prohibited under the Companies Act, 2013".

- NFRA observes that the above contentions of the Audit Firm are made without any valid reasoning.
- NFRA has interpreted the term management services in its plain literal sense as detailed in the SAQRR and the AQRR. NFRA has never interpreted the term as covering "all services to management" as stated by the Audit Firm. 'Management services' in its literal meaning include only the services of performing management actions/functions and providing any kind of support (inclusive of analysis, research, advice etc.) that is required by the management for the performance of such actions/functions as detailed elsewhere in this SAQRR and earlier in the AQRR. It needs to be kept in mind that "management" would mean "the act of running and controlling a business or similar organization" and/or "the people who run and control a business or similar organization" [Reference: Oxford Dictionary]. Thus, provision of other services **to the company** and

not to the "management" of the company such as, for example, internal audit, tax audit etc. are not covered under the definition of management services as these are not services provided to the management of the company. These are specialised services provided to the company by the specified entities as per existing regulatory norms. Similarly all the services listed in clause (a) to (g) are specialised services which the Auditor is expected to be capable of providing and which could be obtained by companies from outside.

- Schedule III is disclosure requirements in financial statements. The clause quoted by the Audit Firm requires disclosure of "(j) Payments to the auditor as (a) auditor; (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services; and (f) for reimbursement of expenses". As far as this argument is concerned, it is clear that:

- Sch III, containing disclosure requirements, cannot be interpreted contrary to the substantive provisions of the law, and certainly not in a manner to override such substantive provisions.

- While it is one thing to argue that a specific service is not a "management service", it would be completely unacceptable to say, on the strength of the words used in Sch III, that "The explicit recognition that such fees will be paid and should be disclosed makes it apparent that not all 'management services' are prohibited under the Companies Act, 2013".

i) Thus, none of the arguments of the **Audit Firm** in interpreting the meaning of the term management services is justified or acceptable. The meaning of the term management services, and the intention of the legislature, is abundantly evident and there is no support for the interpretation of the **Audit Firm**.

j) The **Audit Firm** has argued that the permitted services as per section 144 of the Companies Act are exempt from the scope of the term "business relations" for the purposes of section 141(3)(e) of the Companies Act. 2013. However the Audit Firm has ignored the fact that any services other than those expressly prohibited under section 144 should be approved by the Audit committee. The AQR has clearly shown that none of these services were approved by the Audit Committee of IFIN, which is the competent authority as per section 144. Without prejudice to the fact that the Audit Firm provided prohibited services in the nature of management services, the services provided by the Audit Firm are not in compliance with section 144 in terms of approval by the Audit Committee and hence not exempted for the purpose of the definition of the term business relations, under section 141(3)(e).

k) Accordingly, by all counts the declaration of eligibility submitted by the **Audit Firm** in terms of Proviso to Section 139(1) of the Companies Act 2013 read with Rule 10(4) of the Companies (Audit and Auditors) Rules, 2014, is not valid.

l) The directions issued by RBI require to rotate the engagement partner every three years so that the same partner does not conduct audit of the company continuously for more than a period of three years. The Audit Firm stated that the directions came into force on and from 10th April, 2015 and the partner serving as the Engagement Partner at that time rotated out as the Engagement Partner at the end of F.Y. 2015- 16. However, NFRA observes that the partner who signed the Audit Report dated 6th May, 2016 on standalone financial statements of IFIN had served for 5 years in the Audit, thereby violating the RBI Directions. Having known the RBI requirement, the Audit Firm is guilty of professional misconduct in terms of not bringing out the violations by the Company and not communicating the facts appropriately.

m) The statement by the Audit Firm that "the directions issued by RBI bind the NBFC and impose an obligation on the NBFC (and not the Audit

Firm) to rotate the engagement partner once in three years. Therefore, a violation of those directions, if any, would be committed by the NBFC" betrays a complete lack of responsibility on the part of the Audit Firm. In this regard, a specific query has been asked by NFRA during the presentation made on 28th October, 2020, whether it is the Audit Firm's stand that if a such a direction is not directly addressed to the Audit Firm but is addressed to the audit client company, and the Audit Firm is aware that the audit client company to whom the direction is addressed is willing to look the other way, the firm would be comfortable following that audit client's position. The Audit Firm replied in the negative and stated that the RBI Directions are prospective in nature and hence not applicable to IFIN Audit. In para 1.1 of their subsequent clarification letter dated 11th November, 2020 the Audit Firm sates that "Any continued non-compliance would be viewed seriously, including by evaluating whether to continue serving the client. We would however like to expressly state that the query and our response is not applicable in the context of IFIN audit for F.Y. 2017-18 as no such non-compliance was observed or suspected in the IFIN audit". However, the actions of the Audit Firm does not follow its submissions as above, in so far as the engagement Partner was not rotated out as stipulated in the RBI Directions. The said RBI Directions clearly state that they came into effect from the date of their issue, viz., 10th April, 2015. Hence, the audit partner for FY 14-15 should not have continued for FY 15-16.

n) The listing of fees in the AQRR is to bring out the business relationship the **Audit Firm** had with the Auditee as detailed in para 2.2.2 (b). As per Companies (Audit and Auditors) Rules, 2014 the term "business relationship" shall be construed as **any transaction entered into for a commercial purpose.** (Emphasis added). Hence the contentions of the Audit Firm in this regard are not acceptable. There is violation of Code of Ethics as well because the **Audit Firm**, or a network firm, has a direct and/or indirect material financial interest in the financial

statement audit client. Also, para 290.32 of the Code of Ethics specifically require the Audit Firm to consider whether any threats to independence may be created by previous services provided to the audit client.

2.2.6 On consideration of all the above evidence, the NFRA, therefore, reiterates its conclusions in the DSAQRR that:

a) The reappointment of the Audit Firm as Statutory Auditor of IFIN for the FY 2017-18 was ab initio illegal and void for violation of Section 141(3)(e) and Section 141(3)(i) of the Act.

b) The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139(1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. Hence, this clearly constitutes fraudulent conduct on the part of the Audit Firm.

c) The Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by the self-interest threat.

d) The Audit Firm, its EP, and the EQCR Partner were all guilty of professional misconduct arising out of gross violations of the law and the Code of Ethics.

2.3 Investments

2.3.1 NFRA sought the following clarifications from the **Audit Firm** vide letter dated 21st October, 2019, with regard to sale/purchase of Investments during the FY 2017-18:

a) Whether the Audit Firm had examined the purchase of 93,27,125 equity shares of Gujarat Road & Infrastructure Company Limited (GRICL) and 1,20,00,000 shares of Pipavav Railway Corporation Limited (PRCL) for a consideration of ₹147.18 Crores and ₹54 Crores respectively from a

Related Party?

b) Whether the Audit Firm had examined other sale/purchase transactions of investments to/from related parties?

c) Whether any evidence was collected for verifying the sale/purchase of investments, including agreements and basis for valuation for (a) and (b) above?

d) Whether any evidence was collected for the verification of the arm's length nature of the transactions with related parties?

e) Whether any evidence was obtained/collected for verification of transfer of ownership of shares, and completion of transactions at agreed price?

f) Whether the Audit Firm had examined the list of related parties to ensure the inclusion of all the related parties, as disclosed by the Management?

2.3.2 The **Audit Firm** in its response dated 15th November, 2019, stated as follows: -

a) Investments in equity shares of Gujarat Road & Infrastructure Company Limited ('GRICL') and Pipavav Railway Corporation Limited ('PRCL') purchased during the FY 2017-18 by IFIN was accounted by the Company as Long-term Investments.

These investments were tested as part of the substantive procedures performed by us, the details of which are as follows: (Refer AWP: 23150.01.01 Investment in Equity & Preference Shares):

- Checked the Committee of Directors' (COD) approvals which

include analysis on financial position of Investee Company, for purchase of shares of GRICL and PRCL. Also further checked the subsequent noting by the Board for the said Investments approved by the COD (Refer AWP: 23150.01.01 Investment in Equity & Preference Shares, "manual AWP: 21301 Minutes of Meetings").

- Reviewed the Audit Committee minutes of meeting which approved that all the arrangements / transactions entered with related parties were in the Ordinary Course of Business of the Company and at arm's length as per the approved framework on related party transactions (Refer "21301 Minutes of Meetings"). With respect to acquisition of shares of GRICL and PRCL, Audit Committee noted that post the fulfillment of the conditions by the selling entity and completion of the due diligence, the equity shares have been received against the advance paid earlier. The transaction has been consummated post obtaining the valuation from an independent valuer as prescribed under the framework for related party transactions.
- Advance paid against which the said purchase consideration of shares was adjusted was also tested.
- Verified the share purchase agreement executed between the Company and the seller for transfer of shares to ensure the transfer of ownership of the shares to the Company and completion of the transaction (AWP: 23150.01.01 Investment in Equity & Preference Shares).
- Checked the Valuation report obtained by the Company from M/s. N. M. Raiji & Co. and M/s. Shah Modi Katudia & Co. LLP, independent firms of Chartered Accountants engaged by the Company for assessing the fair market value of shares of GRICL and PRCL, respectively, at the time of execution of transaction.
- Checked the accounting entry passed in the books of account.

- Verified the existence of the shares by tracing the number of shares purchased to the DEMAT statement for GRICL and physical certificates for PRCL (AWP: 23150.01.01 Investment in Equity & Preference Shares states that the investment was verified to DEMAT instead of physical) to ensure the transfer of ownership of the shares to the Company and completion of the transaction.

- With regard to our audit of the aspect of the related party transaction involved in these investments refer procedures performed in (iv) below.

b) Refer Annexure 1 for work performed on other investments with related parties i.e. purchase and sale of shares/units of or investments in the related parties.

c) We selected long-term investments as a material class of transaction under SA 315 for the purpose of our audit (Refer Account Balances, Class of Transactions, Disclosure View under the Lead sheet View- AWP:"23150.01 Investment in Equity Shares & Preference Shares" in the EMS File) and had identified following risk of material misstatement in the account balance. (Refer Risk of Material Misstatement view under the Risk Strategy View AWP: "23150.01 Investment in Equity Shares & Preference Shares" and AWP: 24310 Provision for Investment in the EMS file).

- "Risk that Investments made are out of Approval Framework.
- Inappropriate accounting of payments made for Purchase of Investments and receipts from Sale of Investments
- Risk that provisioning on investments would be incorrect due to non-adherence to NBFC and AS -13 requirements for all

investments..."

Investments were tested through a combination of test of controls and substantive testing in accordance with the Guidance Note on Audit of Investments issued by the ICAI. Refer AWP's: 12113.13.01: Process Note,12113.13.02: Flowchart, 12113.13.03: Identification of Risks from Flow Chart, 12113.13.04: Walkthrough and 12113.13.05: Annexure to Walkthrough (Evidence Verified) with respect to our understanding of the Company's processes for Long Term Investments.

Tested samples for checking the design and implementation (D&I) of the identified controls mitigating the risks identified for the long-term investment account balance. (Refer AWP: 23150.06 "Control Testing")

Tested the operating effectiveness (OE) of the above identified control based on its frequency (Refer AWP: 23150.06 "Control Testing").

Also refer to our responses to (a) and (b) above.

d) With respect to investment transactions referred to in (a) and (b) above, we have complied with the requirements of SA 550 as follows:

Risk Assessment Procedures and Related Activities:

As part of our planning process and through the performance of the audit, we were cognizant of process followed by the Company w.r.t related party transactions. Considering the Related Party Framework established by the Company through its Audit Committee and BOD (Refer AWP: 12111 "Understand the entity's related party relationships and transactions"), and our past

experience with the Company in complying with the same, in our professional judgment we did not identify any specific risks with regard to valuation aspect of related party transactions. Refer AWP: 13501 "ET Discussion" for planning meeting discussions.

We gained an understanding of the Company's related party relationships and transactions through inquiries with the Company's Management. Refer AWP: 12111 "Understand the entity's related party relationships and transactions".

ET members were communicated about the related parties and were informed to maintain alertness for related party information when reviewing records or documents. Refer AWP: 13501 "ET Discussion" and AWP: 13902 "March Audit Planning Presentation" where related parties were discussed within the ET.

During our audit, we noted that the related party transactions were approved by the Audit Committee and Board (Refer Manual AWP: 21301 "Minutes of Meetings"). Further, the internal auditors scope of work included testing of related party transactions for compliance with the requirements of the Companies Act, 2013 and as may be noted from the minutes of the Audit Committee, the internal auditors did not report any exceptions on this matter, which would have then be required to be assessed by us as a risk of material misstatement.

For purchase of investments from/in related parties, regarding compliance with Section 177 and 188 of the Companies Act, 2013, where applicable, we have verified the valuation reports obtained by the Management for the arm's length nature of the transaction. Also refer response to (a) above and AWP: 23150.01.01 Investment in Equity & Preference Shares and AWP: 23150.02.01 Investment in

funds.

e) As mentioned in (a) & (b) above, to ensure transfer of ownership of shares and completion of transactions at agreed price, we have verified the existence of the shares by tracing the number of shares purchased to the DEMAT statement/ physical certificates in the name of the Company.

- We obtained the certified list of related parties of the Company as at March 31, 2018, signed by Company Secretary of the Company (Refer AWP: 27020.03 "IFIN AS18 RPT List as on 31.03.2018", AWP: 27020.01 "Related Party Disclosure Working")
- Completeness of related party list was ensured through verification of the disclosures made by the directors i.e. MBP - 1 (Refer AWP: 30520.12.01 to 30520.12.10 "Form MBP 1 of Directors") and the minutes of Audit Committee Meetings and Board Meetings (Refer manual AWP: "21301 Minutes of Meetings").
- Refer AWP: 27010 "OE Testing" which describes the Company's design & implementation and operating effectiveness of controls over identification of related parties.

2.3.3 NFRA had examined the above contentions of the **Audit Firm** and had concluded in the DSAQRR as follows:

A. <u>Purchase of Investment from Related Parties- GRICL and PRCL</u>

a) The Auditee Company had purchased 91.88 lakh equity shares of Gujarat Road & Infrastructure Company Limited (GRICL) and 1.20 lakh shares of Pipavav Railway Corporation Limited (PRCL) for

consideration of ₹145 Crores and ₹54 Crores respectively from a Related Party.

b) The **Audit Firm** in its reply dated 15th November, 2019, has stated that they have *Checked the Valuation report obtained by the Company from M/s. N. M. Raiji & Co. and M/s. Shah Modi Katudia & Co. LLP, independent firms of Chartered Accountants engaged by the Company for assessing the fair market value of shares of GRICL and PRCL, respectively, at the time of execution of transaction.* However, AWP 23150.01.01- Investment in Equity and Preference Shares- Tab- Test of Details (The WP quoted as evidence by the Audit Firm), mentions the list of documents verified by the ET for verification of Investment in GRICL and PRCL. The documents verified for both the Investments, as mentioned by the ET, are Share purchase document, CoD approval, and DEMAT statement. **The valuation reports are not included in the list of the documents verified by the ET. Further, the valuation reports are not available in the Audit File also. Thus, the claim of the Audit Firm that they have examined the valuation report is false and an afterthought**. In fact, the Audit Firm itself, in its reply dated 15th November, 2019, has stated that they had ruled out *any specific risks with regard to valuation aspect of related party transactions* right at the planning stage.

c) Paras 8 and A34 to A48 of SA 500-Audit Evidence clearly explain how the Auditor should evaluate the work of a Management Expert. Para 8 of SA 500 is reproduced below:

Para 8: *When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes, :(Ref: Para A34-A36)*

(a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para A37-A43)

(b) Obtain an understanding of the work of that expert; and (Ref: Para. A44-A47)

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para A48)

d) Para 8 of SA 500, requires the auditor to check the competence, capabilities and objectivity of the expert, understand the work and evaluate the appropriateness accordingly. Further, Para A38 states as follows:

Para A38. *Information regarding the competence, capabilities and objectivity of a management's expert may come from a variety of sources, such as:*

- *Personal experience with previous work of that expert.*
- *Discussions with that expert.*
- *Discussions with others who are familiar with that expert's work.*
- *Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.*
- *Published papers or books written by that expert.*
- *An auditor's expert, if any, who assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's expert.*

e) The purchase consideration in case of GRICL and PRCL was considered to be at arm's length on the basis of the independent valuation reports. Assuming for the sake of argument, but, clearly, not admitting the same in view of the evidence presented above, that the Audit Firm had, in fact, examined the valuation reports, it is obvious that the **Audit Firm**, had completely failed to evaluate the competence

and objectivity of the Valuer. The competence, capabilities and objectivity of a Management Expert, and any controls within the entity over that expert's work, are important factors in relation to the reliability of any information produced by a Management Expert. SA 500 requires the auditor to evaluate the capability, objectivity and competency of the expert through a variety of sources like personal experience, discussions with expert, discussions with other users, published papers, analysis of qualifications, memberships, or other recognition, etc. However, no such analysis has been carried out by the **Audit Firm.** This shows the casual nature in which the work has been carried out by the **Audit Firm.**

f) The **Audit Firm** has also failed to examine the relevance of the Management Expert's competence to the matter for which that expert's work was used, or the Management Expert's competence with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models where applicable, that are consistent with the applicable financial reporting framework (As required by Para A40 of SA 500).

g) Further, Para A41 of SA 500 states that a broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats, and may be created either by external structures (for example, the Management Expert's profession, legislation or regulation), or by the Management Expert's work environment (for example, quality control policies and procedures). No such analysis of threats to objectivity of Management Expert or mitigating safeguards has been carried out by the **Audit Firm**.

Thus, the **Audit Firm** has failed to comply with Paras 8, A38, A40, and A41 of SA 500.

h) Para 8 (b) of SA 500 requires the auditor to obtain an understanding of the work of the Management Expert. An understanding of the work of

the Management Expert includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the Management Expert, or whether the auditor needs an auditor's expert for this purpose. Para A45 of SA 500 states that:

> ***Para A45.*** *Aspects of the management's expert's field relevant to the auditor's understanding may include:*
>
> - *Whether that expert's field has areas of specialty within it that are relevant to the audit.*
> - *Whether any professional or other standards and regulatory or legal requirements apply.*
> - *What assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.*
> - *The nature of internal and external data or information the auditor's expert uses.*

The **Audit Firm** has shown no evidence that they have done the required analysis to comply with Paras 8 (b) and A45 of SA 500.

The **Audit Firm** did not perform any test or working to check the fairness of the Valuation Reports while evaluating the share value as no separate working was referred by the **Audit Firm** in their response.

The nature, timing and extent of Audit Procedures in relation to the requirement in Para 8 of SA 500, may be affected by such matters as the nature and complexity of the matter to which the work of the Management expert relates; the risks of material misstatement in the matter; the availability of alternative sources of Audit Evidence; the nature, scope and objectives of the Management Expert's work; the extent to which Management can exercise control or influence over the work of the Management Expert; the auditor's knowledge and experience of the Management Expert's field of expertise; etc. No such

Audit Procedures were done by the **Audit Firm**. The **Audit Firm** has also failed to evaluate the relevance and reasonableness of the expert's findings or conclusions, their consistency with other Audit Evidence, and whether they have been appropriately reflected in the Financial Statements; and relevance and reasonableness of the assumptions and methods.

i) Therefore, it is clearly evident that the **Audit Firm** has not complied with any of the requirements of SA 500 and has blindly relied on the management representations about Valuer Reports while giving the opinion which directly or indirectly impacts the Financial Statements of the Auditee Company.

j) Further, the **Audit Firm** has not shared any evidence for transfer of PRCL shares except working in AWP 23150.01.01- Investment in Equity and Preference Shares- Tab- Test of Details where it is stated that "*DHS has verified the existence of securities (of PRCL) by verifying the DEMAT statement as on 31st March, 2018*". Now, the **Audit Firm** in its reply dated 15th November, 2019 has mentioned that physical certificates of PRCL were verified by the auditor. During cross checking with the PRCL Financial Statements, Note-15 of Shareholder Funds states that the transfer of shares took place in FY 2018-19 instead of FY 2017-18 as claimed by the **Audit Firm**. The Financial Statements of PRCL for the FY 2017-18 clearly shows ITNL as the owner of 1.20 Crore shares. In fact, IFIN does not own a single share of PRCL as on 31st March, 2018.

For reference, please find the Financial Statements of PRCL for the FY 2017-18 and FY 2018-19 on the following link:

http://www.pipavavrailway.com/UploadDocuments/Annual%20Report/Annual%20Report%202017-18.pdf and http://www.pipavavrailway.com/UploadDocuments/Annual

%20Repo rt/Annual%20Report%202018-2019.pdf.

In the absence of any proof for such checking, it is observed that the **Audit Firm** has falsely stated that they have physically verified the evidence in the form of certificates. The whole transfer of shares of PRCL was a sham and the **Audit Firm** colluded with the Management in not disclosing a material fact and not reporting a material misstatement known to them to appear in the Financial Statements.

k) The **Audit Firm** in its response attached the Annexure I (attached to the reply) as a disclosure of all the related parties of the Auditee. However, in these documents, no detail was found regarding M/s IL&FS Engineering and Construction Company Limited (IECCL) in which the Auditee holds 21.29% share capital. IECCL is a listed company which automatically becomes one of the significant related parties to the Auditee. Nowhere in the AWPs, was IECCL disclosed as a related party. However, in Financial Statements of the Auditee, there was a disclosure of related party in which IECCL is mentioned. This non-recognition of a significant related party in the Audit File creates a doubt on the credibility and competence of Auditor.

l) IFIN had purchased 15.64 Lakh shares of ONGC Tripura Ltd, from IL&FS Energy Development Ltd. (IEDL). In the WPs related to Investment in Equity and Preference Shares AWP 23150.01.01 Tab Test of Details, the following has been recorded: *"IFIN had advanced an amount of ₹ 3,600 Million to IEDL for the purchase of 156,465,672 shares of ONGC Tripura power Company Limited in November, 2017 and the transaction was to take place subject to approval from shareholders, authorities, etc., NOC from lenders and other advances conditions. DHS has verified the existence of the securities by verifying the DEMAT statement as on 31st March, 2018. DHS has verified the Share Purchase Agreement dated 31st March, 2018 between IFIN and*

IEDL for the transfer of shares of ONGC Tripura Power Company Private Limited. The agreement is at a price of ₹23.01 per share which is in line with the Valuation done by a third party valuer. The number of shares agreed to be transferred is 156,465,672. Documents verified are Share Purchase Agreement dated 31st March, 2018, CoD approval, and DEMAT statement as on 31st March, 2018." The **Audit Firm** has completely failed to examine the transaction along with the valuation report.

2.3.3.1. The Audit Firm submitted in their reply to the DSAQRR as follows.

a) The valuation reports have been verified by the Engagement Team. In support to this claim they point to the remark column in the WP that states "For GRICL:...DHS has verified the Share Purchase Agreement dated 31st March, 2018 between IFIN & ITNL for the transfer of 9,188,846 shares of GRICL. The agreed price is Rs.157.80 per share as against the valuation of Rs.158.30 by N M Raiji.....For PRCL: ....The Agreement is at a price of Rs.45 per share which is in line with the valuation done by a third party valuer. The number of shares agreed to be transferred are 12,000,000."

b) In Engagement Team's professional judgment, GRICL and PRCL valuation reports examined and considered as part of the audit did not need to be included in the audit file. As to the PRCL investment, the 'third party valuer' referenced in the Remarks column in the working paper is M/s. Shah Modi Katudia & Co. LLP. In Engagement Team's professional judgment, based on the facts and circumstances relating to these transactions, including the related timing, accuracy was the most relevant assertion and a risk related to valuation did not arise. The Engagement Team performed appropriate audit procedures to test the accuracy assertion.

c) The Company followed cost basis accounting for Long Term Investments, and therefore the Company had accounted for the

transactions based on purchase price reflected in the share purchase agreement and the cost incurred by the Company and paid to the seller. The cost of these long term investments was the primary determinative factor for the amounts the Company recorded in its books and records relating to these investments. In order to test if the investments were accounted for accurately, the Engagement Team vouched the amount paid for these investments to appropriate evidential matter.

d) The Engagement Team considered the valuation reports as part of testing the Company's compliance with its RPT framework and those reports supported the amount the Company had recorded in the financial statements. The Engagement Team had determined accuracy as the primary audit objective relating to these transactions and did not rely on the valuation reports to support the appropriateness of the recorded amount. To that extent, evaluating the work of those experts under SA 500 did not arise. Notwithstanding that the question of evaluating the management expert did not arise in this context, the Engagement Team had, in fact, evaluated the competence of N M Raiji, the Chartered Accountant who had provided the valuation report concerning the GRICL shares (Refer WP 22006.05).

e) The Company purchased PRCL shares from ITNL on 31st March, 2018, and the physical share certificates relating to that purchase were kept with the Company's secretarial team and provided to the Engagement Team, as evidenced in an email dated 9th April, 2018, forwarded by Jay Kapadia (Client team) to the Engagement Team. The Engagement Team verified existence of the securities by verifying physical share certificates.

f) Regarding IECCL, the Audit Firm in page 32 of their reply states that "IFIN held 21.29% share capital in IECCL does not change the fact that it was not a related party. Although AS 23 includes a presumption that an investor holding 20% or more of the voting rights of an investee has significant influence, it is only a presumption, and the standard expressly acknowledges that presumption can be rebutted where the lack

of significant influence "can be clearly demonstrated." (AS 23 par. 4) Here, the Engagement Team had clear evidence that IFIN lacked significant influence over IECCL. Based on management's representation to us, IFIN did not have any rights to participate in the financial and/ or operating policy decisions of IECCL and it did not have any nominee directors serving on IECCL's Board. (Refer WP 27020.01 "Related Party Disclosure Working".) Based on the audit evidence obtained in the context of the accounting standards, we, in our professional judgment, concurred with management's assessment that IECCL was not a related party" The Audit Firm also states that IECCL is not a related party as per AS 18 and SA 550. Also it quotes the disclosure note 25(a) of the financial statements and states that IECCL is not considered as an associate by IFIN.

g) Regarding investment in ONGC Tripura Ltd, the Audit Firm submits that as detailed in WP 23150.01.01 "Investment in Equity and Preference Shares" the Engagement Team specifically refers to its procedures relating to the ONGC Tripura investment, including its review and consideration of the third party valuation report as part of its audit procedures. Similar to the GRICL and PRCL investments discussed above, the 'Remarks' column in the workpaper references the review of the valuation report: … The Agreement is at a price of Rs. 23.01 per share which is in line with the valuation done by a third party valuer. The number of shares agreed to be transferred are 156,465,672.

2.3.3.2 NFRA has examined in detail the above replies of the Audit Firm and observes as follows:-

a) It is stated in the Director's Report of IFIN for FY 17-18 that "All the related party transactions that were entered into, during the financial year under review were in the ordinary course of business and at arm's length basis". Details of contracts or arrangements or transactions not at arm's length basis is disclosed as NIL in the financial statements of IFIN.

b) Para 24 of SA 550 stipulates that "When management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion." Para A43 states that "Management is responsible for the substantiation of an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Management's support for the assertion may include .....Engaging an external expert to determine a market value and to confirm market terms and conditions for the transaction". Also para 3(xiii) of CARO-2016 requires the Auditor to certify compliance with Section 188 and 177 of the Companies Act, 2013, where applicable, for all transactions with related parties.

c) As per Para A44, of SA 550, Evaluating management's support for this assertion may involve one or more of the following:

i) Considering the appropriateness of management's process for supporting the assertion.

ii) Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.

iii) Evaluating the reasonableness of any significant assumptions on which the assertion is based.

d) As per IFIN's "guidelines on operating framework on related party transactions" the "parameters for arm's length be gauged based on any one or more of the following criteria":

- Market Price if readily available and if the market exists for the same
- Price charged by the Company to Unrelated Parties
- Valuations by an Independent Valuer
- Obtaining two or three quotes from Unrelated Parties for similar

transactions, subject to the availability of the same

- Regulatory and other Obligations including Transfer Pricing norms as required under the Provisions of Income Tax Act, 1961.

e) Out of the above, the only basis for gauging arm's length by the management in case of the above said long term unquoted investments transactions is valuation by an independent valuer.

f) Under the above background, it is clear from the Audit File and subsequent submissions by the Audit Firm that it failed to perform substantive audit procedures to test the accuracy of the valuation to ensure that the amounts stated in the financial statements are in fact at arm's length, as claimed by the company. The Audit Firm failed to comply with the requirements of SA 550, para 24 and A44. The failure is more evident from the following facts:-

i) It is stated by the Audit Firm that "the Engagement Team also obtained from the Company valuation reports because the Company's RPT framework mandated having an external third party valuer assess the value independently" and "the Engagement Team considered the Audit Committee meeting minutes relating to the approval of such transactions, which confirmed that the related party transaction had been consummated in a manner consistent with the Company's approved framework on related party transactions". The statements show that the Audit Firm has not done any independent testing of the aspect of arm's length transactions. Also, NFRA notes that the specific details of the related party transactions are not mentioned in any of the minutes of the Audit Committee.

ii) From the above two quoted statements read with the remark in work paper 23150.01.01 "DHS has verified the Share Purchase Agreement dated 31st March, 2018 between IFIN & ITNL for the transfer of 9,188,846 shares of GRICL. The agreed price is Rs.157.80 per share as against the valuation of Rs.158.30 by N M Raiji", it is clear

beyond any doubt that the **only purpose** of the Audit Firm to obtain the valuation as per the independent valuation report in case of GRICL (there is no evidence from the audit file that the valuation report itself was obtained and examined) was to test that the procedure prescribed in the company's framework on related party transactions has been complied with. Similar is the case with PRCL also. It is also clearly admitted by the Audit Firm that they have not verified the valuation reports with an intention to ensure that these were arm's length transactions.

iii) SA 315 A 123 describes Assertions used by the auditor to consider different types of potential misstatements under three categories. Under category "Assertions about classes of transactions and events for the period under audit" it describes the assertion "Accuracy—amounts and other data relating to recorded transactions". Under category "Assertions about presentation and disclosure" SA 315 describes the assertion "Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts and events have been recorded appropriately". SA 315 further states in para A124 that "The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered".

iv) The Audit Firm submitted that accuracy was the most relevant assertion and a risk related to valuation did not arise. Thus, it is clear that the Audit Firm had not evaluated potential misstatements of presentation and disclosure as stipulated by SA 315. Testing of presentation and disclosure requires considering **accuracy and valuation** as the relevant assertion, whereas the Audit Firm confined themselves to testing of assertions about classes of transactions and events alone. Testing of presentation and disclosure is completely omitted by the Audit Firm.

v) The Guidance note of ICAI on Audit Of Investments stipulates in para 6 that:-

- The auditor's primary objective in audit of investments is to satisfy himself as to their existence and valuation. Verification of investments may be carried out by employing the following procedures.

  — (c) examination of valuation and disclosure.

vi) Para 25 of SA 550 stipulates that "In forming an opinion on the financial statements in accordance with SA 700(Revised), the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework"

vii) By not verifying valuation and disclosure, the Audit Firm has committed a serious lapse in so far as these related party transactions in investments are concerned. The Audit Firm failed to take note of the requirement in the ICAI's Guidance note and did not comply with the requirements of para 25 of SA 550.

viii) The Auditor also failed to comply with SA 500. The evaluation of expertise of one of the valuers in another context is not a substitute for complying with the requirements of SA 500 in the context of valuation of unquoted shares.

ix) Regarding physical verification of share certificates of PRCL, the contentions of the Audit Firm are not acceptable. The evidence produced by the Audit Firm is an email communication from one of the employees of ILFS Group to the engagement team. It has an excel attachment which is a list of companies, inter alia, whose physical share certificates are asserted to be in the custody of the company secretary of IFIN. This is not a conclusive evidence to establish that the Audit Firm had in fact verified the physical share certificates. The fatal omission in this regard is more evident from the fact that the Audit File refers to verification of Demat statement only while the company, in the email, states that the company

secretary was in possession of the physical share certificates of PRCL. Obviously, the audit file record that the Demat statement relating to PRCL was verified by the ET is a complete falsehood. In reply to a specific query by NFRA in this regard during the presentation, the Audit Firm submits in para 2.1 of their clarification dated 11th November, 2020 that "the Engagement Team inadvertently noted that the PRCL investment was further verified to "DEMAT Statement as on 31st March 2018"(refer cells "G111" and "H111" in Tab "Test of Details") instead of "physical share certificate". The inadvertent reference to "DEMAT" does not change the fact that the Engagement Team verified the physical share certificates". Further, in reply to another query the Audit Firm clarifies in para 2.3 of their letter that "On 31st March, 2018, the purchase transaction of PRCL shares was concluded and the share purchase agreement was signed between IFIN and ITNL for transfer of PRCL shares. The Engagement Team reviewed and verified the Share Purchase Agreement as part of its tests of detail. (WP 23150.01.01 Investment in Equity Shares & Preference Shares – Refer Test of Details Tab). Because the share transfer occurred on 31st March, 2018, it is natural that PRCL would make the change in shareholding only when it had been informed vide submitting the share certificate and transfer form to register the shares in the buyer's name". During presentation it was also submitted by the Audit Firm that the engagement team verified that the "risks and rewards" attached with these shares has been transferred to IFIN.

x) NFRA observes that the stated inadvertent errors in the Audit File in such a significant matter points to high degree of negligence on the part of the Audit Firm. Such an error, if at all true, indicates the grossly negligent approach, and the unacceptable lack of due diligence, of the EP, EQCR Partner and the second EP. Referring to an attachment in the email sent by an employee of IL&FS Group (not IFIN) to the ET, the Audit Firm states in the letter dated 11-11-

2020 that "The attachment explicitly states that the share certificates of PRCL were held in physical form as at 31st March, 2018. This email attachment supports that the shares were available in a physical form in the custody of the Company with its Secretarial Department and that the Engagement Team knew the shares were maintained in physical form". The Audit Firm cites WP 23150.01.01 and this email and attachment as proof of verifying the physical certificates. However, as observed earlier, this mail only contains an assertion by the management of the auditee that the physical certificates were available with the secretarial department of IL&FS group. It does not establish that the physical certificates were handed over to IFIN. Had the ET in fact seen those physical certificates, the so called "inadvertent error" in WP 23150.01.01 could not have happened, given the fact that these worksheets are supposedly reviewed by the senior members of the ET. NFRA also observes that the financial statements of ITNL cannot be a conclusive evidence for the transfer of shares to IFIN on the date of balance sheet since these are related parties. Having known such a relationship between the transferor and transferee, the Audit Firm should have exercised professional judgment and skepticism warranted in such circumstances, which the Audit Firm had not done. The reply of the Audit Firm and the Audit File are silent about whether all relevant forms (like form SH 4) are filed, and the statutory registers are updated to reflect the transfer of shares to IFIN.

xi) It is a fundamental concept as per the Framework for the Preparation and Presentation of Financial Statements that an "An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably". None of the Audit procedures stated as performed by the Audit Firm provide evidence that steps have been taken to get the shares transferred in the name of IFIN so that the future economic benefits associated

with the investments will flow to IFIN. Instead of verifying this fundamental aspect, the Audit Firm submits during the presentation that the investment is recognized because the 'risks and rewards' are transferred to IFIN, which essentially is a revenue recognition criterion.

xii) It may also be noted that SA 550 emphasizes the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions (Para 7 and A9).

xiii) Regarding investments in ONGC Tripura Ltd., because of the same reasons as mentioned above in the case of GRICL and PRCL, NFRA concludes that the Audit Firm had failed in this case also, in the same manner as in the cases of PRCL and GRICL.

xiv) Regarding IECCL, the contentions of the Audit Firm are not acceptable in view of the clear provisions of the Companies Act. As per section 2 (76) of the Companies Act, 2013 a "related party", with reference to a company, includes any body corporate which is a holding, subsidiary or an associate company of such company (Substituted by the Companies (Amendment) Act, 2017, effective from 7th May 2018. Before the amendment related party included any company which is a holding, subsidiary or an associate company of such company). IFIN had made disclosures in the standalone financial statements explicitly that IECCL is an associate company. Also in the consolidated financial statements it is disclosed that "Pursuant to the Group holding of 21.29% in IECCL, IECCL qualifies an associate company under the Companies Act 2013. However, IECCL does not qualify as an associate company under Accounting Standards specified under section 133 of the Companies Act, 2013, as the Group does not have significant influence over IECCL. Accordingly the Group has carried IECCL as an investment and not consolidated IECCL in its consolidated financial statements." Thus for the FY 2018 as well as on the date of signing

the Audit Report, IECCL was a related party as per the Companies Act. However, nowhere in the AWPs, was IECCL disclosed as a related party. This non-recognition of a significant related party in the Audit File creates a doubt on the credibility and competence of Auditor.

g) Thus, the above facts confirm the initial observations of NFRA and NFRA concludes therefore that: -

i) It is clearly evident that the Audit Firm has not complied with any of the requirements of SA 500 and has blindly relied on the management representations about Valuer Reports while giving the opinion which directly or indirectly impacts the Financial Statements of the Auditee Company.

ii) In absolute disregard of the overall objectives of the auditor as specified in para 11 of SA 200, the Audit Firm failed to exercise professional skepticism and professional judgment in testing the related party transactions.

iii) The Audit Firm failed to comply with SA 315 since it had not evaluated potential misstatements of presentation and disclosure as stipulated by SA 315. Testing of presentation and disclosure requires considering accuracy and valuation as the relevant assertion, whereas the Audit Firm confined themselves to testing of assertions about classes of transactions and events alone.

iv) The Audit Firm has committed a serious lapse in so far as related to the purchase of Investments in GRICL, PRCL and ONGC Tripura Ltd from related parties is concerned. The Audit Firm failed to take note of the requirement in the ICAI's Guidance note on Audit of Investments and did not comply with the requirements of para 25 of SA 550.

v) The Audit Firm failed to verify the transfer of shares involved in the related party transactions and hence failed to exercise professional skepticism as required by the Standards of Auditing. The

information from the financial statements of PRICL noted in para 2.3.3 (A) (i) corroborates these findings.

vi) Nowhere in the AWPs, was IECCL disclosed as a related party. This non-recognition of a significant related party in the Audit File creates a doubt on the credibility and competence of Auditor.

B. Valuation of Investments in Related Parties

(The above para is clubbed with paras related to PRICL and GRICL)

C. Valuation of Other Investments: NFRA observed in the DSAQRR as follows.

A few cases of investments made by the Company either in the form of equity or properties were also examined by NFRA. Based upon the examination of the relevant AWPs in this regard, NFRA has noted as follows:

Statutory Provisions:

Para 17-19 of AS-13 "Accounting for Investments" provides as below:

"17. Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognise the decline. Indicators of the value of an investment are obtained by reference to its

i. market value,

ii. the investee's assets and results

iii. And the expected cash flows from the investment.

iv. The type and extent of the investor's stake in the investee are also taken into account.

v. Restrictions on distributions by the investee or on disposal by

the investor may affect the value attributed to the investment.

18. Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.

19. Where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist."

Further Para 30 of AS 13, which deals with "Investment Properties", provides as follows:

"30. An enterprise holding investment properties should account for them as long-term investments."

Also, Chapter 5 on "Areas of Audit Concern" of Technical Guide on Audit of NBFCs inter alia provides that:

B. Valuation and Disclosure of Long-Term Investments

1. *The Auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence for valuation and disclosure of long-term investments in accordance with the financial reporting framework.*
2. *When long-term investments are material to the Financial Statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure.*

3. *Other procedures would ordinarily include:*

   a) *In the case of quoted securities, considering related Financial Statements and other information, such as market quotations, which provide an indication of value and comparing such values to the carrying amount to the investments up to the date of auditor's report.*

   b) *In case of unquoted securities, ascertaining the method adopted by the entity for determining the value of such securities as at the year end. The auditor should examine whether the method adopted by the entity is one of the recognised methods of valuation of securities such as Profit Earning Capacity Value Method (PECV),*

   Break-Up Value Method, Capitalisation of Yield Method, and Yield to maturity method, etc.

   c) *In the case of investments other than in the form of securities, ensuring that the market value has been ascertained on the basis of authentic market reports, and/or based on expert's opinion, if warranted.*

   d) *If such values do not exceed the carrying amounts, the auditor should consider whether a write-down is required. If there is an uncertainty as to whether the carrying amount will be recovered, the auditor should consider whether appropriate adjustments and/or disclosures have been made."*

Details of Investments by the Company in the cases identified for examination on sample basis are as follows:

Particulars	Type	As at 31st March, 2018 *(₹ In Million)*	As at 31st March, 2017 *(₹ In Million)*

IL&FS Engineering and Construction Company Limited	Long Term Equity Investment	2,278.42	2,278.42
Investment in Properties at Mumbai	Investment in Properties	5,393.77	4,129.96
Metropolitan Stock Exchange of India Limited (MSEI)	Equity Investment-Unquoted	1118.72	1118.72
Last Mile Online Limited	Unquoted Compulsory Convertible Debentures	680.00	0.00
John Energy Ltd.	Equity Investment-Unquoted	444.27	444.27
RNEL	Other Investment-Quoted	223.94	223.94

NFRA has examined AWP 23150 – Long Term Investment prepared by the ET to summarize their approach to verify the analysis of valuation of non-current investments as at 31st March, 2018. The observations of NFRA are in following paragraphs.

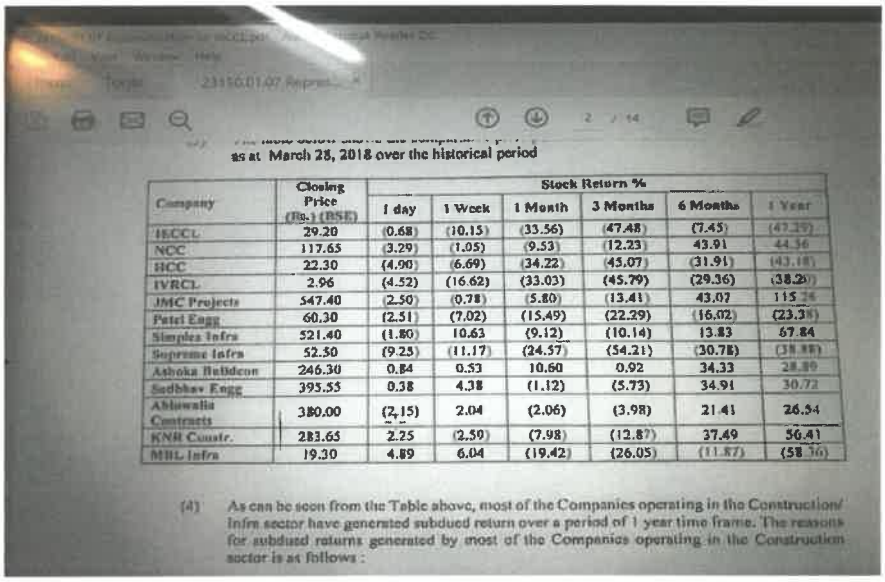
1. **IL&FS Engineering and Construction Company Limited (IECCL)**

i. AWP 23150.01.01 Tab-Schedule shows that IFIN had a net exposure of ₹210 Crore (after deducting the opening provision of ₹17 Crore). The **Audit Firm** has also mentioned that the market value/breakup value/value as per third-party valuation report is ₹81.50 Crore and hence, there is a shortfall of ₹129 Crore. The Tab on "Impairment Testing" mentions that the ET has evaluated the Management Assessment Note for IECCL by considering the

current market price and the order book in hand of the company. ET says further that it has evaluated the claim value of the IECCL by verifying the supporting documents. ET has also noted that the carrying value of the investment is ₹210 Crore and the market value of one year 200 days moving average is lower by ₹24 Crore that is 11% of the carrying value. The Tab on Valuation of Listed Shares also notes that against the cost price of ₹227 Crore, the market value is ₹81.5 Crore, and a diminution of Rs 146 Crore is required.

ii. Based upon its assessment, the **Audit Firm** had clearly noted that there is a requirement to provide for impairment, though, in conclusion, without any further analysis, it records the Management intention not to create any provision for impairment. AWP indicates that no query was raised to the Management by the **Audit Firm** to obtain reasonable justification to support this accounting treatment.

iii. NFRA has also examined the Management Representation on IECCL in WP 23150.01.07. The Management Representation talks about capital market performance, positive outlook for EPC companies, Business development initiatives of IECCL, and value creators like turnaround strategy, recovery of claims, recovery of inter corporate deposits, recovery of investments, and management changes. Most of the Management Representation is very general in nature. It appears that the **Audit Firm** has neither examined it nor even seen it properly. For example, the Para on capital market performance says that most of the operating companies in the construction sector have generated subdued returns over a period of one-year time frame. Following table has been given to support the claim:



as at March 28, 2018 over the historical period

Company	Closing Price (Rs.) (BSE)	Stock Return %					
		1 day	1 Week	1 Month	3 Months	6 Months	1 Year
HCCL	29.20	(0.68)	(10.15)	(33.56)	(47.48)	(7.45)	(47.29)
NCC	117.65	(3.29)	(1.05)	(9.53)	(12.23)	43.91	44.56
HCC	22.30	(4.90)	(6.69)	(34.22)	(45.07)	(31.91)	(43.18)
IVRCL	2.96	(4.52)	(16.62)	(33.03)	(45.79)	(29.36)	(38.20)
JMC Projects	547.40	(2.50)	(0.78)	(5.80)	(13.41)	43.02	115.26
Patel Engg	60.30	(2.51)	(7.02)	(15.49)	(22.29)	(16.02)	(23.38)
Simplex Infra	521.40	(1.80)	10.63	(9.12)	(10.14)	13.83	67.84
Supreme Infra	52.50	(9.25)	(11.17)	(24.57)	(54.21)	(30.78)	(38.88)
Ashoka Buildcon	246.30	0.84	0.53	10.60	0.92	34.33	28.89
Sadbhav Engg	395.55	0.38	4.38	(1.12)	(5.73)	34.91	30.72
Ahluwalia Contracts	380.00	(2.15)	2.04	(2.06)	(3.98)	21.41	26.54
KNR Constr.	283.65	2.25	(2.50)	(7.98)	(12.87)	37.49	56.41
MBL Infra	19.30	4.89	6.04	(19.42)	(26.05)	(11.87)	(58.36)

(d) As can be seen from the Table above, most of the Companies operating in the Construction/ Infra sector have generated subdued return over a period of 1 year time frame. The reasons for subdued returns generated by most of the Companies operating in the Construction sector is as follows :

As can be seen from the table, out of 13 companies, seven companies (more than 50%) have actually shown a positive return in the last one year.

iv. The **Audit Firm** failed to verify the compliance with the requirements of Para 17 of AS 13 which provides five different indicators to be analyzed by the **Audit Firm** as part of obtaining Audit Evidences.

Although the Management Note analyzed a few indicators like market value and value creators, the **Audit Firm** failed to analyse the Management note or provide any justification for not recognizing the diminution in the value of investments.

v. The high, low and average price per share as per the quoted market value during the last FY i.e. 2017-18 comes out to ₹59.14, ₹29.41 and

₹44.28 per share respectively. Even if these figures for the past years were not considered, the **Audit Firm** altogether neglected the continuous decline in the market value of the share prices from ₹91.20 as on 1st April, 2015 to ₹45.25 as 1st April, 2016, ₹54.05 as on 1st April, 2017, and lastly ₹29.41 per share as on 31st March,

2018, i.e., almost a decline of 67.75% over a period of three years. **This decline cannot be treated as temporary in nature.** The Audit File nowhere indicates any query being raised on the Management and brings out the fact the **Audit Firm** had simply relied on the information provided by the Management instead of performing sufficient appropriate Audit Procedures.

vi. The **Audit Firm** has gone against its own assessment and has accepted higher valuation of the Investments. The **Audit Firm** has, thus, colluded with the Management, and has overstated the profit.

2..3.4 The Audit Firm submitted in their reply to the DSAQRR that as part of its testing procedures, the Engagement Team performed its own calculations, identified certain divergences with management's calculations, and discussed those divergences with management. The Engagement Team documented its assessment in Manual WP 29205.03 "ET Assessment memo on representation on specific lending and investments matters". Among the factors the Engagement Team considered was the 200 day moving average over 12 months, which was a factor the management had not considered. In its professional judgment, the Engagement Team considered this average to provide an appropriate benchmark because it is a commonly used term in stock exchange related scrips and had been used in the Engagement Team's prior year evaluation, which provided a consistent basis for comparison. Although the Engagement Team determined there was a deficit of ~ Rs. 24 crores in the value as compared to the carrying value, based on its consideration of the different facts and in its professional judgment, it concluded that management's analysis that such diminution was temporary in nature was reasonable. Management's analysis "addressed the indicators of the value of an investment set forth in Paragraph 17 of AS 13. Manual WP 29205.03."

2..3.5 NFRA has examined in detail the above replies of the Audit Firm and observes as follows:-

a) The statements made by the Audit Firm have not been supported by evidence. The manual working paper referred by the Audit Firm contains only a summary of a few selected extracts from the management representation, without any independent analysis or questions raised to the management.

b) The Audit Firm notes that the long-range market value assessed based on 200-days moving average over one year period is Rs 48.59 per share. The Audit Firm had also noted that the closing price as on 31st March 2018 is Rs 29.20 per share. However, based on the information available in public domain NFRA observes the following values.

	Exponential Moving Average			Simple Moving Average		
Days	200	50	20	200	50	20
31st March 2018	44.86	40.52	35.41	43.35	41.30	34.66
25th May 2018	40.85	34.07	31.61	41.20	33.10	31.87

It is clear from the above table that: -

- The closing price as on 31st March 2018 is much lower than all the moving averages, indicating a downward trend in the stock price.
- All the moving averages immediately before the date of signing the Audit Report is lower than the corresponding numbers as on the balance sheet date, confirming the downward trend.
- All short-range moving averages (50 days and 20 days) are lower than the long-range moving average (200 days) on both the dates, again indicating downward trend.
- The Audit Firm has not even tested the calculation of the management for arriving at Rs 48.59 as moving average. The Audit Firm even failed to note whether it is a simple moving average or exponential moving average.

c) Thus, instead of factoring in for a clearly evident downward trend, the management had added a controlling stake premium of 15% and a premium for qualitative factors of Rs 11 (22.63%) to the calculated

moving average of Rs 48.59 and arrived at a valuation of Rs 55.88 which reflects a 11% decline in the value of investments. Terming this decline as temporary, management chose not to provide for diminution in value of investments. The Audit Firm simply accepted these numbers without even bothering to check the calculations, and the assumptions made while arriving at the premia added to the moving average.

d) Thus the conclusion made by the Audit Firm, that the decline is temporary, has no basis at all since the technical indicators point to the contrary.

2.3.6 NFRA therefore reiterates its conclusions in the DSAQRR and observes that the **Audit Firm** has gone against its own assessment and has accepted higher valuation of the Investments. The **Audit Firm** has, thus, colluded with the Management, and has failed to disclose the overstatement of profit.

2. Investment in Properties at Mumbai – Kohinoor Square Project

i. The Company has an investment in property at Kohinoor Square Project amounting to ₹498 Crores as on 31st March, 2018, as part of their non-current investments.

ii. NFRA has examined the worksheet AWP "23150.03.01 Investment in Property" embedded in the eAudit File and Valuation Report issued by External Fair Value Specialist– EFVS- Knight Frank India Private Limited (AWP 23150.03.02) and Valuation Report issued by Internal Fair Value Specialist– IFVS- Deloitte Touche Tohmatsu India LLP (AWP 23150.03.04).

iii. Based upon the examination, it is understood that the investment in properties pertains to the allotment of specified area of 2,29,234 Sq. Feet area at Kohinoor Square Project, Mumbai, with carrying value of ₹21,770 per square feet. The valuation given by EFVS is ₹24,000 per square feet and valuation given by IFVS is ₹17,500 per square feet to ₹20,000 per square feet.

iv. It is important to note here that the EFVS had mentioned the following restrictive clause in its Valuation Report which certainly restricts the use of the same by the Statutory Auditor for the purpose of considering it as a sufficient appropriate Audit Evidence:

Clause 1.2.2 "Legal Parameters of Property" of the Valuation Report *"While we have been provided with area of the subject property to be considered and copy of the same amended letter of allotment. We have relied on the area details provided by the client for the purpose of this valuation exercise. It is recommended that the documents are subjected to formal legal inspection in order to ensure that there are no elements, restriction or changes contained which are likely to have detrimental effect upon the valuation provided."*

Clause 1.3.1 "Market Value"

"No allowance has been made in our analysis for any charges, mortgages or amounts owing on the property or for any expenses or taxation, which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that the property is free from encumbrances, restrictions and outgoings of an onerous nature, which could affect the analysis."

v. The **Audit Firm** has not carried out any verification of the acquisition, the legal ownership and entitlement of the said property. Also, the **Audit Firm** had failed to verify the restriction imposed on the said immovable property, whether or not there are charges, mortgages or any other lien on the property. Merely accepting a Valuation Report with such restriction cannot waive the Auditor's responsibility towards the verification of an important component of the Financial Statements.

vi. The expert appointed by the **Audit Firm** – IFVS had given the valuation after considering the report of external expert (EFVS) as well as the approved resolution plan. Based on the risk analysis carried on by the IFVS, the summary

of value was as follows:

a). Low value 401 Crores b). Mid value ₹429 Crores c). High Value ₹459 Crores. Even if the middle value of ₹429 Crores as given by the **Audit Firm's** own expert is considered, the **Audit Firm** supported the Management in overstating the profit by ₹70 Crores.

vii. The **Audit Firm,** based upon their assessment in the said AWP, had noted that *"Our valuation team has given valuation of ₹20,000 per square feet which gives shortfall of ₹1770 per square feet aggregating to ₹40.57 Crores".* Even after noting the shortfall, the **Audit Firm** takes note of the resolution plan of the company and concludes that there is no need to create provision for impairment on the said investment. The IFVS had already accounted for the resolution plan in its risk analysis. The **Audit Firm** did not carry out any additional Audit Procedure, overruled its own expert without giving any justification, and hid the diminution in value of this investment without performing sufficient appropriate procedures. The **Audit Firm** has, thus, failed to perform the audit with due professional skepticism.

2..3.7 The Audit Firm submitted in their reply to the DSAQRR that the restrictions in the valuation report of EFVS are standard and do not undermine the valuation analysis. The Engagement Team had noted that the property was registered in favour of the Company during the year in the time period after management's expert had performed the valuation. The Engagement Team performed audit procedures relating to the Company's legal ownership and entitlement to the property, obtained and reviewed the signed allotment letter for commercial space in the building Kohinoor Square, confirmed the title of the project land was clear, reviewed the original property documents to confirm the existence of the property, verified that the expense incurred for registration of the property was in IFIN's name, and evaluated the voucher wise details relating to such payment. At the time when the valuations were performed, the Kohinoor property was not complete, construction was proposed to be completed by June, 2019, and the project required an additional Rs.300 crore funding for completion. Both the valuers arrived at different values for the property because their methodologies differed. The management's expert relied

on a market value approach based on the current physical condition of the property and the auditor's valuation expert relied on a market value approach, considering both the then-existing physical condition of the property along with the current stage of completion. The Audit Firm states that IFIN's carrying value for the Kohinoor property related to the completed property as opposed to then- existing stage of completion because IFIN had acquired its investment interest in the property based on the value of the property at completion. Accordingly, a comparison of the carrying value as a finished property with the valuation of the property based on a work in progress resulted in an inconsistent comparison. The Engagement Team considered that the risk of completion at the current stage of the Kohinoor property development related primarily to the funding for the balance of the project. Then, based on the risk mitigation facts that (i) A lender had deposited into an escrow account Rs.300 crores and (ii) the commercial building was expected to be completed with possession of the Occupancy Certificate by June, 2019, the Engagement Team in its professional judgment concluded that the carrying value of the investment in the property was not impaired.

2..3.8 NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) As disclosed in the Annual Report of IFIN, "Impairment in the investment portfolio is provided, as per the Guidelines issued by the RBI, unless an accelerated provision / write-off is warranted on a case to case basis". Hence the applicable framework in testing impairment of investments is the RBI guidelines in this regard as well as AS 13, Accounting of Investments. However, there is no mention seen in the Audit File regarding the RBI guidelines applicable for impairment of investments.

b) Technical Guide on Audit of Non-Banking Financial Companies issued by ICAI identifies the following factors that may indicate an impairment condition.

   i. the decline in fair value is attributable to specific adverse conditions affecting a particular investment.

   ii. the decline in fair value is attributable to specific conditions, such

as conditions in an industry or in a geographic area, rather than to general market conditions

iii. dividends have been reduced or eliminated, or scheduled interest payments on debt securities have not been made.

iv. the financial condition of the issuer has deteriorated

c) The technical guide suggests the following procedures, inter alia, in this regard.

i. Test the market values of investments by comparing the market value to their sources.

ii. determine whether any decline in value below cost is properly reflected in the financial statements where appropriate.

iii. consider the need for use of specialists to determine the market value of certain investments. Consider steps in the audit area "Use of the work of experts".

d) Certain other impairment indicators in this context of the investee are default in repayment of debt obligations, restructuring of loans, downgrading of the credit rating to below investment grade, and the project not achieving break-even within the gestation period as originally envisaged.

e) The Audit Firm did not test any of such indicators. The Audit Firm also failed to perform the procedures as suggested by ICAI. Though the Audit Firm had engaged an expert, it chose to ignore the findings of the expert.

f) Let alone the internal indicators, at the time of audit there were many other indications available in the public domain about the Kohinoor project. The project began in year 2009 and it was supposed to be completed by year 2013. There was a legal battle with the Municipal Corporation. The project also underwent a change in design from an office project to a mixed-use building. One of the creditors to Kohinoor Group, had, in June 2017, moved the National Company Law Tribunal (NCLT) for bankruptcy and the case was pending as on the date of the balance sheet. There was also default in paying interest and principal of loan by the Kohinoor group since 2015. A resolution plan was under consideration by IBBI in FY

2018. There was cost escalations and substantial delay expected in completion of the project. (https://realtynxt.com/2019/01/06/kohinoor-group-replaced-by-ssa-to-finish-dadars-kohinoor-square/). The Audit Firm did not put in any efforts to test such indicators. Instead it relied on a weak argument that funding risk was the only risk faced by the project and the risk is mitigated on deposit of Rs 300 crore in an escrow account. Based on this argument and the expected date of completion in year 2019, the Audit Firm concluded that there is no impairment.

g) It is pertinent to note that the expert engaged by the Audit Firm had already considered all the risks and provided a much lesser value than the book value. This itself is another strong indicator, especially in light of the facts mentioned above regarding the project, that the investment is likely to be impaired.

h) In view of the facts mentioned above regarding the project, the restrictions mentioned by the expert valuer appointed by the company were significant and hence called for a detailed consideration and professional skepticism. However, the Audit Firm ignored these explicit evidences by terming these restrictions as "standard and do not undermine the valuation analysis".

i) Para 20 of AS 13, Accounting for Investments, states that "an investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10". As per Para 3 of AS 13 "Investments **are assets held** by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise". The cost model in AS 10 stipulates in para 33 that "**after recognition as an asset**, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses" (Emphasis added). From the submissions made by the Audit Firm, it is clear that the investment property accounted by the company is an asset under construction, not a completed asset. Also, the Audit Firm had stated that IFIN had acquired its investment interest in the property based on the value of the property at completion. This implies that the accounted cost of investments in the said project is either not in

accordance with AS 13 or might be overstated due to the element of advance payments included in the cost as on the balance sheet date. This puts a question mark on the very basis of preparation of the accounts on accrual principle. There is apparently no testing of such aspects in the Audit File.

j) If the Investment had been properly accounted as per AS 13, then there is no merit in the argument of the Audit Firm that the investment value is based on the value of the completed asset. Both the expert valuers assessed the market value based on the physical completion as on the date. Contrary to the submissions of the Audit Firm, the assessed value is very much comparable to the investment cost, had the investment been accounted in accordance with AS 13.

k) The explanation provided by the Audit Firm that the ET has verified the registered copy of the allotment letter does not adequately show that the restrictions, if any, attaching to the property were verified to see that they did not impact the valuation thereof.

2..3.9 Thus, NFRA reiterates its observation that the Audit Firm did not carry out any additional Audit Procedure, overruled its own expert without giving any justification, and hid the diminution in value of this investment without performing sufficient appropriate procedures. The Audit Firm has, thus, failed to perform the audit with due professional skepticism.

3. Metropolitan Stock Exchange of India Limited (MSEI)- Formerly MCX Stock Exchange Limited.

a) IFIN had investment of ₹111.87 Crores in Metropolitan Stock Exchange of India Limited (MSEI) formerly known as MCX Stock Exchange Ltd as on 31st March, 2018. The investment also carried an opening provision of ₹15 Crores with a net exposure of ₹96.87 Crores as on 31st March, 2018. As per AWP 23150.01.01 – Investment in Equity and Preference Shares – Tab – Schedule, the market value of the investment was ₹19.53 Crores with shortfall of ₹77.33 Crores. As per the Tab - Breakup Value of Listed Shares, the breakup value of the share was ₹0.74 per share. As against this, the valuation done by the Management Expert (EFVS) i.e. M/s N M Raiji and Company was ₹1.64 per share, whereas the valuation done by the expert appointed by the

Audit Firm – IFVS – Deloitte Touche Tohmatsu India LLP, the valuation was ₹1.62 per share. The Audit Firm has noted in the Tab on Impairment Testing that the carrying cost is ₹9.39 per share against the valuation of ₹1.64 per share, leading to a shortfall of ₹7.75 per share, aggregating to total shortfall of ₹92.34 Crores.

NFRA has gone through the Management Representation on MSEI – AWP 23150.01.03 and comments of the **Audit Firm** in the Impairment Testing note. In the Impairment Testing note, the **Audit Firm** has noted that IFIN has an injunction on assets of La-Fin Financial Services Private Limited (La-Fin) assessed at ₹77.02 Crores and hence there is no need for impairment in the value of investment. The **Audit Firm** has simply copied a paragraph from the Management Note and pasted it in the impairment testing tab. NFRA has gone through the Management Representation on MSEI. The note raises many important questions as follows:

i. The note says that out of the total investment of 11.91 Crores shares in MSEI, 2.71 Crores shares were acquired in August 2009 based on Letter of Undertaking provided by the La-Fin Financial Services Private Limited (La-Fin) for buyback of the above shares at an IRR of 15% within a period of three years. Thus, out of total investment of around 12 Crores shares, only 2.71 Crores shares were covered under the LOU with La-Fin. The remaining shares were not covered under any LOU and hence required impairment. However, no question was raised by the **Audit Firm** in this regard.

ii. The Management has further stated that in August 2012, the Company exercised its right under the LOU. However, La-Fin breached the LOU and refused to honour its obligation. Accordingly, IFIN filed a suit in Mumbai High Court in June 2013 and the court provided relief in the form of injunction on La- Fin assets.

iii. The Management has further stated that IFIN has served a statutory notice for winding up on La-Fin. The case has been heard by NCLT and the matter is now fixed for order.

iv. **It can be seen that the claim of IFIN against La-Fin was more than six years old, was only for part of the investment and against a company whose assets were partly attached by EOW.** However, the **Audit Firm** did not feel the need to question the Management on any of these aspects and blindly accepted the Management claim that they would be able to recover fully from La-Fin and that there was no need for impairment.

2..3.10 In their reply the Audit Firm submits that the Engagement Team had considered all the information relating to the potential impairment of IFIN's investment in MSEI, including the attachment of property by EOW. The gross short-fall between the initial value of IFIN's investment in equity shares of MSEI (Rs.111.87 Crores) and the fair value of such shares as at 31st March, 2018 (Rs.19.53 Crores) was Rs.92.34 Crores. Because the Company had a legally enforceable right to recover Rs.77 Crores from the assets of La-Fin, the net short fall was Rs.15.3 Crores, against which IFIN had already provided for Rs.15 Crores in its financial statements. The remaining amount – Rs. 0.32 Crores – was immaterial to IFIN's financial statements and the Engagement Team passed on further consideration. The Audit Firm reiterated the above submissions during the presentation on 28th October, 2020. On questioning, they did not have any satisfactory reply to the point earlier made by NFRA that out of total investment of around 12 Crores shares, only 2.71 Crores shares were covered under the LOU with La-Fin. The remaining shares were not covered under any LOU and hence required impairment.

2..3.11 NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) According to management representation (Manual WP 29205.03) out

of the total investment of 11.91 Crores shares in MSEI, 2.71 Crores shares were acquired in August 2009 based on Letter of Undertaking provided by the La-Fin Financial Services Private Limited (La-Fin) for buyback of the above shares at an IRR of 15% within a period of three years. This means that 2.71 crores shares of MSEI are a separate class and is different from the rest of the investment in MSEI, as these shares carry a different valuation, different asset back up and different terms under an arrangement with La-Fin. The market value of shares of MSEI are not relevant under the said arrangement. The investment in 9.20 crores shares in MSEI made in a different point in time has no connection with the shares covered under buyback agreement of La-Fin.

b) Para 32 of AS 13 states "Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually."

c) As there are two different classes of investments in the shares of MSEI, these two classes should be valued individually for determination of diminution in value of investments. The management note is silent about the compliance with AS 13 in this regard. The Audit Firm too has ignored this aspect totally.

2.3.12 Thus NFRA reiterates its conclusion that the Audit Firm did not feel the need to question the Management on this aspect and blindly accepted the Management claim that they would be able to recover fully from La-Fin and that there was no need for impairment for the total investments in MSEI Ltd.

4. Last Miles Online Limited

i. IFIN had investment of ₹68 Crores in Compulsorily Convertible Debentures (CCDs) of Last Mile Online Ltd as on 31st March, 2018. As per the details available in AWP 23150.04.01 (Investment G-Sec and Debentures), the CCD's were unsecured and carried interest of

0.01% per annum. The CCD's also had a call option at the end of 12 months from the date of issuance and every three months thereafter to provide an IRR of 12% to the investor. The CCD shall also be convertible into equity shares in the company at the end of five years from the date of allotment at the conversion price which shall be at 20% discount to the fair market value of the company. The date of allotment was 30th June, 2017 and the initial/entry valuation of the company was ₹773 Crores. There is no other work paper regarding valuation, verification or impairment required for the investment.

ii. However, the Audit File contains valuation reports of Last Mile Online Ltd done both by the Management Expert i.e. Biyani Mittal and company (AWP 23150.12.03) and valuation done by the expert appointed by the **Audit Firm**– Internal Fair Value Specialist – IFVS

i.e. Deloitte Touche Tohmatsu India LLP – (AWP 23150.01.09). Against the initial valuation of ₹773 Crores, the valuation done by Management Expert is ₹732 Crores. However, the valuation done by IFVS is ₹157 Crores to ₹357 Crores only. It is surprising that the valuation done by the expert appointed by the **Audit Firm** is less than half of the initial valuation. However, there is no paper work, where the **Audit Firm** has questioned the Management on the valuation/impairment required in the investment. It is not even clear whether the valuation is done on the carrying cost or the call option has been valued.

iii. Even after the low valuation done by the IFVS of the investment made by the company in Last Miles Online Limited, the **Audit Firm** completely neglected the possible negative impacts on the financial position of the Company and it failed to perform any additional independent Audit Procedures that justify the valuation of the Company.

iv. The action of **Audit Firm** seems to be a deliberate effort to hide the diminution in value of this investment without performing sufficient

appropriate procedures. The **Audit Firm** has failed to perform the audit with due professional skepticism.

2.3.13 The Audit Firm submits in page 50 and 51 of their reply that: -

a) "NFRA selectively refers to the terms of the CCD and the details documented in the WP 23150.04.01 "Investment in GSec and Debentures". Although NFRA correctly notes that the CCD was "convertible into equity shares in the company at the end of five years from the date of allotment at the conversion price which shall be at 20% discount to the fair market value of the company," it ignores the additional key facts documented in the WP, namely, that the conversion price was based on a 20% discount to fair market value "at the time of Conversion or the Initial Valuation, whichever is lower.""

b) "key terms provided that the entity value was Rs.773 crores on the date of investment (July 2017), and that the CCD conversion at the end of the 5 years was at a 20% discount to the lower of the fair market value on that initial valuation date..... or the date of conversion".

c) "There was no cap on the number of equity shares IFIN could receive as part of the CCD conversion..... There was a minimum 20% upside on the conversion given that it would be at a discount of 20%, which, given that the discount was applied to the lower of the initial valuation of Rs.773 crores or the fair market value on the date of conversion, effectively meant the conversion would take place at a value that avoided a loss by IFIN unless the valuation of the Company dropped so significantly"

d) "There was no issue regarding potential impairment with IFIN's investment in Last Miles. In short, NFRA's position that the Audit Firm "completely neglected the possible negative impacts on the financial position of the Company" is without basis". The Audit firm reiterated these submissions during the presentation also.

2.3.14 NFRA examined the above contentions and observes that:-

a) The said investments were made by the Company when the valuation of the investee was at Rs 773 crore. Based on the valuation reports relied by the Audit Firm, as on the date of balance sheet there is a clear diminution in the **value of the company** from Rs 773 crore to a value anywhere between Rs 157 crore to Rs 732 crore as per different valuation reports. The Audit Firm has ignored this diminution completely on the pretext that the total value of the investments are protected by the agreement terms.

b) The Audit Firm did not even bother to reconcile the huge gap between the valuations figures made available to them. These facts indicates a clear impairment in the value of the investee and are sufficient material to invoke professional skepticism for testing of **impairment indicators** for the investment.

2.3.15 Therefore, NFRA reiterates the conclusion in the SAQRR. There is no paper work, where the Audit Firm **has questioned the Management on the valuation/impairment required** in the investment in accordance with AS 13. It is not even clear whether the valuation is done on the carrying cost or the call option has been valued. The Audit Firm completely neglected the possible **negative impacts on the financial position of the Company** and it failed to perform any **additional independent Audit Procedures** that **justify the valuation of the Company**.

5.

b) John Energy Limited

i. IFIN had 3.16% share in John Energy Ltd obtained by invocation of security for loan exposure in Kohinoor group. The holding of IFIN in John Energy Ltd was 5,79,830 shares at total cost of ₹44.42 Crores. As per the remarks of the **Audit Firm** in AWP 23150.01.01 – Investment in Equity and Preference Shares-Tab Schedule, the recent valuation of the shares of John Energy Ltd. by a third party independent valuer came to ₹799.823 per share as against the carrying cost of ₹766.12 per share. Since the valuation exceeds the carrying cost, as per the **Audit**

Firm, there is no impairment indicator.

ii. However, in the same AWP 23150.01.01 Tab - Breakup Value of Unlisted Shares, the **Audit Firm** has calculated the breakup value of share as ₹287.84 per share. Thus, the value of IFIN stake in John Energy Ltd would be ₹16.67 Crores– as per the breakup value calculated by the **Audit Firm**. Moreover, the **Audit Firm** has also appointed its own expert, Deloitte Touche Tohmatsu India LLP as Internal Fair Value Specialist– IFVS. The IFVS, after considering the report of the Management Expert, has calculated the value of IFIN stake in John Energy Ltd from ₹37.4 Crores to ₹43.6 Crores as against the carrying value of ₹44.42 Crores.

iii. Even after the low valuation done by the IFVS and its own calculation of Breakup value, the **Audit Firm** completely neglected the possible negative impacts on the financial position of the Company and it failed to perform any additional independent Audit Procedures that justify the valuation of the Company.

2.3.16 Regarding John Energy Ltd, the Audit Firm in their reply submits that as per Master Direction – Non Banking Financial Company – Systemically Important Non Deposit taking Company and Deposit taking Company (Reserve bank) Directions, 2016, in Chapter V – Prudential Regulations, paragraph 10 "Accounting of Investments," loan term investments "shall be valued in accordance with the Accounting Standard issued by ICAI." Under paragraph 17 of AS 13 "Accounting for Investments," long-term investments are generally carried at cost; "however, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline." Thus, the breakup value, which is addressed in the RBI Master Direction with respect to current investments and not long- term investments, is not relevant. Both publicly available pricing information and the results of the valuations prepared by the management's expert and the Audit Firm's valuation experts provided the Engagement Team with information supporting the reasonableness of the Company's assessment that there was no decline in value other than

temporary relating to its investment in John Energy. The difference in valuation by the EFVS and IFVS was due to the application of assumptions that differed to some extent.

2.3.16.1 NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) Note 3 to annexure IV in the RBI Master directions cited by the Audit Firm states "All Accounting Standards and Guidance Notes issued by ICAI are applicable including for valuation of investments and other assets as also assets acquired in satisfaction of debt. However, market value in respect of quoted investments and break up / fair value / NAV in respect of unquoted investments shall be disclosed irrespective of whether they are classified as long term or current in (5) above." Thus the statement of the Audit Firm that the break up value is not relevant for long term investments is not true to the facts. The reply of the Audit Firm indicates that they are not even in a position to understand the purpose and objectives of their own work papers.

b) Para 8 (c) of SA 500, Audit Evidence, stipulates that: -

i) When information to be used as audit evidence has been prepared using the work of a management's expert, **the auditor shall,** to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion

c) Para A48 of SA 500 states that:-.

i) Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

- The relevance and reasonableness of that expert's findings or conclusions,

- their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

d) Para 12 of SA 620, Using the Work of an Auditor's Expert, stipulates that:-

i) The **auditor shall evaluate** the adequacy of the auditor's expert's work for the auditor's purposes, including: (Ref: Para. A32)

- The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; (Ref: Para. A33-A34)
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and (Ref: Para. A35-A37)
- If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data. (Ref: Para. A38-A39)

ii) Para A 33 to 39 of SA 620 provides Application and Other Explanatory Material for the above stipulation. Prominent among them in the present context are:-

- Specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes.
- Relevant factors when evaluating the relevance and

reasonableness of the findings or conclusions of the auditor's expert.

- Evaluating whether the auditor's expert has adequately reviewed the management expert's assumptions and methods.
- When the auditor's expert's work is to develop an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models where appropriate, used by the auditor's expert.
- When an auditor's expert's work involves the use of significant assumptions and methods, factors relevant to the auditor's evaluation of those assumptions and methods.
- When an auditor's expert's work involves the use of source data that is significant to that expert's work, the Auditor may use procedures to test that data, such as verifying the origin of the data, including obtaining an understanding of, and where applicable testing, the internal controls over the data and, where relevant, its transmission to the expert; and reviewing the data for completeness and internal consistency.
- If the auditor's expert has tested the source data, inquiry of that expert by the auditor, or supervision or review of that expert's tests may be an appropriate way for the auditor to evaluate that data's relevance, completeness, and accuracy.

e) In order to comply with the requirements of SA 500, the Audit Firm had engaged Auditor's Expert. In all the cases of investments listed in the DSAQRR above, the Auditor's Expert had a materially different view than that of the Management Expert. However, in all such cases the Audit Firm ruled out its own expert without performing any of the procedures as mentioned in SA 620, as

detailed above. In their reply to NFRA, the Audit Firm had stated that the views taken by the management expert was correct and they have stated many reasons for the same. However, many of these conclusions are not at all documented in the audit file in the manner as required by SA 500 and SA 620.

f) Para 11 of SA 230 stipulates that if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency. In all cases of valuation of investments noted above, where the Audit Firm had engaged IFVS, the Audit Firm's final conclusion was favoring the management valuation. Though there were explicit and glaring inconsistencies between the IFVS and EFVS, there is virtually no documentation in the Audit File that conclusively document how the auditor addressed such inconsistencies, thus violating para 11 of SA 230.

2.3.17 Thus the Audit Firm had violated SA 230, SA 500 and SA 620 and NFRA reiterates its observations regarding investments in John Energy Limited.

6. Reliance Naval and Engineering Ltd (RNEL)

a) IFIN had an investment in the equity shares of Reliance Naval and Engineering Ltd (RNEL) at ₹61.47 per share aggregating to ₹22.39 Crores. NFRA has examined AWP 23150.01.01 – Investment in Equity and Preference Shares – Tab Schedule, Tab Test of Details, Tab Valuation of Listed Shares and Management Representation on RNEL – AWP 23150.01.05.

b) AWP 23150.01.01-Tab Schedule mentions that IFIN has net exposure of ₹22.39 Crores in RNEL. The market value of the investment is ₹10.03 Crores with shortfall of ₹12.36 Crores. The Tab on Test of Details enlists all the sales of the shares of RNEL in the FY 2017-18 and concludes that company incurred a loss of ₹56.79 lakhs in FY 2017–18. Even though the Tab Schedule

refers to the Impairment Testing Tab, there are no details pertaining to impairment of investments in RNEL. Similarly, the Tab on Valuation of Listed Shares also concludes that diminution of ₹12.3 Crores is required. The AWP nowhere mentions about the Management Representation in this regard or examination of the same by the **Audit Firm**.

c) **However, NFRA could locate the Management Representation on RNEL in AWP 23150.01.05**. The Management has stated that the shipping industry has been going through one of the worst phases globally and defense order book by the Government of India is yet to materialise. The delay in the above has led to adverse impact on the order book position of the RNEL thus affecting its financial performance over the last three years. The Management has concluded that RNEL is currently in the process of bidding for various defense contracts and expects positive result of the bidding. This is expected to enable significant improvement in the current market price. Surprisingly, the **Audit Firm** has neither examined the representation of the Management nor obtained any Audit Evidence to overrule its own conclusion of requirement of impairment of ₹12.39 Crores.

d) It is, thus, evident from the discussion above that the **Audit Firm, including EQCR,** failed to verify the investments of the Company and their valuation with valid, sufficient, appropriate and reliable Audit Evidences and failed to comply with the applicable Accounting Framework.

c) NFRA, therefore, concludes that:

i. The **Audit Firm** is found to be grossly negligent in performance of its professional duties and responsibilities.

ii. The **Audit Firm** indulged in a deliberate effort in collusion with the

Management that has led to various Material Misstatements in the Financial Statements.

iii. It is observed that the audit has not been conducted with professional skepticism in accordance with Para 15 of SA 200 and it lacks the overall objective of an independent audit and the conduct of an audit in accordance with SA 200.

iv. The **Audit Firm** failed to perform its responsibility for forming an opinion on the Financial Statements in accordance with Para 10, 11 and 16 of SA 700.

2.3.18 The Audit Firm in their reply submits that IFIN classified its investment in RNEL as a long term investment, which, under AS 13, was measured at cost less any other than temporary diminution in value. The highest traded price of the shares of RNEL during FY 2017-18 was Rs.70.65, and there were many days during FY 17-18 where the closing traded price of shares of RNEL were more than the carrying value of the shares in the books of account of IFIN. Given such share prices and the general volatile nature of the RNEL share price, there certainly was no decline in value other than temporary as on 31st March, 2018. The Engagement Team documented important facts set forth in management's representation regarding the RNEL investment in WP 23150.01.05 including carrying cost and price movement, in the documentation of its testing reflected in WP 23150.01.01 "Investment In Equity and Preference Shares"- Refer Tab 'Valuation of listed shares'.

a) NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) As per information available in public domain, the exponential moving average for 200 days (which the company resorted in selective cases to support their valuation and trend analysis, but not on this case) as on the balance sheet date was Rs 46.82 as against a closing price of 27.55 on NSE. Similarly, all the short term moving averages are lower than the long range average. On 25th May 2018, the moving average for 200 days and closing price are respectively 38.37 and 14.05. Thus, none of the claims by the Audit Firm that the decline is temporary are supported by evidence.

The Audit Form has totally failed to do any independent evaluation of the management evaluation and ignored clearly available indicators of impairment in value.

b) Para A7 of SA 230 states that "In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file: For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries". There is no evidence in the audit file to show such specific procedures done to corroborate management representations in any of the cases of investments noted in DSAQRR.

b) NFRA, therefore, reiterates its conclusions in the DSAQRR that:

a) The Audit Firm is found to be grossly negligent in performance of its professional duties and responsibilities.

b) The Audit Firm indulged in a deliberate effort in collusion with the Management that has led to various Material Misstatements in the Financial Statements.

c) It is observed that the audit has not been conducted with professional skepticism in accordance with Para 15 of SA 200 and it lacks the overall objective of an independent audit and the conduct of an audit in accordance with SA 200.

d) The Audit Firm failed to perform its responsibility for forming an opinion on the Financial Statements in accordance with Para 10, 11 and 16 of SA 700.

2.4 Reversal of General Contingency Provision

a) In its communication dated 21st October, 2019, **NFRA** had requested the **Audit Firm** to submit a summary of work done (specifically citing relevant WPs from the Audit File) with regard to examination of reversal of ₹175 Crores in GCP.

b) The **Audit Firm** in its response dated 15th November, 2019, had stated as follows:

"The Company had a Board approved policy for creation of a General Contingency Provision (GCP) which has also been disclosed in note 1 (n) (v) of the significant accounting policies of the Company in the annual financial statements for the year ended March 31, 2018. Extracts of the said policy is given here under "... the Company carries a significant quantum of project finance and investment banking assets in its books. Given the risk profile of such assets and based upon internal risk assessment, the Company creates a provision for General Contingency to cover adverse events that may affect the quality of the Company's assets".

During the FY 2017-18, the GCP of ₹1, 750 Million was reversed considering the tough market conditions, whereby the company had created specific provision on loans and investments and additional provision on certain standard assets exposures for the year ended March 31, 2018, in addition to the regulatory provisions required by the RBI.

We obtained a certified true copy of the extract of the matter approved by the BOD of the Company at its meeting held on May 28, 2018, wherein it was approved that "... pursuant to the tough market conditions, an amount of ₹1,750 Million was proposed to be used towards the above additional provision on account of further specific provisions on asset/investments and additional standard assets provision."(Refer AWP: 26780.03 Resolutions for GCP)

Also refer to AWP 26780.02 'Working on GCP', for basis of utilization of GCP wherein following was mentioned in respect of utilization of GCP, "During the current year, due to stress in the environment and defaults, the Company has created specific NPA provision as well as specific additional standard asset provision for certain borrower exposures. No additional GCP

has been created. However, the company has utilized GCP due to these higher provisions observed due to tough and competitive environment and cases being referred to NCLT based on new IBC law...".

2.4.1 **NFRA** had examined the above contentions of the **Audit Firm** and had concluded as follows in the DSAQRR:

a) The Company's policy related to GCP, which is available in "Framework for Contingency Provision" states as follows:

"As explained above, prudential norms primarily take care of specific provision requirements on problem assets ***leaving other assets at the current value which exposes such assets against future losses in adverse market environment****. In order to safeguard itself from such circumstances which could have adverse impact on the financial position, the Company realize need for the creation of additional provision as a cushion against contingencies after management assessment of its credit portfolio IL&FS, the Holding Company of the IL&FS group has been creating provision for Contingency since FY 2003 as a % of the total assets.* ***IFIN intends to achieve contingency provision at ~ 5% of the total assets of the Company on or before 31st March, 2018****". (Emphasis added)*

As per the policy of the Company, the Company should have provided further to reach the targeted 5% level. Instead of that, the Company wrote back ₹225 Crores (₹50 Crores provided in half yearly results and reversal of ₹175 Crores) from GCP and thus overstated the profit. This action was only a method used by the Management to inflate the profit, and the **Audit Firm** did not display the required professional skepticism and challenge the evidence produced by the Management.

b) Note 1 (n) (v) of the Significant Accounting Policies of notes forming

part of the accounts of the Financial Statements of the company for the year ending March 2018, as mentioned by the **Audit Firm**, mentions creation of GCP to cover adverse events that may affect the quality of the company's assets. It nowhere talks about reversal of GCP provision. However, the Financial Statements, instead of providing further for the contingency, reverses ₹225 Crores from the Profit and Loss Account. **NFRA** also observes that notes to accounts to the Financial Statements do not cover reasons for reversal of GCPs. Thus, it is amply clear that the **Audit Firm** has colluded with the company in over statement of profit and violation of the accounting policies.

c) The **Audit Firm** has quoted the minutes of the Board meeting held on 28th May, 2018. **NFRA** has gone through slides 23, 29 and 30 in 'WP 30301 Audit Committee Presentation' of the eAudit File. The three slides pertain to additional provision made of ₹26 Crores for KVK, ₹55 Crores for ERA, and ₹40 Crores for SIVA. The total additional provision on these assets as referred by the **Audit Firm** amounts to ₹121 Crores. The justification for the additional provision as given in the presentation is as follows:

Significant matters discussed with management

RBI Draft Inspection Report - Observations and Responses

Rs. in Mn

Name of the Borrowers	Op. bal	Disb.	Repay ments	Cl Bal	Company's Representation
KEIPL- Loan	1,200	70	-	1,270	- Per RBI draft report loan is NPA due to evergreening; - Additional security of 51% equity stake in MMS Steel obtained last year; - Collaterals are towards loan exposure; - Advance against equity of Nagai Power Rs. 250 mn & KVK Energy & Infra (KEIPL) Rs. 400 mn - covered by adequate underlying valuation; - OCD Rs. 590 mn of KEIPL Unsecured - NW Rs. 1,950 mn - The Company has created additional standard asset provision of Rs.260 mn against exposure of KVK.
KEIPL - OCD	-	590	-	590	
KEIPL - Adv. for Investment	1,240		590	650	
KEIPL Total	2,440	660	590	2,510	
Collateral	2,060			1,750	

Non Performing asset ^ Security under creation ~ Written off

Golden Glow*	1,740	-	-	1,740	• Per RBI draft report Golden Glow loan is NPA due to evergreening • Collateral of Era Infra (India) equity share valued Rs.720 mn expected to cover Dev Rishabh exposure – security not perfected; • Separate SPV to be formed to acquire Developmental rights of Badshahpur project with new developer Silver Glades & final approvals awaited; • Collections from which are expected to cover the exposure of Golden Glow • Golden Glow exposure treated as NPA and a provision of Rs.174 mn made • The Company has created additional standard asset provision of Rs.350 mn against exposure of Dev Rishabh.
Dev Rishabh *	-	1,170	-	1,170	
Era Group	1,740	1,170	-	2,910	
Collateral	2,286			2,286	
Siva Green (OCD)		1,900	1,500		Specific provision of Rs.400 mn made as additional standard asset provision Financial statements and valuation not available. Shortfall, if any to the extent of Rs.1,500 mn, covered through receivable from Affordable Housing Joint Venture between Shiva Group and ITUAL Signing of binding agreements expected by June 2018.

d) **NFRA** observed the following from the presentation:

- KVK - as per RBI draft report, loan is NPA due to ever greening. Against collateral of ₹175 Crores, the outstanding loan amount is ₹251 Crores.

- ERA - as per RBI draft report Golden Glow loan is NPA due to ever greening. Against collateral of ₹228.6 Crores, the outstanding loan balance is ₹291 Crores.

- SIVA - against the cost of ₹190 Crores, the valuation as of March 2018 is ₹150 Crores and specific provision of ₹40 Crores is made as additional standard asset provision.

Thus, it can be seen that in all the three cases specific additional provision has been made to cover the shortfall in collateral/valuation. It may further be noted that all the three companies are also covered in the complaint received through RBI on 15th November, 2017 for non- recoverability of loan (Slide 11 of the same presentation). Further, ERA and SIVA are also listed as watch list parties in slide 24 and 25 respectively of the same presentation.

The basic question that arises is how these assets are called standard assets when these were identified as NPA due to ever greening by RBI. As these assets were NPA, provisions had to be calculated and made as directed by RBI. Note 5(g) of the balance sheet is also completely misleading in this regard as the assets, which have been identified by RBI in its draft report as NPAs, have been described as standard assets. Even if it is argued that this was only a draft RBI report, what questioning was done by the **Audit Firm** before deciding that these were standard assets, and not NPAs as decided by RBI, is nowhere available in the Audit File.

e) Further, the presentation showcases the additional standard provision created for three specific loans and the attempted justification for the same. Even assuming that the justification and amounts of additional provisions against these NPAs was acceptable, this could, by no logic, be treated as any justification for reversal of the general contingency provision. **At no point in the presentation has the reversal of contingency provision been considered. The Audit Firm has not quoted any other WP where they have raised the question of reversal of GCP with the Management.** Thus, the explanation given by the **Audit Firm** in its reply dated 15th November, 2019, is an afterthought and is not supported by any Audit Evidence. This is especially so in the light of the admitted position that the GCP was for assets in general that were not covered by any specific provisions.

f) AWP 26780.02 'Working on GCP', for basis of utilization of GCP, simply mentions the explanation as given by the Management. **This is despite the fact that the Audit Firm, in 'AWP 13303 – Risk Assessment', has identified provision for General Contingencies as a significant risk.** The **Audit Firm** has also noted that "the account balance is substantially affected by qualitative factors, whereby the

amount of provision is based on the overall credit strength of the portfolio and general economic scenario. The account balance is also affected by quantitative factors wherein, the percentage of provision to be made is decided based on the amount deemed fine by the BOD and is subjective." However, no further Audit Procedure has been carried out in this regard. The provision of ₹50 Crores made in the first quarter has been written back and another ₹175 Crores have been deducted from GCP in the Financial Statements ending 31st March, 2018 and added to the profit and loss account. Thus, the total reversal is of ₹225 Crores which must be treated as overstatement of profit in the absence of any evidence in the Audit File to support this reversal.

2.4.2 NFRA, therefore had concluded in the DSAQRR that:

a) The **Audit Firm** has colluded with the company in fraudulent and wrongful disclosure of the Accounting Policies forming part of the Financial Statements. The **Audit Firm** has failed to invite attention to the material departure from the generally accepted procedure of audit applicable in the circumstances.

b) Instead of providing another ₹333.3 Crores (as per Company's Policy), the Company wrote back ₹225 Crores from GCP and thus overstated the profit by Rs 578 crores. The **Audit Firm** has failed to report a material misstatement known to them to appear in the Financial Statements.

c) The explanation given by **Audit Firm** for reversal of GCP, in its reply dated 15th November, 2019, is an afterthought and not supported by any Audit Evidence. **This is taken as a deliberate attempt by the Audit Firm to mislead the NFRA.** The **Audit Firm** did not display the required professional skepticism and has completely failed to obtain sufficient information which is necessary for expression of an opinion while critically evaluating reversal of GCP by Management.

d) **The Audit Firm has completely failed to disclose a material fact known to them and was a colluding party to the fraudulent presentation of the Financial Statements, by describing the assets which have been identified by RBI in its draft report as NPAs as Standard Assets. This is also violation of Para 18 of SA 700.**

e) **The reversal of GCP (of ₹225 Crores) is completely unjustified and is not based on any objective evidence and appears to be a calculated fraud in collusion with management to inflate the profit. The Audit Firm has also failed to bring the matter to the notice of Central Government as required by Section 143 (12) of Companies Act, 2013.**

2.4.3 NFRA has examined in detail the submissions made by the Audit Firm in response to the DSAQRR and observes as follows: -

a) The replies provided by the Audit Firm do not provide any additional grounds or evidence from Audit File to support the rejection by the Audit Firm of the conclusions in the DSAQRR. Specifically, no evidence from the Audit File has been presented to show how the Audit Firm satisfied itself that the GCP was overstated by the specific amount of Rs 175 crores that was written back to profit. In the absence of such evidence, NFRA reiterates its conclusions in the DSAQRR.

b) In pages 58 to 62 of the reply to DSAQRR, the Audit Firm, citing disclosures in the financial statements of IFIN for FY 2018 regarding GCP, has stated that "IFIN was completely transparent with the users of its financial statements about the changes to its General Contingency Provision". The Audit Firm terms the write back as a "reclassification of Rs.1,750.00 million from the GCP to specific provisions" and states that it is approved by the Board of IFIN. The Audit Firm also states that the "reclassification was consistent with practices known to RBI" citing an earlier reversal made in FY 2015 in respect

of Reid & Taylor India Limited. The Audit Firm also claims that the "reclassification" of the GCP to specific provisions did not result in a smaller combined provision. To the contrary, IFIN substantially increased its overall provision (general and specific combined) in 2017-18 and this reclassification did not cause the financial statements to be misstated. As the Engagement Team considered all of this information, it reasonably determined that IFIN's decisions to 'reclassify' some amount of GCP was reasonable. Hence there is no negligence or collusion with the management in fraud. The Audit Firm reiterated the above contentions during the presentation made on 28th October 2020 and submits in their subsequent written clarifications that "Reversal of Contingency Provision of Rs. 175 crore was less than the total provisions made during the year. The Reversal from the Contingency Provision was consistent with the Company's own internal policy and transparently disclosed".

NFRA observes that none of these arguments are tenable because: -

i) None of the submissions are supported by evidence in the Audit File. As such all these arguments are simply afterthoughts.

ii) The claim of 'complete transparency' of disclosure in financial statements is untrue. To the contrary, the disclosures made are inadequate and misleading and against the fundamental accounting assumption of consistency which states that "accounting policies are" required to be "consistent from one period to another" (AS -1). The accounting policy of the company as disclosed in note 1 n (v) under significant accounting policies for FY 2018 states "The Company carries a significant quantum of project finance and investment banking assets in its books. Given the risk profile of such assets and based upon internal risk assessment, the Company creates a provision for general contingency to cover adverse events that may affect the quality of the Company's assets". NFRA has examined the financial statements of IFIN from FY 2014 onward up to FY 2017 and it is observed that the company had consistently followed the same accounting policy in all these previous years. In FY 2014 and 2015 there were reversals from

the GCP, in both cases for **writing off loss assets** as approved by the Board. The Company had **also created additional GCP on standard assets** in all these years, irrespective of write offs. This is in accordance with the disclosed accounting policy cited above. However, it was in FY 2018 alone that there were deviations from this consistently followed accounting policy, without adequate disclosure about the deviation. The reversal in FY 2018 was stated to be for **making specific provision on few standard assets and Provision for NPA** for the year ended March 31, 2018. Also, there was **no additional creation** of GCP on standard assets in FY 2018, contrary to what is stated in the note 1 n (v). Moreover, notes to accounts do not cover reasons for reversal and non-creation of GCP. Hence there is a clear concealment of facts. The company also had not followed para 26 and 27 of AS 1, Disclosure of accounting policies since the decision to change the stated policy of the company, the reversal of the GCP provided earlier (and also in the first half of the current year) and the reason for the reversal of GCP has not been disclosed in the financial statements. In not disclosing a clear deviation from a consistently followed accounting policy as previously disclosed in the financial statements, the Company intentionally misrepresented the financial statements.

iii) After having noted in AWP 26780.02 that "No additional GCP has been created. However, the company has utilized GCP due to these higher provisions observed", the Audit Firm's further silence and failure to perform due audit procedures clearly indicates collusion with the management.

c) Contrary to the claims of the Audit Firm, glaring absence of professional skepticism, and due diligence on the part of the Engagement Team is proven beyond any doubt from the following facts:

i) In WP 26780.02 (Workings on GCP) the Audit Firm notes that the policy of creation of GCP is approved by RBI and the RBI approval is quite clear that the said provision should not be construed as an exemption from creation of other NBFC provisions, as it should be over and above the other provisions required

as per the prudential norms of RBI. The Audit Firm also notes that "We have also assessed that this is not a reserve but a provision for expected loss".

ii) Thus, the Audit Firm clearly knew that the GCP is a provision for covering losses on standard assets which are not otherwise covered under prudential norms. Therefore, the use of GCP partly towards 'provision for NPA' as disclosed in the financial statements is clearly contrary to the accounting policy and the observations in the Audit File.

iii) Notwithstanding the above, the amount of the disclosed purpose of utilization of GCP, i.e., "to make specific provision on few standard assets and Provision for NPA", should tally with the amount utilised from GCP. Neither the financial statements nor the WPs provide any such matching. The specific provisions on standard assets/NPAs made was only Rs 121 crores, while the reversal of GCP was for Rs 225 crores.

iv) In the DSAQRR, NFRA observed from the Audit Committee presentation that the specific provision made consists of ₹26 Crores for KVK, ₹55 Crores for ERA, and ₹40 Crores for SIVA, totaling to ₹121 crore only. Out of this, a provision of ₹17.4 crore is on account of NPA of one of the group entities, as confirmed by the Audit Firm and as noted in the Audit Committee presentation. Thus, the amount of GCP that is 'over and above the other provisions required as per the prudential norms of RBI' and hence can be set off against this provision (if it is assumed without admitting that all the claims of the Audit Firm are true) is only ₹103.60 crore. Even in this case there is no justification for reversal of ₹225 crore.

v) The Audit Firm states in their reply to DSAQRR in page 66 that "although RBI maintained that Siva had been under secured as at 31st March, 2017, Rs.150 crore of security for Siva was in place subsequently". This is contradictory to what is stated in the presentation to Audit Committee in respect of Siva that "Financial statements and valuation not available" and "Signing of binding agreement expected by June 2018". Thus, neither on the date of balance sheet nor on the date of Audit Report, there was a binding contract for the security of ₹150 crore and the Engagement Team had not done any evaluation of the security. Read this fact with the recommendation of the RBI that ₹190 crore

provision is required for this advance, the contention of the Audit Firm that this is a standard asset cannot be accepted.

vi) According to RBI prudential norms contained in RBI Master directions 'Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016', loss asset shall mean: (a) an asset which has been identified as loss asset by the applicable NBFC or its internal or external auditor or by the Bank during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC; and (b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower. Going by this definition also, Siva was a loss asset as on the Balance sheet date.

vii) The contention of the Audit Firm that the above three loans are standard is not tenable in view of the RBI definition of loss assets. The utilization of GCP against the specific provision on such loss assets is contrary to the accounting policy of GCP. On the other hand, if the contention of the Audit Firm, that the utilisation of GCP against these assets comply with the accounting policy, is accepted then it is clear that the company also recognised the fact that these assets are loss assets and hence the GCP is utilised for making good the expected loss. If this is the case, as pointed out by NFRA is para 2.4.4 (d), the Audit Firm was a colluding party to the fraudulent presentation of the Financial Statements, by describing the loss assets as Standard Assets.

viii) As per the definition contained in the RBI Master Directions cited above, Standard asset shall mean the asset in respect of which, no default in repayment of principal or payment of interest is perceived **and** which does not disclose any problem or **carry more than normal risk** attached to the business. The Audit Firm repeatedly stated in their reply that the specific provision on certain standard assets was due to higher perceived risk on these assets. For e.g., in page 65 it is stated that "The fact that, despite the borrower groups' conformity with the definition of standard assets, IFIN made the prudent decision to make additional specific provisions for the borrower groups to address **the higher**

perceived risk due to shortfalls in security, does not change that the loans were properly classified as standard and unsecured to the extent the security shortfall was noted."(Emphasis added). As the said assets were having risk more than the normal, these assets do not fall under the category of standard assets. The statements of the Audit Firm that these are standard assets and at the same time carry higher perceived risk are contradictory.

ix) The decision to change the stated policy of the company, the reversal of the GCP provided earlier (and also in the first half of the current year) and the reason for the reversal of GCP has neither been disclosed, nor was it raised in the presentation made to the Audit Committee. The slide in the Audit Committee presentation, is just a line in the table indicating reversal of GCP of Rs.175 Crores. It does not even mention the reversal of GCP provided in the first half of the current year.

x) The PBT as disclosed in the SFS is ₹201.96 crore. The PBT excluding reversal of ₹175 crore will be ₹26.96 crore only. Thus, the GCP reversed out of opening balance is 649% of PBT before such reversal and it is also a material transaction when considered in the light of the amount fixed for materiality.

xi) Even assuming for the sake of argument, but not admitting the same, that a reduction in the GCP was justified, there is nothing in the Audit File to show how the Audit Firm satisfied itself that the reduction in GCP should be only Rs 175 crores and not any other figure. No reasoning, identification and quantification of specific factors has been documented. The minutes showing approval of the Audit Committee and Board for reversal of GCP that has been relied by the Audit Firm in support of their acceptance of this reversal shows merely "utilised" provision of Rs 175 crores with zero explanation for the number.

xii) Due to the creation of specific provision, if the company found that the GCP created in previous years was in excess of the reasonable requirement, the Company was at a liberty to re-assess the GCP and reverse the excess provision in accordance with AS 5, with due disclosures as provided in para 27 of the AS. This was totally ignored in the present case. Since the reversal of GCP of ₹ 175 crore out of opening balance to profit and loss account was not in

accordance with the accounting policy, it was essentially a reversal entry requiring disclosures as per AS 5. Had such disclosure been made, the nature and amount of a change in the accounting estimate would have been separately disclosed and known to the users of financial statements. Instead of doing so, the Company chose to hide the facts and provided a misleading and inadequate disclosure in the financial statements. This is nothing but clear accounting fraud to overstate the profits as concluded by NFRA in the DSAQRR.

xiii) The contention of 'reclassification' is not supported by any evidence in Audit file as there has been no such term used in any of the work papers referred by the Audit Firm or in the minutes of the Audit Committee or Board of IFIN. Instead WP 26780.03 "Resolution for GCP, states that "Pursuant to the tough market conditions, an amount of 1750 mn was proposed to be used towards the above additional provision on account of further specific provision on assets/investment and additional standard assets provision". None of the disclosure notes mention the reversal as a reclassification. Instead the disclosures use the words "written back" and "reversed during the year to make specific provision".

xiv) If the contention of the Audit Firm, that the reversal of GCP is not a write off but a "reclassification", is accepted, it means that such reclassification should either be a prior period item or a change in accounting estimate, as the case may be, and should be accounted and separate disclosures should have been made as per AS 5. As this is not done, there is no merit in this contention.

xv) The Audit Firm states in page 59 of the reply that "the reclassification (write back) of the GCP to specific provisions did not result in a smaller combined provision. To the contrary, IFIN substantially increased its overall provision (general and specific combined) in 2017-18, as also was made plain on the face of the financial statements". This contention is untrue and has no relevance to the reversal of GCP. From the SFS of IFIN, NFRA observes that the NPA has increased by 155% in FY 2018, as compared to the increases of 59% and 49% in FY 2017 and 2016 respectively. However, provisions and write offs (net) shows an increase of just 13% in FY 2018 as compared to increase of 75% and 30% in FY 2017 and 2016. The above ratios indicate an inconsistent and

extraordinary adjustment in provisions and write offs in FY 2018, which the Audit Firm ignored completely. Read this with the gross failure of the Audit Firm in performing analytical procedures as detailed in this SAQRR.

xvi) The above acts of the Company squarely fall under the definition of fraud as stated in explanation (i) to section 447 of the Companies Act, 2013, which states ""fraud" in relation to affairs of a company or any body corporate, includes **any act**, omission, **concealment of any fact** or abuse of position committed by any person or any other person with the connivance in any manner, **with intent to deceive**, to gain undue advantage from, or **to injure the interests** of, the company or its shareholders or **its creditors or any other person**, whether or not there is any wrongful gain or wrongful loss." (Emphasis added) The intentional suppression of information in the disclosure notes regarding GCP is clearly an accounting fraud, for which the Audit Firm has been a colluding party, because of its blind support of the management even after complete knowledge of the entire transactions.

xvii) Para 12 of SA 240 stipulates that "In accordance with SA 200, **the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist**, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance". Para 22 of SA 240 states "The auditor shall **evaluate whether unusual or unexpected relationships** that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud." Para A2 of SA 240 explains "**Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures** in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. **Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management**." Para A3 states "Fraudulent financial reporting may be accomplished by .....

Misrepresentation in or intentional omission from, the financial statements of events, transactions or **other significant information**. **Intentional misapplication of accounting principles** relating to amounts, classification, manner of presentation, or disclosure." SA 240 also describes opportunities to engage in fraudulent financial reporting that can arise from "Assets, **liabilities,** revenues, or expenses **based on significant estimates that involve subjective judgments** or uncertainties that are difficult to corroborate." (Emphasis added).

xviii) As detailed above in this SAQRR, the Audit Firm did not maintain professional skepticism throughout the audit as required under para 12 of SA 240. Also having failed in performing analytical procedures as detailed in this SAQRR, the Audit Firm failed to identify unusual relationships and trends (such as the one mentioned in para 15 above) that might have indicated risks of material misstatement due to fraud as stated in para 22 of SA 240. The omissions of amounts and disclosures, misapplication of accounting principles, misrepresentation of accounting policies, and hiding of facts in the financial statements of IFIN as detailed in this SAQRR, are found to be intentional and deliberate, since this is evident from the contentions of the Audit Firm that vehemently support without question all the actions of the management where significant estimates that involve subjective judgments are involved.

xix) By terming the reversal of GCP as a reclassification the Audit Firm has made it explicit that the Engagement Team had understood clearly that the GCP has not been used consistently with the previous practices, or disclosed in the financial statements in a manner consistent with the accounting policy. This is reiterated by the statement of the Audit Firm in page 61 of their reply that "The Engagement Team was aware of and considered the robust review and **disclosure of the reclassification** from the GCP account to specific provisions" (Emphasis added). Though there is absolutely nothing in the disclosures in the financial statements to indicate that reversal of GCP is a reclassification, the Audit Firm's stand of terming it as a reclassification implies that what is stated in the financial statements is not the actual scheme of transactions. Having understood so, instead of reporting the fraudulent accounting practices and inadequate disclosures, the Audit Firm went along with the management in

misstating the financial statements.

xx) Clearly, the Audit Firm has completely, and, as appears to be evident from the totality of the circumstances, as a result of a decision to actively support the Management in unjustifiably inflating profits, failed to perform its audit with the required professional skepticism. Thus, the explanation provided by the Audit Firm is a complete sham, an afterthought, and not supported by any audit evidence. The Audit Firm is a colluding party to the fraudulent accounting practice resorted to by IFIN.

2.4.4 In view of the above NFRA therefore reiterates its earlier conclusions made in para 2.4.4. above.

2.5 Materiality

2.5.1 NFRA made the following observations in the DSAQRR regarding materiality.

a) The assessment of the Audit Firm (as mentioned in WP 13101.02) about the Auditee Company is that the Company is debt listed and its principal operations include Lending, Investments, Borrowings and Syndication Fee Income. Also, Audit Firm itself has mentioned that the principal external users of the Financial Statements would be debt-holders, SEBI and RBI.

While stating the basis for selection of the determined materiality benchmark, inter-alia, the Audit Firm's assertion that "the revenue could not be relevant benchmark for determining materiality, as the Company is in the business of lending, where the spread of the lending rate and borrowing rate is more important for the shareholders and hence the PBT becomes more important from the share-holders point of view" focuses on the shareholders as the users of the Financial Statements. Given that IFIN was owned 100% by IL&FS Ltd., who was also in charge of management, the view point that shareholders are the principal users of Financial Statements is unsustainable. Moreover, by the Audit Firm's own assertion, it was the debt holders, SEBI and RBI who were the

principal users of the Financial Statements.

According to Para 2 of SA 320, misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could normally be expected to influence the economic decisions of the users taken on the basis of Financial Statements. Also, that judgments about matters that are material to users of the Financial Statements are based on consideration of the common financial needs of users as a group.

Para A2 of SA 320 also mentions that if the entity is financed by debt rather than equity, users may put more emphasis on assets, and claims on them, rather than on the entity's earnings. Notwithstanding all the above, the rationale for picking up profit before taxes rather than any other indicator including one for ability to repay debt has not been examined at all by the Audit Firm. The Audit Firm has simply presumed that the Benchmark of PBTCO would be the most appropriate without any application of mind or due diligence as required.

b) In WP 13101.01 for determining materiality, the Audit Firm has mentioned that, as per their Deloitte Audit Approach Manual, "For audits of Listed Entities, we typically identify PBTCO as the benchmark of the Financial Statements because it is typically what users of Financial Statements primarily focus on". As such, Audit Firm used a standard template to determine the benchmark for materiality irrespective of the nature, size of the entity and even the industry the entity belongs to. This simply means the Audit Firm did not evaluate the nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates, as required by Para A2 of SA 320.

c) Assessment of Materiality based on final numbers for the year ended 31st March, 2018, is detailed as below:

Particulars	Amount (₹ in Million) (As per WP 13101.02)	Amount ($) (As per WP 13101.01)
Benchmark- PBT	2,019.60	2,01,96,00,000

Factors Finalized during planning stage	8%	8%
Materiality	161.57	16,15,68,000
Performance Materiality (Materiality*90%)	145.41	14,54,11,000
CTT (Materiality*5%)	8.08	80,78,400

i) On perusal of Audit File submitted by the Audit Firm to NFRA, it was noticed that in "WP 23300.01.02.04- Test of Details", Audit Firm had used the Performance Materiality as ₹151 Million, instead of ₹145.41 Million, for performing its Audit Procedures.

ii) The currency as used in both the above-mentioned WPs are different as one shows amount in "₹" and other shows amount in "$". Even, within the WP 13101.01, tabs- "Input & Summary" and "Materiality- AB, COT and Disc" shows different currency. This clearly indicates that Audit Firm has calculated the materiality with a casual approach and they themselves are not clear in what currency they are calculating the materiality.

d) Para 10 of SA 320 states that if there are one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than the materiality for the Financial Statements as a whole could reasonably be expected to influence the economic decisions of users, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. The Audit Firm did not identify if there were any such particular classes of transactions, account balances or disclosures where the lower materiality level would be applicable.

e) The Audit Firm has also failed to show how the performance materiality as determined in WP 13101.01 was used for determining the nature, timing and extent of further Audit Procedures as required by Para 11 and Para A12 of SA 320.

2.5.2 On consideration of all the above evidence, the NFRA had concluded in the DSAQRR that:

a) The Audit Firm did not assess the status of the Auditee Company as a debt listed company as determinative of the benchmark to be used for determining materiality. The Audit Firm did not examine any indicator for ability to repay debt but simply presumed that the benchmark of PBTCO would be most appropriate, without any application of mind or due diligence as required by Para A2 of SA 320. Thus, the Audit Firm failed to exercise due diligence and was grossly negligent in the conduct of its professional duties.

b) The Audit Firm failed to evaluate the nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates, as required by Para A2 of SA 320. Therefore, the Audit Firm failed to exercise due diligence and was grossly negligent in the conduct of its professional duties.

c) The Audit Firm has calculated materiality with a casual approach and without clarity about the currency to be used for calculating materiality.

d) The Audit Firm has failed to make any attempt to identify particular classes of transactions, account balances or disclosures where a lower materiality level would be applicable, as required by Para 10 of SA 320.

e) The Audit Firm has also failed to show how the performance materiality as determined in WP 13101.01was used for determining the nature, timing and extent of further Audit Procedures as required by Para 11 and Para A12 of SA 320. Therefore, the Audit Firm has failed to exercise due diligence and also failed to report a material departure from the generally accepted procedure of audit applicable to the circumstances

2.5.3 The **Audit Firm** submitted in their reply to the DSAQRR that:

a) Rather than assessing the professional judgments of the Engagement Team concerning materiality or assessing how those judgments actually impacted sample size, and thus, the timing, nature, and extent of testing, the allegations in Section 2.5 attempt to create issues where there are none.

b) Profit before tax was determined as a benchmark for materiality considering Para 4 of SA 320 which says "*The auditor's determination of materiality is a matter of professional judgment*" as well as Para A3 of SA 320 which says

"Profit before tax from continuing operations is often used for profit-oriented entities". Shareholders of IFIN were not only equity shareholders, but also included Preference Shareholders, which shares were listed on the Bombay Stock Exchange. In the section of WP 13101.02 titled "Description of the principal external users of the financial statements," the Engagement Team noted that IFIN had its NCDs and preference shares listed on the Bombay Stock Exchange, and, the principal users of IFIN's financial statements were "debt holders, SEBI, and RBI. This discussion directly refutes NFRA's allegation that the Engagement Team considered IL&FS Ltd. as the principal user of IFIN's financial statements.

c) Relevant factors documented in WP 13101.02 as bases for determining PBT as basis for materiality are:

   i. The important elements of the FS of IFIN are Lending, Investments, Borrowing and Syndication Fee Income.

   ii. Item of focus for the users of the Financial Statement – IFIN is in the business of NBFC, has its NCDs and preference shares listed on the Bombay Stock Exchange and focuses on lending and investment. Accordingly, the users of the FS are more interested in the profit generated by the Company which is total of return on asset build by IFIN over the period (fund based income) and other non-fund based income.

   iii. The Revenue could not be relevant benchmark for determining materiality, as the Company is in the business of lending, where the spread of the lending rate and borrowing rate is more important for the shareholders and hence the PBT becomes more important from the shareholders point of view.

   iv. If total assets is taken as the benchmark, the materiality numbers would be very high and it may result in low coverage.

   v. The Company is making regular profit every year and hence it is also one of the relevant criteria for selection of benchmark for determining materiality.

   vi. The Company's operations are not seasonal in nature hence the

results of any interim period are not necessarily an indication of the results that may be expected for any interim period / full year.

d) WP 13101.01 is not a mere standard template. The tab titled "Input & Summary" reflects information specifically tailored to IFIN Determination of materiality was done by considering alternative benchmarks as per WP 13101.02, the materiality determined based on PBT and used in performing the audit was the lowest among the alternative benchmarks considered which ensured a higher level of testing.

e) The mention of Rs.151 million in the WP 23300.01.02.04 as the performance materiality was an immaterial error as there is no change is sample size because of that error. The Audit Firm, being part of an international network, uses audit software that is used internationally. As a result, some work paper templates may reflect $ as the currency by default. This may not have been changed to INR in some instances, but that is merely a clerical matter. The amounts considered for determining materiality are in INR.

In the professional judgment of the Engagement Team, it was not required to lower the materiality for testing different ABCOTD. Furthermore, in WP 13202, twenty-two account balances selected that were of lesser amounts than the materiality level and were selected for further audit procedures.

f) Para 14 of SA 320 addressing audit documentation does not require the auditor to document how the performance materiality impacted the nature, timing, and extent of further audit procedures in the WP where the performance materiality is determined.

g) The mention of Rs. 151 million in the work paper 23300.01.02.04 as the performance materiality was an immaterial error. By fixing that error to reflect the correct figure of Rs.145.41 million as the performance materiality, there would have been no change to the sample size.

2.5.4 NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) The statement of the auditor mentioned in para 2.5.3 (a) above shows ignorance

of the Audit Firm in conducting an audit in accordance with the SAs. The Audit Firm is either ignorant of the fact that SAs are now part of the Companies Act, 2013 or are conveniently overlooking this fact in order to bring in their own interpretation of standards to suit their auditing practices. NFRA is a body constituted under the Companies Act, 2013, to, inter alia, monitor and enforce compliance with auditing and accounting standards prescribed under the said Act. Such a compliance means compliance in letter and spirit within the four corners of the laid down law. All conclusions and observations of NFRA have their basis in SAs which are binding on the Audit Firm.

b) All the conclusions of NFRA in the DSAQRR regarding materiality primarily arise from the fact stated by NFRA in para 2.5.1 (a) that "Notwithstanding all the above, the rationale for picking up profit before taxes rather than any other indicator including one for ability to repay debt has not been examined at all by the Audit Firm." However, the replies by the Audit Firm have not responded to this aspect or the major conclusions reached by NFRA. On the other hand, the replies bring out the failure of the Engagement Team in providing justification for the materiality benchmark. The Engagement Team also failed in documentation of significant matters related to materiality as required by the SAs. NFRA reached this conclusion based on the following facts.

   (i) In their reply, the Audit Firm had repeatedly stated that **the Engagement Team applied its professional judgment** in arriving at materiality benchmark and percentages. However, there is virtually no evidence to prove the same. In fact, the Audit Firm had adopted the benchmark and percentages mentioned in the standard guidance of the Audit Firm applicable to all listed entities. The Audit Firm's standard guidance provides that the **determination of a percentage to apply to a chosen benchmark involves the exercise of professional judgment**. It further provides that for audit of listed entities PBT from continuing operations is typically chosen as benchmark because that is typically where users of financial statements focus on. The Audit Firm had simply adopted the guidance regarding PBT without demonstrating application of professional judgment as required by the firm's own guidance.

(ii) The reply does not provide evidence that the Audit Firm had in fact considered users of the financial statements other than equity and preference shareholders while determining materiality. Other than adopting PBT as the benchmark as provided by the Audit Firm's guidance, the Engagement Team had not analysed any other parameters with an intention to evaluate the information needs of users of financial statements other than shareholders.

(iii) With respect to financial information needs of users other than shareholders, the reply does not give any rationale for selection of PBT as the base for materiality. As per Director's Report of IFIN, the consolidated performance of the group as per consolidated financial statements has been indicated using Total Income, Profit Before Tax, Profit After Tax and Net worth. This implies that the users of financial statements may be interested in indicators other than PBT as well. There is no clarity regarding the factors considered by the Engagement Team in this regard.

(iv) Para A3 of SA 320 clearly mentions that "Benchmarks that may be appropriate, depending on the circumstances of the entity", Profit before tax from continuing operations is often used for profit-oriented entities but this should be taken into effect considering the circumstances of the entity. The Audit Firm has itself mentioned that it was the debt holders, SEBI and RBI who were the principal users of the Financial Statements, which altogether makes the emphasis on assets as the more appropriate benchmark. Para A2 of SA 320 also mentions that if the entity is financed by debt rather than equity, users may put more emphasis on assets, and claims on them, rather than on the entity's earnings. Under the above circumstances, the basis of professional judgment exercised in choosing PBT is still unclear in the Audit File, since the replies of the Audit Firm do not explain how the Audit Firm addressed the above stipulations of SAs.

(v) Notwithstanding the fact that the Audit Firm has considered a few alternative benchmarks for calculating materiality, it has ignored the

most basic benchmark i.e. ability to repay debt which is highlighted by Para A2 of SA 320. IFIN was a company with borrowings of Rs 175,846.93 Million (as compared to Rs 3,906.67 Million of equity and preference share capital, as per CFS) including non-convertible debentures which are listed on Bombay stock exchange.

c) Thus, it is evident that the Engagement Team simply used the benchmark and percentages provided in the general guidance of the Audit Firm without documenting complete justification in the Audit File. Such an approach is not consistent with appropriate exercise of professional judgment of the Engagement Team as required by the SAs. The replies of the Audit Firm make it clear that the Audit Firm even failed to distinguish between exercise of professional judgment by the Engagement Team, as required by the SAs, and the mechanical adoption of templates created only for the Audit Firm's guidance. Hence the claim of the Audit Firm regarding due exercise of professional judgment is not fully justified.

d) The Audit Firm's claim that error of 6 million in performance materiality value is immaterial cannot be accepted. Using a number which is totally different from what is calculated and leaving the error uncorrected, in all the subsequent stages of the audit and reviews by the Engagement Team, Engagement Partner and EQCR team, shows absolute recklessness and absence of professionalism. Instead of admitting the error, the Audit Firm's attempted justification in a manner that implies 'either is fine' merely displays absence of professionalism and a casual approach to the Audit. Moreover, the possibility of material transactions falling within this limit might have been ignored by the Audit Firm.

e) Even on perusal of WP 26550.02.01 "Payroll Substantive Testing & Salary Reconciliation" referred by the Audit Firm, it was noticed that performance materiality was taken as 168 million instead of 145.41 million. The Audit Firm has used different performance materiality numbers in different WPs and later claims this to be an immaterial error. This is unconvincing.

f) Para 10 of SA 230 stipulates that "when establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular

classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures". The Audit Firm stated that "in the professional judgment of the Engagement Team, it was not required to lower the materiality for testing any of the account balances and such conclusion has been stated as "No separate materiality identified for different ABCOTD" in tab "Materiality – AB COT and Disc" in WP 13101.01". However, the exercise of professional judgment here is not justified after having ignored the users other than shareholders in deciding materiality benchmark and after having not provided adequate evidence to ensure that the Engagement Team had in fact covered all such transactions or disclosures.

g) Para A 11 of SA 320 stipulates that "in considering whether, in the specific circumstances of the entity, such classes of transactions, account balances or disclosures exist, the auditor may find it useful to obtain an understanding of the views and expectations of those charged with governance and management". No such communication with management and TCWG on such matters has been found in the audit files. There is no conclusive evidence to show that the Audit Firm had in fact covered all such transactions or disclosure.

h) NFRA has not stated that the selected benchmark (PBT) for materiality is incorrect. While the selection of PBT may not have been completely inappropriate , and may not have impacted the performance of the Audit, the rationale for the selection was not properly documented in the audit files as required by the SAs, because: -

   (i) Para 4 of SA 320 stipulates that "The auditor's determination of materiality is a matter of professional judgment"

   (ii) Para 8 of SA 230 stipulates that "The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant

professional judgments made in reaching those conclusions."

(iii) Para A27 SA 200 states that "Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented".

(iv) Para A8 of SA 230 states that "Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include: Matters that give rise to significant risks (as defined in SA 315), Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks."

(v) Para A10 of SA 230 -A10 states that "Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant: The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement."

(vi) Para 10 and 11 of SA 320 uses the word "shall" for determining Materiality and Performance Materiality when Planning the Audit, which makes it mandatory for Audit Firm. This, being a significant professional judgement, has to be adequately documented as provided in SAs.

2.5.5 On consideration of all the above evidence, the NFRA, therefore, concludes that:

a) The Audit Firm did not assess the status of the Auditee Company as a debt listed company as determinative of the benchmark to be used for determining materiality. The Audit Firm did not examine any indicator for ability to repay debt but simply presumed that the benchmark of PBTCO would be most appropriate, without any application of mind or due diligence as required by SA 320. Thus, the Audit Firm failed to exercise due

diligence and was grossly negligent in the conduct of its professional duties.

b) The Audit Firm failed to evaluate the nature of the entity, where the entity is at in its life cycle and the industry and economic environment in which the entity operates, as required by SA 320. Therefore, the Audit Firm failed to exercise due diligence and was grossly negligent in the conduct of its professional duties.

c) The Audit Firm has calculated and applied the materiality with a casual approach.

d) The Audit Firm has failed to calculate a lower materiality level for particular classes of account balances or disclosures where a lower materiality level would be applicable, as required by Para 10 of SA 320.

e) The Audit Firm has also failed to show how the performance materiality as determined in WP 13101.01was used for determining the nature, timing and extent of further Audit Procedures as required by Para 11 of SA 320.

f) The Audit Firm failed to appropriately document the significant professional judgments exercised in materiality as required by the SAs.

2.6 Analytical Procedures

2.6.1 NFRA made the following further observations and asked the Audit Firm to respond to them.

a) The Audit Firm in their response had justified their analysis on substantial analytical procedures with reference to Para A4 read with Para 4 and A6 of SA 520. NFRA, having examined the response of the Audit Firm, has found that the Audit Firm has ignored the objectives of the audit under clause 3(b) of SA 520 which provides for performance of Analytical Procedures as mentioned below:

"To design and perform Analytical Procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the Financial Statements are consistent with the auditor's understanding of the entity".

The above referred clause, read with Para 6 and Paras A17-A19 of SA

520, requires the Audit Firm to design and perform Analytical Procedures near the end of the audit that assist the auditor when forming an overall conclusion. This cannot be confused with the objective mentioned in 3(a) read with Para 5 and Para A4 and A5 of SA 520.

b) Further, as defined in Para 4 of SA 520, "Analytical Procedures" means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data. Para A1 of SA 520 states that Analytical Procedures include the consideration of comparisons of the entity's financial information with comparable information for prior periods, anticipated results of the entity and similar industry information. Para A2 of SA 520 states that Analytical Procedures also include consideration of relationships amongst elements of financial information that would be expected to conform to a predictable pattern and also between financial information and relevant non-financial information. It may be noted that both Para A1 and A2 gives an inclusive illustrative list of Analytical Procedures that has to be carried out by the Audit Firm. The Audit Firm was expected to perform these Analytical Procedures which, as per the observation of the NFRA, have been neglected by the Audit Firm except the variance analysis in a few WPs.

c) Appendix to SA 520 gives a list of Analytical Procedures to be carried out. It includes trend analysis, test of reasonableness, ratio analysis and confirmation of sources of information. As admitted by the Audit Firm, they have restricted their working on Analytical Procedures to variance analysis only. Thus, the Audit Firm has not carried out the processes required under SA 520.

d) The Audit Firm has referred to WP 23750.01 Unamortised borrowing cost, 26101 Interest Re-computation, 26102 Front End Fee Income, WP 26200.02 Lease income, 26400.02 Fee Income Testing, WP 26450.02 Testing of interest on TL STL TD STD, WP 26450.04 COB yield analysis, WP 26500.02 Other Finance cost and variances, WP 26550.02.01 Payroll Substantive Testing & Salary Reconciliation, WP

26800.10 Rent Substantive Working, WP 26800.11 Operating and Admin Expenses - Combined Lead-sheet, and 26860.04 Legal & Professional Substantive, as proof of carrying out the Analytical Procedures. NFRA has gone through these WPs. The observations of NFRA are as follows:

i. The variance analysis should have been carried out for all the line items of Balance Sheet and Profit and Loss account in line with the general practice in such cases. The Audit Firm has, however, carried out Variance Analysis for only few balances.

ii. Two WPs referred by the Audit Firm i.e. 26101 Interest Recomputation and 26102 Front End Fee Income, do not even have basic Variance Analysis, leave alone any other Analytical Procedure. It appears that the Audit Firm has tried to mislead NFRA by referring to irrelevant data.

iii. AWP 23750.01 is regarding unamortised borrowing cost. The Audit Firm has calculated the variance between opening and closing balances of borrowing related expenses in abstract numbers. Ordinarily, the variance analysis is done in percentage terms. Further, the arranger fees have gone up from ₹3.42 Crores to ₹23.90 Crores, which is an increase of 600 percent. The only explanation given for increase in the fees is "on account of new issue of NCD amounting to ₹11.60 Crores". This definitely sounds incongruous since the increase in fee income cannot be greater than the absolute value of the NCD issue itself. Thus, it can be seen that even when a substantial variance has been found, no further analysis in terms of amount of NCD issued or loans arranged et cetera has been carried out by the Audit Firm. Similarly, the bank charges have gone up from ₹Zero to ₹67.68 lakhs. However, no reason has been noted. Even though the amount involved maybe small, this brings out the lax attitude with which the audit was carried out.

iv. AWP 26400.02 is regarding Income Testing. The Tab on "Consultancy and Other Fees received" shows that the consultancy

income has gone down from ₹4.65 Crores to Zero. However, no detailed analysis or questioning with the Management was done by the Audit Firm.

e) Further, the WPs cover only arithmetical variance analysis. As per Para A3 of SA520, various methods are to be used to perform Analytical Procedures. These methods range from performing simple comparisons to performing complex analysis using advanced statistical techniques. The Audit Firm has used only simple comparisons and that also for the year under report. The Audit Firm has clearly failed to carry out Analytical Procedures, as required under SA 520.

f) The Audit Firm in their response have admitted that matters which were highlighted by the Whistle blower letters or RBI Inspection Reports including loan and advances utilisation, collateral on loans and borrowings, sanctioning as per CAM, ever-greening of loans, circuitous transactions, exposure to single entity, risk categorization of accounts, divergence in net owned funds, provisions and diminution in value of investments, etc., have not been covered under the Analytical Procedures. The Audit Firm has not complied with the requirements of Para 5 and 6 of SA 315 which has been separately covered in Para on ROMM in the earlier report of NFRA dated 12th December, 2019. Moreover, the Credit Rating Agency ICRA in its report published on 28th March, 2018, had reported that the gross NPA has increased from 0.60% in March 2012 to 4.48% in September 2017. Similarly, the Net NPA to Net Worth Ratio has increased from 2.18% to 21% in the same period. These reports were publicly available. The Audit Firm should have carried out proper ratio analysis and trend analysis as required under the SA 520, and should have investigated the differences and inconsistent relationships. This would have enabled the Audit Firm to identify misstatements while forming an overall conclusion on the Financial Statements of the Company.

2.6.2 On consideration of all the above evidence, the NFRA had concluded in the DSAQRR that the Audit Firm failed to:

a) design and perform Analytical Procedures near the end of the audit as required by Para 3(b) read with Para 6, Para A17 and Para A19 of SA 520.

b) carry out Analytical Procedures like comparisons with prior periods, anticipated results and similar industry information, consideration of relationships between financial and non-financial information, etc. as required by Para A1 and A2 of SA 520.

carry out the processes of Analytical Procedures as required by Appendix to SA 520.

c) carry out Analytical Procedures by using various methods as required by Para A3 of SA 520.

d) has failed to identify misstatements while forming an overall conclusion on the Financial Statements of the company by not carrying out proper Ratio Analysis and Trend Analysis as required under SA 520.

2.6.3 The **Audit Firm** denied all the observations and submitted in their reply to the DSAQRR that :-

a) Substantive analytical procedures are not intended on their own to be independently sufficient and appropriate audit evidence; where appropriate, they are used in conjunction with other procedures contemplated by other Standards and considered together with other audit evidence obtained. NFRA's approach in the DSAQRR ignores this basic principle regarding the overall approach to an audit. The Engagement Team performed numerous analytical procedures based on the final numbers included in the Company's financial statements. The analytical procedures performed included comparisons of information in IFIN's financial information with comparable information for prior

periods, anticipated results of the entity, the relationship between financial information and relevant non-financial information, and various methods ranging from performing simple comparisons to performing complex analyses using advanced statistical techniques.

b) Following the specific guidance given in paragraph 4 of SA 520, the Engagement Team exercised its professional judgment in determining which procedures, including analytical procedures, to perform. The most important business areas for the Company such as lending, investments, borrowings, interest / dividend or profit or loss on sale of investments, finance cost on borrowings does not require testing based on analytical procedures that use any complex / advanced statistical techniques.

2.6.4 NFRA has examined in detail the submissions of the Audit Firm and observes as follows:-

a) NFRA has verified in detail all the work papers mentioned by the Audit Firm in Exhibit 2.6.1 of their reply and other work papers mentioned in the reply, as support of their claim of complying with SA 520. Out of which, many of the work papers referred by the Audit Firm in their earlier communications have been already addressed in the DSAQRR. Apart from this, NFRA observed that these references are just an eye wash in many cases and an afterthought in a few cases because many of the analysis and conclusions described by the Audit Firm in their reply now is not seen documented in the Audit File. Also, many of these work papers are procedures done in other areas of audit, not for meeting the objective of SA 520, para 3(b). The details of examination are given in the following table.

WP referred by the Audit Firm	Comments on Examination of the WP
12401 (Preliminary Analytical Procedures)	WP now referred for the first time. The Audit Firm states that these are analytical procedures performed as required by SA 315 read with paragraph 1 of SA 520. The statement is not true as the objectives of both the SAs are different. The use of analytical procedures in the planning stage of the audit is not a substitute for the objectives mentioned in para 3(b) SA 520. Also, in the said WP most of the figures related to FY 2017-18 are having substantial differences with the financial statements of the company. A few examples are: Long term debt has been shown as 99,785 million instead of 101,947 million. Non-current investments differ by 6,634 million & other long-term liabilities differ by 280 million.
24102 and 24106 (Borrowings)	WP now referred for the first time. With reference to these WPs, the Audit Firm states in page no 90 of their reply to DSAQRR that "prepared product wise / facility wise opening balance and compared with the previous year work paper to provide audit evidence regarding the accuracy and completeness". However, it is seen from the WP that the opening balance has been taken from the borrowing movement statement of FY 17-18. Though the Audit Firm had mentioned in their reply about verification of "Deal Register", "NCD Listing", "CP Register", "Repayment Summary" and "CBLO Register" as being obtained and worked upon, there is no mention of any such documents in the WPs except Deal Register. All the workings done were based on a single document as mentioned in the WP. So, the

	references of the other documents and analysis in the reply of the Audit Firm are just an afterthought without the support of evidence in Audit File. These WPs did not show any analytical procedures as contemplated in para 3 (b) of SA 520.
24109 (Borrowings)	WP already considered by NFRA in DSAQRR. No new information provided by the Audit Firm.
23300.01.02.04 (Lending)	WP in which no adequate variance analysis is done. This WP is submitted as basis for the claims made by Audit Firm that the Engagement Team compared anticipated results of the entity. However, no adequate evidence to support the claim of comparison of party-wise interest income for the year with the interest income as per the books of accounts. The derivation of party-wise interest income by the Audit Firm has no backing in the WP as all the figures have been manually entered without any formulae or calculations.
23250.01 (Current Investments in equity shares)	WP now referred for the first time.
23200.01(Current Investments in Mutual Funds)	With reference to this WP the Audit Firm states that "Prepared a summary of schemewise movement sheet giving quantity (units) and amount for opening balance, purchases, sales and closing balance along with the profit / loss made during the year and the market value on the last trading day of the year". However, there is no mention of market value of the mutual funds in the WP. No comparisons or variance analysis have been found to

	derive any meaningful conclusions.
23200.02 (Current Investments in Government Securities	WP now referred for the first time. Shows comparison of figures based on internal registers maintained by the Company to select balances to be tested based on professional judgment of the Engagement Team. These WPs did not show any analytical procedures as contemplated in para 3 (b) of SA 520.
23150.01.01, 23150.02.01, 23150.03.01 and 23150.04.01 (Non-Current Investment s and Current Maturity of Non-Current Investments	WP used for other audit procedures. These WPs did not show any analytical procedures as contemplated in para 3 (b) of SA 520.
23750.01 (Unamortised Borrowing Cost)	WP already considered by NFRA in DSAQRR. Regarding this WP, the Audit Firm now states that "the increase in arranger fees from Rs.3.42 crores to Rs.23.90 crores related to prepaid fees". The reply then proceeds to provide a reconciliation, which identified certain erroneous naming (prepaid arranger fees of 13.36 crores erroneously named under Legal and Professional charges) and impacts on other line items. The earlier explanation by the Audit Firm for reason for increase in arranger fees that "on account of new issue of NCD amounting to ₹11.60 Crores" has now been revised to arranger fees paid on new NCD issue and Perpetual Bond issued (Rs 200 crore) during the year. This attempt to explain the differences which the Audit

	Firm had not done at the time of audit but is attempting now when pointed out by NFRA, is clearly an afterthought. In the absence of a working in the Audit File, NFRA cannot accept the contention of erroneous naming of accounts and having done the analysis as warranted in the situation.
26800.11 (Operating Expenses and Admin Expenses)	WP already considered by NFRA in DSAQRR.
26800.10 (Rent)	WP already considered by NFRA in DSAQRR.
26450.04 and 26450.02 (Finance Cost)	WP already considered by NFRA in DSAQRR
26500.02 (Other Finance Cost)	WP already considered by NFRA in DSAQRR.
26550.02.01 (Payroll)	WP already considered by NFRA in DSAQRR.
26101 (Interest Income on Corporate Loans and Debentures)	WP already considered by NFRA in DSAQRR. Regarding this work-paper, the Audit Firm claimed that the Engagement Team tested the expected party wise interest income against the amount as per the books of accounts and "documented the reasons for the difference". Some of such reasons documented in the WP are "Chennai" and "Delhi", which gives no meaningful explanations understandable to a third party for difference in amounts, amounting to 11.5 lakhs and 12.3 lakhs respectively.
26102 (Front end fees)	

	WP already considered by NFRA in DSAQRR . This WP was used only to make a pivot table of front end fee to select samples. Nonetheless, the claim of the Audit Firm that they have analysed 6 samples for performing substantive procedures is untrue as the WP shows that they had selected only 4 samples; that too of 8.8 crores, not of 11 crores as claimed in the reply to DSAQRR.
26200.02 (Lease Income)	WP already considered by NFRA in DSAQRR.
26400.02 (Fee Income & Syndication Fee Income)	WP already considered by NFRA in DSAQRR . With reference to this WP, the Audit Firm stated that risk pertains to fee income related to the potential overstatement of revenue, not understatement. However, contrary to the claim, when the revenue from IREL group got increased by 800% from FY 16-17, the Audit Firm did not analyse the variance.
WP 13306 "Analytic - Risk Assessment (Syndication)" and WP 13307 "Analytic -Risk Assessment (Lending)"	WP in which no adequate variance analysis is done. Regarding this WP, the Audit Firm claims that focused analytical procedures has been performed in respect of fee income but not even simple variance analysis or comparison with the previous year was found in the WP. As per Para 5 of SA 315, the auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. So, performance of risk assessment procedures only at the planning stage of the audit does not serve the purpose. RBI inspections reports & whistleblower letter was a trivial risk factor which must have required

	complex analytical procedure to be done by the Audit Firm. The Audit Firm did not even conduct simple analytical procedures for the same.

Notwithstanding the fact that Para 4 of SA 520 also says "The auditor's choice of procedures, methods and level of application is a matter of professional judgment" it also refers to Para A1 & A2 of SA 520 which are not just the examples of analytical procedures that may be performed as Audit Firm has depicted. Para A1 states "Analytical procedures include the consideration of comparisons of the entity's financial information", and Para A2 states "Analytical procedures also include consideration of relationships", after this, both paras give some examples under each category, which altogether means that the comparison of the entity's financial information and consideration of relationships are a part of analytical procedures. Thus, both Para A1 and A2 of SA 250 give an inclusive illustrative list of Analytical Procedures that has to be carried out by the Audit Firm. The Audit Firm was expected to perform these Analytical Procedures in order to achieve the objectives of SA 520. Moreover, professional judgment is neither arbitrary, whimsical nor capricious. As per para 5 of SA 230, "The objective of the auditor is to prepare documentation that provides: (a) A sufficient and appropriate record of the basis for the auditor's report; and (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements." Further para 8 of SA 230 stipulates that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. Para A8 further explains that "Judging the significance of a matter requires **an objective analysis** of the facts and circumstances" (emphasis added). Para A9 states "Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance." Read this with para A10 of SA 230, it is clear enough that the significant professional judgment exercised shall be objective and documented as stipulated in the SAs. Hence the claims of the Audit Firm

(regarding analytical procedures and at many other places in their reply regarding other matters) that the Engagement Team exercised professional judgment is not acceptable in the absence of proper documentation rather than unwarranted discretion without following the guidelines in SAs.

c) The Audit Firm stated that they did not do analytical procedures in the case of NPA, since the population of loans that were susceptible to being NPA was heterogeneous. Also, with respect to the observations of NFRA on credit rating reports, the Audit Firm stated in page 104 of their reply that "the risk associated with NPAs as identified by the Engagement Team was the non-identification or understatement of provision for NPAs." In this regard, NFRA observed as follows.

   i. The Audit Firm failed to ensure completeness of the NPA list as there is no documentation in the Audit File to show that the assertions related to occurrence, existence and completeness of NPAs. The statement of the Audit Firm quoted above confirms this fact.

   ii. From the SFS of IFIN, NFRA observed that the NPA has increased by 155% in FY 2018, as compared to the increases of 59% and 49% in FY 2017 and 2016 respectively. On the same hand, provisions and write offs (net) shows an increase of just 13% in FY 2018 as compared to increase of 75% and 30% in FY 2017 and 2016. The ratio of provisions to NPA stood at 43% in FY 2018 while in FY 2017 and 2016 it was 89% and 69% respectively. The above ratios and trends indicate an unnatural movement in NPA as well as an extraordinary adjustment in provisions and write offs in FY 2018. Also, the increase in NPA raises questions on Going Concern assumption.

   iii. On further examining the going concern issue, it is observed that the current ratio, indicating short term liquidity, is 0.96 in FY 2018 compared to 1.18 in FY 2017, 1.11 in 2016, thus raising doubts on the ability of the company to meet its current liabilities and thus may affect Going Concern. The PAT to Operating Revenue ratio declined sharply from 13% in FY 2015 to 4% in FY 2018. The ratio was 9% in FY 2017. With respect to the preceding years, the diminution in value of Investments increased by 122% in FY 2018 as compared to the increase of only 30% in FY 2017 and 16% in FY 2016.

These facts emanating from the unprecedented raise in NPA in FY 2018, calls for additional Audit Procedures around going concern and the ability of the company to meet regulatory requirements regarding liquidity and solvency.

iv. Based on the above indications on solvency, NFRA briefly looked into the cash and cash equivalents balance in the SFS for 2018. It is seen that the cash and cash equivalents stood at Rs 1049 crore in FY 2018, a decline of 64% compared to FY 2017. Out of the above balance an amount of Rs 550 crore is in fixed deposits opened on 28th March 2018. Out of these FDs, an amount of Rs 300 crores is for a duration of 7 days, i.e., maturing on 4th April 2018. Balance amount of Rs 250 crore is for a duration of three months but having restrictions on withdrawal as disclosed in note 14 of the financial statements, where the bank has a right to adjust against dues of IFIN under specific circumstances. Thus, after eliminating the effects of these probable window dressing (it is pertinent to note that March 29, 30 and April 1st being bank holidays in Mumbai, and March 31st being Saturday, hardly 3 working days have been there for which the funds could have been blocked in FD of 7 days) by the company, the actual cash and cash equivalents were only Rs 499 crores showing a decrease of 83% as compared to FY 2017. The actual current ratio might be 0.89 only as against 0.96 as it appears from the audited balance sheet. Nowhere it is documented whether this liquidity position of the NBFC is in line with the regulatory requirements, apart from serious doubts on going concern. There is not even a single reference in the Audit File regarding verification of the genuineness of the above year end transactions. The findings of the auditor could have been different, had there been a proper analytical procedure, in accordance with SA 520, carried out by the firm.

v. These relations, ratios and trends are some of the examples for possible analytical procedures at the end of the audit. In the above cases, the findings are apparently inconsistent with the conclusions the Audit Firm reached in their final audit report. Thus, NFRA did not see any merits in the statements of the Audit Firm that proper analytical procedures have been performed towards end of the Audit and also about the so called 'exercise of professional judgment' claimed by the Audit Firm all thorough their reply.

d) NFRA also notes the statement of the Audit Firm on page 103 of their reply that "ratio analysis and trend analysis were not "required under the SA 520 as NFRA alleges". The statement again indicates total disregard of the SA, absence of professional knowledge, and immature thinking by the Audit Firm.

2.6.5 On consideration of all the above evidence, the NFRA, therefore, concludes that the Audit Firm completely failed to achieve the objectives of para 3(b) of SA 520 and thus violated the SA. NFRA reiterates its conclusions in the DSAQRR that the Audit Firm failed to:

a) design and perform Analytical Procedures near the end of the audit as required by Para 3(b) read with Para 6, Para A17 and Para A19 of SA 520.

b) carry out Analytical Procedures like comparisons with prior periods, anticipated results and similar industry information, consideration of relationships between financial and non-financial information, etc. as required by SA 520.

c) carry out Analytical Procedures by using various methods as mentioned in Para A3 of SA 520.

d) identify misstatements while forming an overall conclusion on the Financial Statements of the company by not carrying out proper Ratio Analysis and Trend Analysis as required under SA 520.

2.7 Subsequent Events

2.7.1 In its communication dated 21st November, 2019, NFRA, referring to SA 560, had sought clarification regarding the action taken by the Audit Firm in respect of the following:

a) Based upon the documentary evidence referred in the Management Assessment Note on the impairment testing of investment in "IL&FS Transportation Networks Limited (ITNL)", the Audit Firm (WP- 23150.01.01) had concluded that the decrease in the market price is temporary. This was despite the continual decline in the market price of the shares of ITNL. Further, the Statutory Auditors of ITNL, in the limited review Report issued on 13th August, 2018, raised the issue of existence of material uncertainty about the Company's ability to continue as a going concern.

b) RBI issued SCN for cancellation of Certificate of Registration to IFIN on 05th June, 2018. The matter was inter-alia discussed in the Audit Committee Meeting of 29th August, 2018, i.e. before AGM.

2.7.2 The Audit Firm in its response dated 15th November, 2019, has stated as follows:

a) The Audit Firm, taking into consideration Management Assessment Note (WP 23150.01.01), and based upon the documentary evidence and independent assessment (AWP: 29205.03), had concurred with the Management that the decrease of share price of ITNL was only temporary.

b) The Audit Firm's independent assessment showed requirement of diminution of ₹104 million in the valuation of investment in ITNL. However, the qualitative and quantitative plans referred in the Management assessment note were considered by the Audit Firm and it was concluded that the diminution is not permanent in nature.

c) The Audit Firm also presented its analysis to the Audit Committee on 28th May, 2018, (AWP 30301 Audit Committee Presentation) and Audit Committee approved the Financial Statements as at 31st March, 2018, with the carrying values as recorded earlier (i.e. without recognizing any impairment).

d) The Audit Firm stated that Limited Review Report of ITNL for 30th

June, 2018, issued on 13th August, 2018, (by SRBC & CO LLP) raised the issue of existence of material uncertainty about the Company's ability to continue as a going concern. However, the Auditor of ITNL had further stated in their report that their conclusion was not modified with respect to the above matter.

e) The Audit Firm stated that their Audit Report on the Standalone Financial Statements was issued on 28th May, 2018, and Audit Report on the Consolidated Financial Statements was issued on 28th June, 2018, and that both the Audit Reports of IFIN were issued before the Limited Review Report of ITNL dated 23rd August, 2018. Therefore, the limited review reports of ITNL could not be considered for issuance of their Audit Report of IFIN. Further, the Audit Firm stated that though the Statutory Auditor of ITNL had highlighted the matter of material uncertainty, they had nevertheless not modified their report with either a qualified or adverse opinion on the results based on their assessment of the Management's plans to mitigate the uncertainty. Auditors of ITNL had not withdrawn/reissued their Audit Report to ITNL for the year ended 31st March, 2018, thereby signifying that the events/conditions that caused the material uncertainty on 30th June, 2018 did not exist as at 31st March, 2018.Therefore, the Audit Firm had not tested the same under SA 560 'Subsequent Event'.

f) With respect to the matter relating to the Show Cause Notice dated 5th June, 2018, relating to IFIN's Certificate of Registration issued by the RBI, the company had not furnished the road map to achieve the minimum regulatory requirement of CRAR and NOF by 31st March, 2018. The Company submitted the road map on 8th June, 2018. Further, the Audit Firm has stated that they were informed that in the meeting with RBI officials on 18th July, 2018, the Company was directed by the RBI officials to re-assess the progress on reduction of exposure and submit a revised plan. The series of communications continued thereafter. Further, the Certificate of Registration was not cancelled

even as on the date of the AGM held on 25thSeptember, 2018.

2.7.3 NFRA has examined the above contentions of the Audit Firm and has observed in the DSAQRR as follows:

a) As per SA 560, the following are the relevant dates for understanding the responsibilities of the Audit Firm relating to dealing with the subsequent events in the audit of Financial Statements of IFIN:

Date of Financial Statements- Standalone & Consolidated	31st March, 2018.
Date of Auditor's Report by the Audit Firm of Standalone Financial Statements	28th May, 2018.
Date of Auditor's Report by the Audit Firm of Consolidated Financial Statements	28th June, 2018.
Date of issue of the Standalone Financial Statements and Consolidated Financial Statements	#29thAugust, 2018.

#Para 5(d) of SA 560, defines the term "date the Financial Statements are issued" as the date the Auditor's Report and Audited Financial Statements are made available to the public. According to Section 136 of the Companies Act, 2013, "a copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to every member of the company, to every trustee for the debenture-holder of any debentures issued by the

company, and to all persons other than such member or trustee, being the person so entitled, not less than twenty-one days before the date of the meeting." The Financial Statements were made available to public before AGM vide notice dated 29th August, 2018.

b) The Limited Review Report of ITNL dated 13th August, 2018, where the Statutory Auditor mentions existence of material uncertainty on the Company's ability to continue as a going concern comes under the ambit of, 'fact which become known to the Auditor after the date of the Audit Report but before the date the financial statements are issued' (as per Paras 10 to 13 of SA 560). The Audit Firm has failed to discuss with Management/TCWG and address the issue regarding "not recognizing diminution in the value of the Investment of ₹58 Crores in equity and ₹160 Crores in preference shares of ITNL" in the Financial Statements of IFIN. The question on the 'going concern' assumption raised by in the Limited Review Report of the ITNL dated 13th August, 2018, should have been considered as having caused a diminution in the value of investments, which is permanent in nature, and it should have been appropriately dealt by the Company and the Audit Firm should have followed the procedure laid down in the relevant Paras of SA 560. The Company's Financial Statements do not show a true and fair view if this development is ignored. The Audit Firm has failed to fulfill its responsibility according to SA 560, by not dealing appropriately with the facts that came to the notice of the Audit Firm after the date of the Auditor's Report but before the date of issue of the Financial Statements. The Audit Firm has, therefore, failed to report a material misstatement known to them to appear in the Financial Statements.

c) The RBI SCN was for cancellation of Certificate of Registration of IFIN which had serious implications on the going concern assumption. As admitted by the Audit Firm, they were fully aware about the SCN. This would have required amendments in the Financial Statements as well as the Auditor's Report. However, the Audit Firm did not exercise any

professional skepticism and accepted the Management reply without any due diligence/inquiry. The Audit Firm has, thus, failed to obtain sufficient information which is necessary for expression of an opinion and failed to report material misstatement known to them.

2.7.4 NFRA, therefore, concluded in the DSAQRR that:

(a) The question on the '*going concern*' raised in the Limited Review Report of the ITNL dated 13th August, 2018 should have been taken as a factor that would tantamount to a diminution in the value of investments which is permanent in nature and it should have been appropriately dealt by the Company and the Audit Firm should have followed the procedure laid down in the relevant Paras of the SA 560. The Audit Firm has, therefore, failed to report a material misstatement known to them to appear in the Financial Statements.

(b) The RBI SCN for cancellation of Certificate of Registration of IFIN had serious implications on the assumption of going concern. However, the Audit Firm did not exercise any professional skepticism and accepted the Management reply without any due diligence/inquiry. The Audit Firm has, thus, failed to obtain sufficient information which is necessary for expression of an opinion and failed to report a material misstatement known to them.

2.7.5 The Audit Firm submitted in their reply to the DSAQRR that:-

(a) The Audit Firm quoted Paragraph 10 SA 560 and then proceeds to explain that para 6 of SA 560 is not applicable with respect to matters arising out of ITNL's limited review report. The Audit Firm then quotes AS 4, and submits that the events in ITNL were not adjusting subsequent events as defined in AS 4 and hence the further procedures prescribed in Paras 11 to 13 of SA 560 were not applicable in the instant case. Therefore this is not a subsequent event that would have required any additional steps on the part of IFIN's 2017-18 auditor because it did not

relate to a condition that existed at the balance sheet date of 31st March, 2018. Hence, they are not subsequent events as envisaged under SA 560 that should have been considered by the Engagement Team. Further, ITNL Auditor never withdrew / reissued / amended its audit report on the financial statements of ITNL for the year ended 31st March, 2018. Accordingly, in consideration of SA 560 and in its professional judgment, the Engagement Team did not determine the same to be an adjusting subsequent event that impacted the financial statements of IFIN.

(b) Regarding the Show Cause Notice (SCN) dated 5th June, 2018, issued by RBI the Audit Firm submits that the SCN itself makes it evident that the same was issued solely because the Company "till date" (the date of issuance of the SCN) had not submitted the road map as required by RBI for reduction of group exposure. This was a matter of timing, not a rejection of the Company's proposed road map for achieving the statutorily required NOF/CRAR norms. Moreover, the Company's timeframe for achieving compliance with the minimum NOF and CRAR remained 31st March, 2019 as permitted by RBI. As the Engagement Team had already considered and evaluated RBI's request for a road map along with the substance of the road map and knew that it had been submitted to RBI. To that extent, the SCN did not present a subsequent event that warranted separate consideration by the Engagement Team at that time. Hence, the question of this being an adjusting subsequent event does not arise and consequently the question regarding a potential amendment to the financial statements and/or the audit report, as alleged by NFRA, did not arise.

2.7.6 NFRA has examined in detail the submissions of the Audit Firm and observes as follows: -

(a) As per Para 5(d) SA 560 and as explained in the DSAQRR, the term "date the Financial Statements are issued" is the date the Auditor's

Report and Audited Financial Statements are made available to the public (at large). The Auditor's Report and the Audit Financial Statements are approved in the AGM of the Company and thus, is made available to third parties as part of the notice of AGM. The Audit Firm has not disputed this fact in their reply to the DSAQRR.

(b) The view of Audit Firm regarding Para 10 of SA 560 is not correct because the existence of material uncertainty regarding ITNL's ability to continue as a going concern comes under the ambit of 'fact which become known to the Auditor after the date of the Audit Report but before the date the Financial Statements are issued. Further, Para 10 of SA 560, requires the auditor to perform certain procedures in relation to such facts which became known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Para 10 of SA 560 is reproduced hereunder:

(i) **Para 10:** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, **a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall**: (Ref: Para. A11) **(emphasis added)**

- Discuss the matter with management and, where appropriate, those charged with governance.
- Determine whether the financial statements need amendment and, if so,
- Inquire how management intends to address the matter in the financial statements.

e) The above para 10 has no reference or recourse to the accounting principles laid down in AS 10. While para 10 covers "fact become

known to the Auditor" AS 4 covers "Events occurring after balance sheet date". Publishing of the review report is the "event" and permanent diminution of value of shares is the "fact" in the instant case. While para 6 to 9 of SA 560 covers "events", para 10 to 17 covers "facts". Hence the attempt of the Audit Firm to bring in the theories of adjusting events as per AS 10 into the scope of para 10 of SA 560 is futile and arises out of a deliberate attempt to justify a serious lapse. In this case, through the limited review report the Audit Firm came to know about the fact that diminution in the value of ITNL shares was not temporary. The diminution is thus a fact existing at the date of balance sheet and at the time of signing audit report, as the report relates to the quarter ending 30th June 2018. However, the auditor accepted management 's qualitative analysis and concluded that the diminution is temporary. Having not performed the procedure as laid down in para 10 of SA 560, the Audit Firm has failed to comply with the SA.

f) In any case, AS 4 covers only those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company (refer para 3.2 of AS4). On the other hand, SA 560 covers a wider range of events that happens between the balance sheet date and up to date the Financial Statements are issued (to the public at large).

g) Thus the Audit Firm again shows its lack of understanding of the basic principles of AS 4 while interpreting Para 8.2 & 8.3[1] of the said standard, because the issue regarding ITNL shares are not at all covered by AS 4, as it happened after the financial statements were approved by the Board on 28th May 2018 (standalone financial statement) and before these statements were issued to public on 29th August 2018.

h) It may be argued that as AS 4 is not applicable (or in the language of the Audit Firm, this is not an adjusting event as per AS 4) the management is not required to make amendments in the financial

[1] The Audit Firm quoted the text of Para 8.3 termed as Para 8.4 of AS 4.

statements and hence para 13 of SA 560 may apply. Accordingly, the Auditor need not provide an amended or new auditor's report. This argument is also not tenable since:-

i. There is no prohibition under the Companies Act, 2013 for amending financial statements before it is approved by the shareholders.

ii. As the subsequently known fact proves that the qualitative aspects brought out by the management in support of the temporary diminution of value of shares of ITNL is incorrect, the management is duty bound to review its analysis in order to ensure compliance with section 129 (1) of the Companies Act, 2013 and Para 9 of AS 1.

iii. Thus, para 10 of SA 560 becomes more relevant and in case management makes any revisions to its earlier estimate, para 12 also becomes relevant. In case management does not take the necessary steps, then para 17 of SA 560 will be applicable.

i) As the above fact of permanent diminution in value of shares has implication on the true and fair view of the financial statements, the Auditor should have followed the procedure mentioned in para 17 of SA 560. Accordingly, the auditor should have notified management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor should have taken appropriate action to seek to prevent reliance on the auditor's report.

j) The **Audit Firm** was clearly aware about the SCN relating to the cancellation of the registration certificate of IFIN before the date of notice of AGM of the Company and hence, the date of issue of the Standalone Financial Statements and Consolidated Financial Statements i.e. 29th August, 2018. It is surprising that when the Company had

informed about the SCN received from RBI, even after submitting of the plan for reduction of group exposure, the Audit Firm had not raised any question on this matter with Management and was satisfied with the proposed plan. The Audit Firm is also aware that the non-compliance by the Auditee started as early as in 2016. The Audit Firm states that "far from a "subsequent event," the communications between the Company and RBI were affirmatively consistent with what the Engagement Team had expected and what had been discussed at the 28th May, 2018 Audit Committee meeting". Contrary to what is stated by the Audit Firm, the SCN by RBI was a clear indication from the regulator for initiating action against the Company, unlike the other communications referred by the Audit Firm. The Audit Firm had ignored the overwhelming fact of continuous non-compliance by the Company and its regulatory consequences. Further, the RBI issued the SCN on 5th June, 2018 for cancellation of the Certificate of Registration of IFIN, even after filing of letters dated 17th April, 2018 and 16th May, 2018 addressed to RBI explained/requesting that the Company would be submitting its detailed plan by 30th June, 2018. The above facts make it clear that the Audit Firm should have followed the procedure stipulated in para 10 and para 17 of SA 560.

k) The Audit Firm stated in their reply to the DSAQRR that the Engagement Team gained an understanding of IFIN's plans for remediation of the exposure due to loans to "companies in the same group" (for which the RBI had provided it time until 31st March, 2019) through its inquiries to IFIN's management, discussion with the Audit Committee at the meeting held on 28th May, 2018, from information available in the public domain, and ongoing work in other areas performed for the IL&FS group. Based on such information, the Engagement Team understood that the Company was considering, inter alia, various methodologies for remediation of the exposure due to loans to companies in the same group. However, NFRA observes that none of

these matters which is now being brought into the replies, is documented in the Audit File in the form of an independent analysis. Hence NFRA did not take these matters into consideration.

l) Without prejudice to the above, there is no evidence in the Audit File that the Audit Firm had at least evaluated these important events and followed the process stipulated in SA 560 in letter and spirit.

m) The Audit Firm has, thus, failed to comply with SA 560, failed to obtain sufficient information which is necessary for expression of an opinion, and failed to report a material misstatement known to them.

2.7.7 On consideration of all the above evidence, the NFRA, therefore, concludes that:

(a) The question on the '*going concern*' raised in the Limited Review Report of the ITNL dated 13th August, 2018 tantamount to diminution in the value of investment which is permanent in nature and it should have been appropriately dealt with by the Company and the Audit Firm should have followed the procedure laid down in the relevant Paras of the SA 560. The Audit Firm has, therefore, failed to report a material misstatement known to them to appear in the Financial Statements.

(b) The RBI SCN for cancellation of Certificate of Registration of IFIN had serious implications on the going concern assumption. However, the Audit Firm did not exercise any professional skepticism and accepted the management reply without any due diligence/inquiry. The Audit Firm has, thus, failed to comply with SA 560.

(c) Thus, the Audit Firm failed to obtain sufficient information which is necessary for expression of an opinion and failed to exercise due diligence in accordance with SA 560 regarding the facts that came to its notice before the date of issue of financial statements.

2.8 Creation of Charges

2.8.1 NFRA had sought clarification from the Audit Firm vide letter dated 21st October, 2019, regarding Creation of Charges. There were outstanding loans amounting to ₹2079.46 Crores (as on 31st March, 2018), which were contractually secured but pending for Security Creation/Registration. Referring to audit WP 23300.01.02.02-Tab DHS Testing of Classification in eAudit File, the following questions were asked from the Audit Firm:

a) Whether any Audit Procedures were performed to ensure the validity and recoverability of loans?
b) Whether the Audit Firm verified Registration of Charges against borrower companies for loans advanced?
c) How many loans did the Audit Firm verify?
d) What was the basis to select the loans verified by the Audit Firm?
e) In the absence of registered charge against borrower companies, how did the Audit Firm arrive at an unqualified opinion?
f) Location of the various WP references such as WP 23300.01.02.04, 23400.01, etc. mentioned in the Lead sheet and elsewhere of the embedded worksheet.

2.8.2 The Audit Firm, in its response dated 15th November, 2019, has stated as follows:

a) "Validity of the loans were tested through:

i) Verification of the approvals by approximately 15 personnel of the Company as per the Unified Approval Framework for sanction of loans, which also included members of the Committee of Directors.

ii) Verification of disbursement memos

iii) *Verification of loan documentation such as agreements, etc (Refer AWP: 23300.01.02.04 - Test of Details)*

iv) *Verification of direct balance confirmations received. These were obtained by the other joint auditor pursuant to the allocation as per the Joint Responsibility Letter, which were shared with us and documented in our audit file - Refer manual AWP: 11308 "Signed Joint Responsibility Letter", AWP: 30610.01 "Related Party Tracker" and AWP: Section 30630 "Lending Confirmations" for the confirmations received through the joint auditors.*

The procedure in regard to recoverability of loans was primarily based on:

i. *reading of the Committee of Directors Approval Memorandum which detailed amongst other things the method of recovery,*

ii. *reading of the minutes of the meetings of the Board and Audit Committee where discussions with respect to specific loans was made (refer manual AWP: "21301 Minutes of Meetings"),*

iii. *verification of the asset classification of the party based on the RBI Prudential Norms to determine if the party was a NPA as at 31 March 2018 (refer AWP: 26720.02 Provision on Loans and Advances as at 31st March, 2018),*

iv. *the aging of the interest and loan balances tested in AWP: 23400.01 "Interest Debtors",*

v. *where the charge is pending creation but the charge is to be additionally created on a pari passu basis on security(ies) available and created in respect of other loans to parties in the same Group, where applicable, assessment of such security (Refer AWP: 23300.01.02.04 "Test of Details").*

b) *Registration of charges was verified for the samples selected for testing (Refer AWP: 23300.01.02.04 "Test of Details"). In case the loans were*

contractually secured, but security creation was pending as at the date of our Audit Report, verification of registration of charge was not applicable in those instances.

c) *We verified 62 loans covering approximately 62% of the total value of corporate loan balance outstanding as at 31st March, 2018. (Refer AWP: 23300.01.02.04 "Test of Details")*

d) *Samples were selected based on quantitative and qualitative parameters. Refer AWP: 23300.01.02.04 "Test of Details".*

e) *Kindly refer to our response above in point 3(i) with respect to the procedures performed by us on the audit of validity and recoverability of loans.*

Additionally, we state that at the outset, we would like to state that the non- creation of a registered charge does not imply that the financial statements are misstated, so long as the recoverability of such loans were assessed and they were appropriately disclosed as unsecured loans in the financial statements.

We noted no exceptions in the classification of the loans by the management and as such the same did not impact the amounts recognised as standard loans in the financial statements. Please refer to our comments in 3(i) above.

The loans were also appropriately disclosed as unsecured loans in Note 12 "Loans and Advances" to the standalone financial statements for the year ended 31st March, 2018.

Para 7 of the SA 705(Revised): Modification to the opinion in the Independent Auditor's Report states that:

7. The auditor shall express a qualified opinion when:

a. The auditor shall express a qualified opinion when: (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.
Based on the procedures performed by us, we submit that our audit plan and procedures were adequate and there were no material misstatements and disclosure misstatements. Therefore, the question of modifying our Audit Report under SA 705 did not arise."

2.8.3 NFRA had examined the above contentions of the Audit Firm and had noted in DSAQRR that:

a) Clarification was required about the Audit Evidence and Audit Procedures performed for testing the validity of the security available, and the recoverability of the loans, **on which charge was not created**. The verification of approvals, verification of disbursement memos, confirmation of balances from parties and their non NPA status for loans in general do not provide this clarification.

b) The AWPs referred by the Audit Firm, AWP 23300.01.02.04, for verification of loan documentation and registration of charges, verification of loans, etc. AWP 21301- Minutes of meetings, AWP 26720.02- asset classification, etc., do not have any working regarding validity of the security available, and the recoverability of the loan **on which charge was not created.** There is no work sheet which covers the information of all the 25 parties. And the AWPs referred by the Audit Firm have hardly any information regarding Creation/Registration of Charges. The whole exercise seems to be an attempt to mislead NFRA.

c) Another AWP 23400.01 "Interest Debtors" – "aging of the interest and loan balances" contains testing regarding Debtors. It neither contains

any Audit Procedure regarding Charge/Security creation, nor Audit Procedure for loans. It is a clear attempt to confuse the issue and mislead NFRA.

d) AWP 23300.01.02.04 – Test of Details, Tab 3 – coverage of checking – DAAM, identifies seven risks pertaining to loans given and requires sampling checks for these seven-identified risks. Two of the identified risks –No.5 – risk that interest over dues may not be recoverable and No.7
– impairment of assets given in securities, have been identified as: High Risk" and "Significant Risk" respectively. However, no samples have been checked for these two risks. Thus, the Audit Firm has not done any sample checking for the identified risk of "impairment of assets given as security", even though the population identified for this risk is ₹112.149 Million.

Similarly, for the risk related to non-adherence to security, the tab mentions that no samples have been checked in this regard. However, in the next column, it also claims that 95% of the amount has been covered in sampling. This shows the lax attitude with which the whole process has been carried out by the Audit Firm.

Further, Risk No.1- loans processed outside UAF, and risk No.4 – rollovers, modifications, etc., not approved have also been identified as 'High Risk'. According to Para A53 of SA 500, it is more appropriate to examine 100% of the population for tests of detail where the population constitutes a small number of large value items and there is significant risk. However, only 26 and 33 samples have been checked in this regard even though the Deloitte Audit Approach Manual (DAAM) also requires minimum 50 samples to be taken up. Thus, the Audit Firm did not comply with SA 500, and its own DAAM, and failed to exercise due diligence.

e) NFRA has examined and analysed the WPs referred to by the Audit Firm and found that in one-third of the cases, security creation was pending for more than one year. As on 31st March, 2018, security creation/registration was pending, for the following parties where the disbursement of loans was prior to 1st April, 2017:

S. No.	Name of Borrower	Date of Disbursement	Total Amt. Unsecured in ₹Crores
1	Bharat Road Network Ltd.	31st March, 2017	70
2	Earth Environment Mngt. Services Pvt. Ltd.	29thMarch, 20 17	121
		29thMarch, 20 17	8
3	Essar Shipping Ltd.	30th September, 2015	4
		28th December, 2015	3
		29th February, 2016	35
4	Himachal Sorang Power Pvt. Ltd.	22nd July, 2016	7
5	IL&FS Engineering & Construction Co. Ltd.	20thMarch, 20 17	48
6	Indian Furniture Products Ltd.	31st March, 2017	3
7	Neelkamal Realtors Tower Pvt. Ltd.	31st March, 2017	12
8	Oscar INFRA Pvt. Ltd.	5th October, 2016	28
		31st March, 2017	15
9	Sahaj E Village Ltd.	30th March, 2017	68

		31st March, 2017	212
10	SKIL-Himachal Infrastructure & Tourism Ltd.	3rd November, 2016	43
	TOTAL		**677 or 32.56%**

The Audit Firm failed to exercise due diligence in verifying the loans which were contractually secured but pending for Security Creation/Registration especially where Creation/Registration of charge was pending for such a significant number of loans for more than a year.

f) The Audit Firm has completely ignored the provisions of Companies Act, 2013, pertaining to Registration of Charges as provided in Chapter VI (Section 77 to 87 of Companies Act, 2013). The Audit Firm failed to check or collect substantive evidence regarding the compliance with legal requirements for Creation and Registration of Charges as required by SA 250.

2.8.4 NFRA, therefore, concluded in the DSAQRR that:

a) The Audit Firm failed to exercise due diligence and perform sufficient Audit Procedures to ensure validity and recoverability of loans which were contractually secured but pending for Security Creation/Registration.

b) The Audit Firm did not comply with Para A53 of SA 500 because it adopted sampling even where the population constituted only a small number of large value items and there is significant risk.

c) The Audit Firm failed to exercise due diligence in verifying the loans which were contractually secured but pending for Security Creation/Registration especially where Creation/Registration of charge was pending for such a significant number of loans for more than a year.

d) The Audit Firm failed to check or collect substantive evidence regarding

the compliance with legal requirements for Creation and Registration of Charges as required by SA 250.

2.8.5 After examining the responses of the Audit Firm to the findings of the DSAQRR, NFRA concludes as follows:-

a) In their reply to the observations in DSAQRR, the Audit Firm submitted in detail the audit procedures performed by the Engagement Team in verifying the validity and recoverability of the loans in question. Such procedures included a review of the evaluation by the Committee of Directors of the method of recovery, assessment of repayment status, testing of ageing of interest and loan balances, asset classification as per prudential norms, assessing the charge to be created on securities provided by the borrower group and, in many cases, tests of details. Regarding registration of charges pending for more than one year the Audit Firm submits in page 131 of their reply that "non-creation of a registered charge does not imply that the financial statements are misstated or that such loans were doubtful of recovery, so long as the loans were valued/ measured and presented appropriately". Further, all 10 of the loans NFRA lists in paragraph 2.8.3(e) were subject to various audit procedures by the Engagement Team, including consideration of payment history, direct confirmations with the borrowers, and testing of aging of dues from such parties. Regarding all the loans for which registration of charges have not been done, the Audit Firm states in page 144 of their reply that "the status of the security for these loans was fully disclosed as "unsecured" in the financial statements and thus was transparent to the users of the financial statements. Therefore, no user of the financial statements could have understood these loans were secured. Of course, as noted above, although these loans were required to be disclosed as unsecured, there were, in fact, security interests against which such loans were granted, even if the Company had not yet perfected its security interest in such loans as at 31st March, 2018". Quoting section 77 of the Companies Act, 2013, the Audit Firm states in page 143 of their reply that "A bare perusal of the aforesaid provision

makes it apparent that it is not the responsibility of the lender to comply with the requirements of compliance with the Companies Act, 2013. We submit that NFRA's allegation in respect of provisions of Companies Act, 2013, pertaining to Registration of Charges as provided in Sections 77 to 87 of Companies Act, 2013 is based on an incorrect interpretation of the law and is misplaced. Therefore, the requirements of SA 250 on evaluating compliance with laws and regulations do not apply to the audit of IFIN in this regard, and the question of checking and collecting on evidence in this regard does not arise."

b) On examination of the replies of the Audit Firm, NFRA observes that the Engagement Team has performed the Audit in respect of audit of 'charges created on loans without considering the applicable provisions of law, the implications of such provisions and the consequences of non-compliance of such laws, and the impact on the financial statements of IFIN. In this regard, NFRA draws attention to the following provisions of the Companies Act 2013:

   i) Section 77 (1), which states "It shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation."

   ii) Section 78, which states "Where a company fails to register the charge within the period of thirty days referred to in sub-section (1) of section 77, without prejudice to its liability in respect of any offence under this Chapter, the person in whose favor the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge, within such time and in such form and manner as may be prescribed".

iii) Subsection 3 of section 77, which states "Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016, as the case may be, or any other creditor unless it is duly registered under sub-section (1) and a certificate of registration of such charge is given by the Registrar under sub-section (2)".

iv) Subsection 4 of section 77 which states, "Nothing in sub-section (3) shall prejudice any contract or obligation for the repayment of the money secured by a charge".

v) Section 143 (1) (a) which stipulates that the auditor of a company shall inquire into "whether loans and advances made by the company on the basis of security have been **properly secured** and whether the terms on which they have been made are prejudicial to the interests of the company or its members" (emphasis supplied).

c) The above provisions make it clear that:-

i) The registration of charge is a statutory obligation. In case of failure to register that charge, the charge holder loses his claim in the event of liquidation of the company creating the charge.

ii) In case the company creating the charge fails to do so, the charge holder himself can file for registration.

iii) Unless the charge is registered as provided above, the loan/advance cannot be treated as "properly secured".

iv) The consequences of the noncompliance with section 77 and 78 kicks in at the time of liquidation of the company creating charge on its assets. Also the non-registration of charges leaves the asset in the status of no-encumbrance and consequently could make the asset freely transferable by the owner. Thus it is always in the interest

of the lender to get the charges registered within the stipulated time, and in case it is not so done, the lender is at liberty to invoke section 78 to safeguard his assets and interests.

d) For the above reasons, it is clear that the loans made by IFIN on the basis of security **had not been properly secured** in the case of loans for which creation of charge is pending. The non-registration of charges are clearly prejudicial to the interest of the company because of the reasons explained above. As the loans in question are 'contractually secured' and hence are secured loans in substance for all practical purposes, the disclosure of the same under 'unsecured loans' alone do not absolve the auditor from meeting his obligation under section 143 (1) (a). As these loans had **not been properly secured as stipulated in section 143 (1) (a)**, the Audit Firm is duty bound to deal appropriately with this matter in their report. Instead of doing this, the Audit Firm simply ignored this area by stating that registration of charge is "not the responsibility of the lender". For the purposes of section 143 (1) (a), the matter of 'responsibility for registration' is totally irrelevant.

e) Regarding recoverability of these loans the procedures performed by the Audit Firm are inadequate due to the following reasons.

i) Recoverability means the recoverability of the loan in full either as per the contractual terms or at the event of liquidation of the debtor before the expiry of the contractual term.

ii) As the loans in question are not properly secured as provided by law, the audit procedures performed by the Audit Firm like the method of recovery, assessment of repayment status, ageing analysis, the asset classification, assessing the charge to be created, tests of details, payment history, and direct confirmations with the borrowers provide less relevant audit evidence relating to the recoverability of the loan balances, than they do of their existence or validity.

iii) As the implication of non-registration of charges is in the event of

liquidation of the debtor and on free transferability of the underlying assets by the owner during the tenure of the loan, an analysis of the going concern aspect of the debtor should have provided the evidence required for the Audit Firm regarding recoverability of these loans. There is no evidence in the Audit File that either the management has considered this aspect, or the Audit Firm has enquired with the management regarding such an analysis.

iv) Proper securing of the loans has material impact on the presentation and disclosures made in the financial statements, not only because of the amounts involved in the present case, but also on account of the following facts as disclosed in the SFS of IFIN for FY 2018.

- Provisioning for NPAs is dependent upon, inter alia, whether the NPA is secured or unsecured. Loans are considered as secured, where the Company has valid recourse to assets / recovery, as stated in Note 1 (n) of SFS of IFIN for FY 2018.
- Secured Loans includes Loan aggregating ₹ 17,296.23 mn pending security creation on balance sheet date which has since been completed. Unsecured Loans include loans aggregating ₹ 10,002.50 mn, which are contractually unsecured. Remaining amount of Unsecured Loans represents contractually Secured Loans where either the realizable value of underlying security is less than Loan amount or Security Creation is under process, as disclosed in Note 12 (c) of SFS of IFIN for FY 2018.

f) NFRA also notes that the Exposure to Real Estate Sector has been disclosed in the SFS as ₹ 2,479.48 crore as Commercial Real Estate Lending **secured** by mortgages on commercial real estates. (Note 2.6.1 of Annexure II, of SFS, Additional Disclosures in terms of paragraph 70 of Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company

(Reserve Bank) Directions, 2016 (As certified by the Management and relied upon by Auditors)). Out of the above amount, 8 loans amounting to ₹ 351 crore are unsecured loans falling in the category of loans contractually secured but disclosed in the financial statements as unsecured pending registration of charges (Reference: WP 27061.07). Therefore, the above disclosure made in Annexure II of SFS in accordance with the RBI regulations is inconsistent with the disclosure of loans in the financial statements. Though the RBI requirement for disclosure of exposure to real estate sector does not mandate separate disclosure of unsecured loans, it is always prudent to disclose the fact that out of such loans mentioned as 'secured', a portion is technically unsecured due to legal non-compliance. In the absence of such a full disclosure, the financial statements provide misleading and inconsistent information. Thus the claims of the Audit Firm in page 131 ("all 10 loans were appropriately disclosed as unsecured loans in the financial statements, and thus the status of their charge creation was transparent to the users of the financial statements and in no way hidden") and in page 144 ("the status of the security for these loans was fully disclosed as "unsecured" in the financial statements and thus was transparent to the users of the financial statements") of their reply to DSAQRR are not acceptable . The Audit Firm failed to pay any attention to this fact and this amounts to gross negligence.

2.8.6 Thus NFRA concludes that:-

a) The Audit Firm has failed to check or collect substantive evidence regarding the compliance with legal requirements for Creation and Registration of Charges. The Audit Firm has failed to comply with para 13 of SA 250 in so far as the non-compliance with Section 77 to 79 and section 143(1) (a) of the Companies Act, 2013 is concerned. The Audit Firm also failed to comply with para 15 and 16 of SA 250 and consequently failed to comply with paras 18 to 27 and 29 of SA 250.

b) The Audit Firm has failed to document its work properly as stipulated in SA 230.

c) The Audit Firm failed to exercise due diligence and perform sufficient Audit Procedures to ensure recoverability of loans which were contractually secured but pending for Security Creation/Registration, especially where Creation/Registration of charge was pending for such a significant number of loans for more than a year.

d) The Audit Firm failed to exercise due diligence and failed to deal appropriately regarding a misleading disclosure on exposure to commercial real estate sector made in the financial statements of IFIN for FY 17-18.

2.9 Integrity of Audit File and Audit Firm's IT Controls Review

2.9.1 Major compliance requirements, regarding Audit File documentation and monitoring of the firm's policies and procedures pertaining to the same, as prescribed by SA 220, SA 230 and SQC 1 are as follows:

a) SA 230 - Audit Documentation

i. Para 2- Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs should provide:

- Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

ii. Para 3- Audit documentation serves a number of additional purposes, including the following:

- Assisting members of the ET responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- **Enabling the ET to be accountable for its work.**

- Retaining a record of matters of continuing significance to future audits.
- **Enabling the conduct of quality control reviews and Inspections in accordance with SQC.**
- **Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements**. (emphasis added)

iii. Para 6 (a) - Audit Documentation – The record of Audit Procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used).

iv. Para 6 (b) Audit File – One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

v. Para 9- In documenting the nature, timing and extent of Audit Procedures performed, the auditor shall record:

- Who performed the audit work and the date such work was completed; and
- Who reviewed the audit work performed and the date and extent of such review.

vi. Para 15- After the assembly of the Final Audit File has been completed, the auditor shall not delete or discard audit

documentation of any nature before the end of its retention period.

vii. Para 16- In circumstances other than those envisaged in Para 13 where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the Final Audit File has been completed, the auditor shall, regardless of the nature of the modifications or additions, document:

- The specific reasons for making them; and
- When and by whom they were made, and reviewed.

viii. Para A9- An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

ix. Para A13- SA 220 requires the auditor to review the audit work performed through review of the audit documentation. The requirement to document who reviewed the audit work performed does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

b) SA 220 - Quality Control for an Audit of Financial Statements

i. Para 19 (c)- Not date the auditor's report until the completion of the EQCR.

ii. Para 25 (b)- The EQCR shall document, for the audit engagement reviewed, that the EQCR has been completed on or before the date of the auditor's report;

c) SQC 1

i. Para 74- The firm should establish policies and procedures for ET to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.

ii. Para 86 - The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice.

2.9.2 Based on requirements of SQC 1, SA 220 and SA 230 as listed above, it is imperative that:

a) The Audit Documentation provides evidence of auditor's bases for conclusions drawn and evidence that the audit was planned and performed in accordance with SAs. Such Audit Documentation serves the purposes of discharging the review responsibilities, enabling accountability, retaining records of matters of continuing significance, enabling quality control reviews, and enabling the conduct of external inspections. Audit Documentation referred here includes Audit Files maintained in electronic form as well.

b) The Audit Documentation shall be completed in a timely manner without performing any further Audit Procedures or changes other than

administrative changes.

c) The contents of the Audit File are essentially the documentation of the professional judgments made and serve to explain the auditor's conclusions and to validate the quality of the judgment. The audit work performed is reviewed through review of the Audit Files.

d) Any such Audit File shall provide evidence to ensure that:

i. The Audit Procedures are performed, documented and reviewed contemporaneously and, in any case, before the date of Audit Report, ensuring documentation for such review at the same time.

ii. Documentation of who has performed the Audit Work and the date such work was completed.

iii. Documentation of who has reviewed the Audit Work performed and the date and extent of such review is done.

iv. None of the audit documents is deleted or discarded before the end of its retention period.

v. In exceptional circumstances, if new or additional Audit Procedures are performed or any new conclusions are drawn after the date of the Auditor's Report, the same is documented meeting the requirement of Para 13 of SA 230.

vi. The Audit Documentation is completed in a timely manner without performing any further Audit Procedures or changes after the Audit Report date other than administrative changes, such as the following:

- Deleting or discarding superseded documentation.

- Sorting, collating and cross-referencing WPs.

- Signing off on completion checklists relating to the file assembly process.

2.9.3 Thus, in an electronic environment, ensuring these requirements of the SAs and SQC1 and eliminating the possibility of tampering/ unauthorized modification/deletion/ replacement, etc. of audit documentation and data before or after the closure of the Audit file, is dependent upon ensuring the following basic attributes for the electronic platform used for Audit File Management and Documentation.

a) Keeping inbuilt electronic records for version history and security of the electronic documents. This is required for monitoring or tracing changes to the Audit Files so as to, *inter alia*, ensure some of the requirements mentioned in Para 2. This involves basically defining a change management process and adhering to the process flow in the electronic platform.

b) Keeping inbuilt records for system logs and their monitoring. This is required to monitor Audit File integrity. Retention of all the logs along with the Audit File will ensure the requirements mentioned in Para 2, particularly regarding proper evidence for accountability, tampering of records, deletion of records, review, subsequent changes to the audit documents and regulatory verifications. The electronic platform shall have controls deployed to ensure that the integrity of the logs is maintained throughout their lifecycle. Lack of event monitoring may lead to security violations being unnoticed with respect to the electronic platform as well as the documents in the platform.

c) Standard authentication and access control protocols- Such protocols that permit access only for the authorized personnel for respective files at the required period ensure integrity of Audit Files. They also prevent

unapproved modifications to the Audit Files, incorrect updates and modifications and prevent security violations. These protocols are essential for meeting many of the requirements of Para 2, particularly regarding proper evidence for accountability, tampering of records, deletion of records, review, subsequent changes to the audit documents and regulatory verifications.

2.9.4 NFRA, through its IT consultants, conducted an in-person review of the Firm's IT systems and procedures of Audit File documentation and archival, along with respective controls and monitoring procedures. The Audit Firm's IT experts as well as the Audit Partner were present to demonstrate and respond to NFRA's queries. Subsequently, the NFRA team along with the IT consultants conducted a detailed review at the premises of the Auditor in their Delhi Office, of the Engagement Management System (EMS), the IT platform used by the Auditor for audit documentation. Subsequently, the Audit Firm was asked the queries as listed in Annexure A, for which the Audit Firm provided replies vide their email dated 21st February, 2020.

2.9.5 During the review, and after examining the replies furnished, the NFRA's IT consultants observed the following vulnerabilities in the electronic platform (EMS) and the Audit Archival Tool (AAT) with respect to the attributes mentioned in Para 2.9.3. The flaws identified during demo include unavailability of event and activity logs, lack of administrator logs, ability of reviewer to revoke sign-off, lack of alerts in case of artifact modification post sign-off, issues in configuration management of EMS etc.

The details of changes made within a document/ form in the EMS Application are not captured and logged for the application, and since the older versions of the document/ form are not available either, it is not possible to track the changes made to a document. Further no logs are maintained in the system in the following critical areas indicating:

a) absence of attributes mentioned in Para 2.9.3(a), version history and

security and 2.9.3 (b) system logs and its monitoring:

i. Maintaining and reviewing the audit trail of all the changes made, who made them, and time stamp of the change, is crucial for ensuring document/form integrity. It was noted that it is possible for "User A" to make changes to "User B" documents in the EMS application.
However, there is no logging or monitoring of such events.

ii. There is no logging and monitoring of EMS Application events to detect and prevent unauthorised activities.

iii. There is no logging and monitoring of EMS server and database (DB) events.

iv. There is no logging and monitoring of end user or administrator activities in the EMS Application, to detect and prevent unauthorised activities.

v. Only limited application level logs are captured throughout the Engagement Lifecycle. Server performance and availability are alone monitored. Crucial logs such as Application event and activity logs, administrator logs, alerts in case of artefact modification post sign-off etc. were not captured by the application.

vi. As stated in the access control matrix, AAT administrators have crucial authorisations such as Archive File Retrieval and Deletion. It is therefore imperative to capture the administrator activity logs. However, the administrator logs are not available in AAT, and due to this the activities performed by the administrator cannot be monitored or reviewed.

b) It was noted that EMS and AAT applications are not integrated with Security Information and Event Management (SIEM) solution for monitoring for security incidents and events. In case of a security breach, impacting the Integrity- Availability- Confidentiality of the

Engagement Audit File, the same would not get recorded or captured. [Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security and Para 2.9.3(c) authentication and access control protocols].

c) During demo it was observed that an Archived Audit File can be accessed, opened, and documents within the same can be modified. Further, the Audit File can be re-archived, wiping out all the logs and notes in the process, and requiring no authorisation. Though the log of documents deleted before archival of Audit File is maintained in the EMS application, all the logs and related reports, including the "Review Notes" added to the Audit File, from the start of the Audit, are wiped off by the application at the time of Archival of the Audit File, thereby leaving no trail available for subsequent review by various agencies/Audit Firm's personnel. All these inadequacies result in non-compliance with requirements of SA 230 as detailed in Para 2.9.1 [Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security and 2.9.3 (b) system logs and its monitoring].

d) In order to be able to track changes made and maintain the integrity of an Audit File, it is important that the various versions be maintained in Archive, and no one has access to delete document/ Audit Files. However, it is observed that the EP has the authorisation to Delete Engagement Files.

[Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security].

e) Having a maker-checker system in place is essential to ensuring integrity of Audit Files. It was noted that there is no independent review (automatic or manual) conducted of the Engagement Profile Details created by the Audit Team. Also, there is no defined periodicity to review the Access Control List for the Audit File created, to ensure that Access is granted on need basis only. [Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security and Para

2.9.3(c) authentication and access control protocols].

f) As stated in the access control matrix, EMS administrators have crucial authorisations such as managing File Configuration, Engagement Access Control, File Deletion, etc. It is therefore imperative to capture the administrator activity logs. However, the administrator logs are not available in EMS, and due to this the activities performed by the administrator cannot be monitored or reviewed [Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security and Para 2.9.3(c) authentication and access control protocols].

g) An uploaded document in the EMS, which has been marked as reviewed and signed-off, can be replaced with any other document. The document preparer can also mark the document as "Reviewed", thus there is no maker-checker mandated by the EMS application. Further, as the details of changes made to a document are not logged, the replacement does not get flagged in the EMS for mandatory review. Audit file within EMS Application, and its contents, can be modified post release of Audit Report till the Audit File is archived, without any indication to the members of the ET who are responsible for the conduct of the Audit. [Indicating absence of attributes mentioned in Para 2.9.3(a), version history and security, and Para 2.9.3(c) authentication and access control protocols].

h) No logging and monitoring of end user or administrator activities in the eAudit Application, to detect and prevent unauthorized activities, is inbuilt into the system. Concurrent logins, using same user credentials on different systems, are possible and there is no mechanism in place to detect, alert or prevent such events, leading to serious accountability issues. In case of an incident, root cause analysis (RCA) may lead to inappropriate results, since there would be no IP/Unique system ID logged-in along with user identifier [Indicating absence of attribute mentioned in Para 2.9.3(c) authentication and access control protocols].

2.9.6 It is, therefore, evident from the above that the EMS and AAT applications, which are the only audit documentation system used by the **Audit Firm**, completely fail to ensure even the minimum controls essential to meet the requirements of SQC 1, SA 220 and SA 230 as detailed in Para 2.9.1. The fundamental aspects of integrity of Audit Files, accountability of the firm and its personnel, maintaining sufficient appropriate Audit Evidence for the audit planning, performance and basis for conclusions for achieving audit objectives, are seriously compromised as a result.

2.9.7 As discussed above, NFRA had pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the authenticity and reliability of the audit documentation. The details given above show that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for the basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose. In not having ensured that the IT systems used for Audit File documentation did not suffer from any of these serious deficiencies, the Audit Firm has been guilty of serious professional misconduct.

2.9.8 In reply to the above observations, the Audit Firm submitted that:-

a) NFRA's proposed approach to audit documentation would completely rewrite SA 230, for Audit Firms using an electronic audit file management system. The various allegations concerning the ability of the EMS system to "log," "track," or "monitor" changes in the work papers during the course of the audit depends on the notion that the Firm is required to do so. SA 230 expressly permits Audit Firms not to do the kind of logging and tracking that NFRA contends the Standard requires. Though there are requirements of the integrity of archived work papers, no such requirements apply to pre- archived work papers. The content and integrity of audit documentation is governed by the Standards on Auditing, and not by any particular framework of any particular firm's information security and control system. SA 230 expressly contradicts NFRA's position, stating in paragraph A4: The auditor need not include

in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of other documents. NFRA has stated correctly that the documentation requirements of an audit are prescribed by SA 230 and SQC 1. Therefore, there can be absolutely no expectations beyond these standards. And because the standards expressly state that they do not require the actions NFRA requests, this is the end of the matter. The Audit Firm then proceeds to explain at length the merits of SA 230 provision that the auditors need not retain superseded drafts.

b) NFRA's concerns regarding audit work paper integrity are relevant to post- archival situations, and the firm has various controls in place to protect work paper integrity after a file is archived and SA 230 does place emphasis on the final, archived file. DHS has various controls in place to protect the integrity of its archived audit files, not mentioned in NFRA's allegations. Since August 2019, once an engagement file is archived, it is not possible for the engagement team or any other professional staff to delete or modify the file.

c) EMS is essentially a tool that was designed to allow audits to be documented and the final records archived, which is in line with the requirements of SA 230 and SQC 1. AAT can generate a History Report that provides Log Action, Action Date, Action By, Approved Archival, Submitted Archival, Submitted - but Rejected, Processed by Audit Archive Tool and activity within AAT.

d) EMS and AAT are integrated with Information and Event Management (SIEM) solution from 30th June, 2020. With effect from 20 May 2020, engagement team members do not have access to Audit Archive Tool.

e) During the demo, an archived audit file was retrieved because the action was performed by the IT administrator who has rights to access the AAT and who was present for providing the demo to the NFRA

officials. During the demo it was also shown that one of the professional staff could not retrieve the file for modification. Therefore, NFRA's observation that it was observed that an Archived Audit File can be accessed, opened, and documents within the same can be modified, is incorrect.

f) Under the SAs, the engagement partner has the overall responsibility on an engagement. As such, the engagement partner has the right to delete an audit file before its archival. Once an audit file is archived, the same cannot be deleted by anyone in the audit function, including the engagement partner. In the event that the single IT administrator who has the permissions necessary to delete an archived file initiated that process, the engagement partner from that engagement would receive a notification of the same via email, and final deletion could not occur without the engagement partner's approval.

g) To the extent NFRA is suggesting that any changes to the audit file between the report date and the archive date must be documented and/or logged, that is not consistent with the professional standards. SA 230 does not require that all administrative work performed or edits made to work papers in the process of assembling the final audit file be logged. Paragraph A.22 of the guidance to SA 230 recognizes that administrative changes to the audit documentation may be made during the assembly of the audit file and expressly recognizes that such actions do not fall within paragraph 13 of the Standard. If no such changes could be made, there would be no need for an archive period at all.

2.9.9 NFRA has examined in detail the submissions of the Audit Firm. It is clear that the Audit Firm is reluctant to adhere to professional standards in electronic audit documentation. It is evident that the Firm does not want to build system level controls to the audit documentation tool for compliance with the Standards of Auditing. The responses to the observations in DSAQRR show an aggressive unwillingness to correction. The practices followed lack of transparency and seriously compromise integrity of the Audit Evidence and Audit Documentation in electronic form.

a) The argument of the Audit Firm that SA 230 permits a virtual free-for-all in the maintenance of the audit file up to the time of its archival is an amazing display of complete disregard for all the principles of integrity of audit evidence. The need for proper documentation logs of corrections, deletions, additions etc to the audit file is so fundamental to the integrity of the audit file that this would not need specific and explicit elucidation to anyone other than persons interested in ensuring that the audit evidence is continuously tampered with till final archival.

b) Para 7 of SA 230 says that the auditor shall prepare audit documentation on a timely basis. Para A1 explains this further. The system of logs is only to guarantee and provide proof that the evidence was indeed obtained contemporaneously.

c) The Audit Firm has quoted Para A4 of SA 230 to say that superseded drafts etc need not be preserved. However, there is no support for the contention that the changes need not be logged at all, and that they can be entirely subject to the arbitrary and capricious decision making of the person in charge.

d) Apart from SA 230, several other SAs stipulate documentation requirements specific to those SAs. Neither SA 230 nor any other SAs specify that the documentation is only required to be completed at the end of the audit or at the time of archival. Instead, audit documentation is a concurrent activity with the engagement.

e) The Audit Firm submits that integrity of the audit documentation is required only after archival of the audit file and not before archival. Such theories of the Audit Firm are totally against the express provisions of SAs as detailed in this AQR. The position taken by the Audit Firm is a clear violation of para 77, 79 and 80 of SQC 1 and throws disturbing signals that the Audit Firm wants to keep the Audit Documentation loose and flexible to accommodate unwarranted changes and possible tampering at any time before archival. **This makes their entire electronic audit documentation unreliable.**

f) Such Audit Documentation even casts doubt on the Audit Firm's adherence to the fundamental principles of professional ethics as stipulated in the Code of Ethics issued by the ICAI, in so far as integrity and professional behavior are concerned. In the context of understanding an auditee's control activities, SA 315 acknowledges the importance of IT control with respect to integrity of the data when it states "The use of IT affects the way that control activities are implemented. From the auditor's perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process, and include effective general IT controls and application controls". It is ironical that the Audit Firm is expected to satisfy itself about the IT controls of its audit client, while admitting the absence, and, indeed, denying the necessity, of such controls in place for the Audit Firm's own IT tool.

g) NFRA agrees with the Audit Firm that only final audit documentation is required to be preserved. So, incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents, discarded drafts, etc. need not be preserved. However, the observation of NFRA in DAQRR is not about the preservation of such documents. The comment refers to maintenance of audit logs, and notes that in the absence of either logs or the older versions of the document, tracking changes made to a document is impossible. The reply of the Audit Firm is silent on the aspect of tracking changes made to a document which is completed and made part of the Audit File during the audit.

h) It is abundantly clear from NFRA's examination that has been detailed above, that any documents, **including documents/procedures completed in all respects by the engagement team and documented during the audit**, could be altered, substituted or sign offs could be changed at any time after the document is finalized/reviewed by the responsible member of the engagement team. There are no system level checks in the EMS platform to ensure that such changes to a completed

document are either not made, or if made, then it is either logged permanently in the EMS or the old version of the document is retained to understand the changes. As there is no mechanism to mark a document as completed, all documents are vulnerable to unauthorised changes till the day it is archived. As acknowledged in SA 315, IT platforms can be programmed to address such vulnerabilities through application controls. However, the Audit Firm has chosen to leave this gap unplugged. Under such circumstances, the objective of enabling the conduct of external inspections [para 3 of SA 230] for regulatory and other matters is not met by the EMS/AAT platforms.

i) Audit file within EMS Application, and its contents, can be modified post release of Audit Report till the Audit File is archived, without any indication to the members of the ET who are responsible for the conduct of the Audit. Para 79 of SQC-1 requires that the Audit Firm designs and implements appropriate controls for engagement documentation to enable the determination of when and by whom engagement documentation was created, changed or reviewed and to protect the integrity of the information at all stages of the engagement. The practices of the Audit Firm amount to a clear violation of this SQC requirement.

j) If a document that is an abstract or copy of the entity's records (for example, significant and specific contracts and agreements) is deleted altogether from the EMS after a specific procedure based on the document is completed by the engagement team and after it is duly reviewed, the EMS permits such deletions and leaves no traces of the deleted records. Technically, the IT platform design is such that any or all of the documents in an electronic audit file could be deleted or modified after the signing of the Audit Report, without providing any recourse to a subsequent reviewer, such as NFRA, to examine the earlier documents.

k) Attention is drawn to para 7 of SA 230 which says that the auditor shall prepare audit documentation on a timely basis. Para 8 of SA 230,

requires that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements. Executing an alteration, without keeping any logs or records, to a previously concluded and electronically documented audit procedure/document, is tantamount to tampering with the original timing and documentation of performing the audit procedure.

l) Also, when such a completed document is deleted or replaced after completion of the Audit (may be before or after signing the audit report), it is again tampering with the evidence of the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions [Para 8 (c) of SA 230]. Though it has been stated by the Audit Firm that the Engagement Partner has the ultimate responsibility on an engagement and hence he has the right to delete an audit file **before its archival**, in this regard it may be noted that:-

i. The entire engagement team is accountable for the due performance of the engagement. By enabling deletion of critical data, such as reviewed date, completed date, who reviewed, who prepared etc., the Audit Firm loses control that needs to be exercised over the members of engagement team to hold them accountable for their work [Para 3 of SA 230].

ii. The statement of the Audit Firm also makes it clear that the engagement partner can delete components of the Audit File after the date of audit report, but before the date of archival. This is totally against the provisions of SA 230 and SQC1. SA 230 requires the auditor to complete the assembly of final audit file ordinarily in not more than 60 days after the date of the auditor's report. The stipulation in Para 14 of SA 230 does not mean that the assembly of audit file begins after the date of audit report.

Assembly of audit file is an ongoing process concurrent with the engagement and para 14 only means that the administrative process of final assembly shall be completed on a timely manner after the date of audit report. Para A22 of SA 230 permits only administrative changes to the audit file during final assembly. As per SQC 1, the retention period of the audit file starts from the date of Audit Report or if later, the date of the group auditor's report. Thus, the so called right of the engagement partner to delete components of the audit file after the audit report and before the end of the retention period is a violation of para 15 of SA 230.

iii. The Audit Firm's confirmation, that the IT Administrator can delete components of an archived Audit File with approval from engagement partner, is again a violation of para 15 of SA 230.

iv. The permission in SA 230 to delete or discard superseded documentation does not imply permission for deletion of a completed audit documentation. This permission in SA 230 only means retention of a final document in place of a redundant or discarded old document. However, the EMS is capable of deleting altogether any document in the audit file irrespective of whether it is an old superseded document or a final, completed document filed in the EMS at the time of audit after performing due Audit Procedures. There is no system level checks to verify the status of the document (whether it is a superseded document or a final, completed document) before its deletion. Hence, any document can be deleted irrespective of its relevance in the Audit Documentation.

v. Attention is drawn to para 17 of SA 220, which requires that on or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. As, technically, the IT platform allows modification or deletion of documents after such review and

discussion by the engagement partner, the original review undertaken by the engagement partner may lose its relevance. It is as good as not meeting the requirement of SA 220.

vi. The practice of the Audit Firm also violates provisions of para 79 of SQC 1, since the Audit File can be permanently lost on deletion and there is no protection on the integrity of the information **at all stages of the engagement**. Para 79 of SQC-1 states that whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, the firm has to design and implement appropriate controls for engagement documentation to:

- Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- **Protect the integrity of the information at all stages of the engagement,** especially when the information is shared within the engagement team or transmitted to other parties via the Internet.

m) In EMS, there is no ultimate finality to a document captured or procedure performed during the engagement, until and unless the audit file is archived. All documents, processes and procedures performed maintain an "open" position, vulnerable to any changes, though there are controls at the time of closing of audit file. There are several documents that serve as evidence for various decisions of the Auditor such as acceptance or continuance of the engagement, disclosure of interest by the engagement team members, engagement letters, minutes, etc. which forms the very foundations of starting an engagement. Even such documents, though captured in the EMS platform at the beginning, remain in an open position, and hence are vulnerable to unwarranted

alterations. Hence, apart from para 79 of SQC 1, the requirements of para 7 of SA 230 (the auditor shall prepare audit documentation on a timely basis) and Para 8 of SA 230, (the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements) are also not fully met by the EMS platform.

n) Auditor makes conclusions based on the audit evidence obtained up to the date of auditor's report. Such evidences are gathered during the performance of the engagement. By not fixing a finality to a documented procedure or audit evidence, the IT platform is not compliant with para 8 of SA 230.

o) The above factors makes both internal as well as external inspections ineffective since the evidence of compliance by the engagement team is capable of being modified at a later stage without making available the details of the alterations in the archived file, which is the only record available for inspections. SQC-1 defines inspection as "in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures".

p) Concurrent logins, using same user credentials on different systems/locations, is an indication of compromised user credentials. It is impractical for a user to be logged in from more than one location at a point in time. Allowing concurrent logins may result in compromising the integrity and reliability of the data and dilutes accountability required from the engagement team and the firm. The practice of the Audit Firm amounts to clear violation of the requirements of Para 79 of SQC-1, which stipulates that the Audit Firm designs and implements appropriate controls for engagement documentation to enable the determination of when and by whom engagement documentation was created, changed or reviewed and to protect the integrity of the

information at all stages of the engagement.

q) NFRA notes that Exhibit 2.9.1 (AAT Access matrix - AAT v4.5 User Guide DHS (extract)) states "With effect from 14-August-2019, engagement team members do not have access to retrieve an archived file for modification in the Audit Archive Tool. In case Engagement Team members are required to make changes to any work papers in an archived file, they will be required to open a new file, prepare fresh work papers clearly indicating the changes from the previous version of the work paper that was archived and will make a specific statement that this fresh work paper will supersede the work paper in the earlier archived file. Such modified work paper shall be subject to review by the Engagement Partner, Engagement Quality Control Reviewer and concurred by the NPPD. The new file with the fresh work paper, which carries the modification, needs to be archived separately. In case the engagement file is sought for any internal / external inspections, both the archived files should be provided for such inspections." This is apparently a move in the right direction in so far as archived audit file is concerned. However, the same conditions should apply to any audit documentation which is completed and filed during the course of audit.

2.9.10 It is, therefore, evident from the above that the EMS application, which is the only audit documentation system used by the Audit Firm, completely fails to ensure even the minimum controls essential to meet the requirements of SQC 1, SA 220 and SA 230 as detailed above. The fundamental aspects of integrity of Audit Files, accountability of the firm and its personnel, maintaining sufficient appropriate audit evidence for the audit planning, performance and basis for conclusions for achieving audit objectives are seriously compromised as a result.

2.9.11 As discussed above, NFRA had pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the integrity, authenticity and reliability of the audit documentation. The details given above show that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for SQC 1 and SAs and

basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose. In not rectifying these deficiencies, the Audit Firm is guilty of serious professional misconduct.

2.10 Documentation of EQCR Processes

2.10.1 In the AQRR issued on 12th December, 2019, NFRA had concluded that:

a) The argument of the Audit Firm that SA230 is not applicable to EQCR is completely erroneous;

b) The EQCR has completely failed in documenting its working properly and separately from the work of the Audit team as required by SQC 1 and SA230;

c) The contention of the Audit Firm that "Para 25" of SA220 requires only an affirmation from the EQCR on compliance with the statements is completely invalid;

d) The exaggerated claims of the Audit Firm about involvement of EQCR team is clearly unsupported by evidence and is an attempt to mislead NFRA;

e) The Audit Firm has failed in complying with various provisions of SQC 1, SA220 and SA230;

f) The conclusion, therefore is inescapable that such EQCR as was, if at all, performed, was so perfunctory as to render it a complete sham;

g) The large-scale failure of the EQCR process that comes out of the above analysis is also evidence of the inadequacy and ineffectiveness of the QC policies of, and their implementation by, the Audit Firm; and

h) The refinement in the EQCR process that the Audit Firm intends to apply is an acknowledgement of the merit of the issues raised by NFRA.

2.10.2 The above observations of NFRA are reinforced by various observations of NFRA in this SAQRR, which are as follows:

a) In Para 2.3 above, it has been conclusively shown that the reappointment of the Audit Firm as Statutory Auditor of IFIN for the FY 2017-18 was ab initio illegal and void for violation of Section 141 (3) (e) and Section 141 (3) (i) of the Act. The declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139 (1) of the Act when read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. The Audit Firm's compliance with the fundamental principles of the Code of Ethics was threatened by the self-interest threat. Thus, the EQCR Partner was guilty of professional misconduct arising out of gross violations of the law and Code of Ethics.

b) As shown in Para 2.3.3.19, the ET and EQCR failed to verify the investments of the Company and their valuation with valid, sufficient, appropriate and reliable Audit Evidences and failed to comply with the applicable Accounting Framework.

c) There is absolutely no record of any discussion held by the EQCR with the ET. For example, the reversal of ₹175 Crores from provision for general contingencies has not been explained in any WP. The EQCR team has neither done any independent Analysis nor questioned the ET on the same. The conclusion is, therefore, inescapable that the profits for the year were inflated by ₹175 Crores, without any basis or justification.

d) As shown in Para 2.9.7, NFRA had pointed out several discrepancies in audit documentation that raised doubts, even at a prima facie level, about the authenticity and reliability of the audit documentation. The details given in Para 2.9 shows that the deficiencies are systemic and structural in nature and arise substantially from a complete disregard for the basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose. In not having cross verified that the IT systems used for Audit File documentation did not suffer from any of these serious deficiencies, the EQCR has been guilty of serious professional misconduct.

2.10.3 NFRA has examined in detail the submissions of the Audit Firm in reply to the above observations and observes as follows:

a) Reference to 'para 2.3' and 'Section 143(3)(e)' in para 2.10.2 (a) of DSAQRR stands corrected as 'para 2.2' and 'Section 141 (3)(e)' respectively, as rightly pointed out by the Audit Firm in their reply. Also reference to 'para 2.3.3.19' in para 2.10.2 (b) of DSAQRR stands corrected as 2.3.3 C (s) as noted by the Audit Firm in their reply.

b) In page 171 of their reply, the Audit Firm states that "....overall evaluation of independence is the Engagement Team's responsibility. The EQC reviewer's responsibility was to consider the Engagement Team's evaluation of the firm's independence. While performing the engagement, the Engagement Team and Engagement Partner were not notified of any independence breaches through the Audit Firm's systems of quality control nor were there in fact any independence breaches communicated to the EQCR Team". The Audit Firm then lists certain work papers prepared by the Engagement Team and which are claimed to be reviewed by the EQCR team.

c) NFRA has examined these work papers. WP 11201 (Threats to independence and safeguards template) has nothing to review by the EQCR as there is nothing written in the WP except a remark that "None noted". Neither were any threats (which were clearly there as explained in the earlier paras by NFRA) analysed by the Engagement Team or by the EQCR team. WP 11202 (Independence and confidentiality checklist - public interest entity listed entity) is a general checklist having no specific issues related to IFIN.

d) The response of the Audit Firm from page 171 of their reply, and quoted in sub para (b) above makes it further clear that since there were no notifications of any breaches of independence to the EQCR team, no review of independence has been done by the EQCR Team. In fact, it is not practical for the EQCR team to do a review of the Engagement Team's non-existent evaluation of independence. Though the Audit Firm states that "The EQC reviewer's responsibility was to consider the Engagement Team's evaluation of the firm's independence", the truth is that there does not exist any such evaluations either by EQCR or by Engagement Team. Thus, the EQC Reviewer violated para 21 of SA 220.

e) Regarding review of significant judgments made by the Engagement Team in the area of investments, the Audit Firm states initially that the term 'verification' used by NFRA does not have any support in the SQC 1 or SA 220 with regard to EQC Review. The Audit Firm also states that, the EQCR Team covered the significant matters in respect of investments as detailed. In the details the Audit Firm refers to the work papers of the engagement team and states simply that all those work papers were reviewed by the EQCR and on professional judgment of EQCR the Engagement Team had addressed the assertions of valuation, tested the controls, performed Test of Details, evaluated the appropriateness of valuation reports, etc. A similar reply has been provided by the Audit Firm with respect to reversal of GCP as well.

f) None of the claims above are supported by evidence of objective evaluation in the Audit File. The discrepancies in the audit performed by the Engagement Team on investments and reversal of GCP have already been detailed by NFRA in this SAQRR. Instead of demonstrating the objective review (if any done) by the EQCR team, the reply of the Audit Firm has simply detailed the work done by the Engagement Team. There is no documentation of both the objective review done and professional judgments made by the EQCR team as claimed by the Audit Firm in this regard. Thus, the EQCR Team had violated para 20 of SA 220.

g) The Audit Firm cites audit planning presentation and certain emails to show that there had been discussions with the EQCR team regarding significant matters related to the engagement. However, NFRA notes that the audit planning meeting is not the right forum and time to discuss significant matters arising during the course of Audit. All the submitted email communications between the EQCR Team and the Engagement Team were related to review of the financial statements and comments on EOM para. One email dated on the same day as the signing the audit report (28th May 2018) of SFS mentions a few audit documentations to be prepared/maintained in the Audit File. Such emails nowhere depict any significant judgements which were discussed with the Engagement Team.

h) Regarding systemic deficiencies in the IT based Audit Documentation system as pointed out by NFRA in para 2.10.2 (d), the Audit Firm submits in page 180 of their reply that "The EQCR is an evaluation of the significant judgments of the Engagement Team. The standards for evaluating an EQC reviewer's conduct must be the actual standards that apply to EQC reviews, and not, as NFRA apparently contends, the standards that apply to a firm's SQC more generally. Further, it is not the EQC reviewer's responsibility to verify the IT systems used by the Audit Firm." NFRA accepts the contention and the said para 2.10.2 (d) is withdrawn. However, the fact remains that the so called review of selected workpapers by EQCR as claimed by the Audit Firm does not serve any purpose and does not meet the objectives of SAs, because the basic tool used for such review and documentation lacks integrity and is proved to be not fit for the purpose.

i) The Audit Firm states in page 174 of their reply that "NFRA's contentions are an attempt to expand the scope, role, and responsibilities of the EQC reviewer beyond what is prescribed in the professional standards. It must be appreciated that the professional standards do not require an EQC reviewer to re-perform the audit or any of the Engagement Team's audit procedures, nor is the EQC reviewer required to review 100% of the audit risks and 100% of the audit workpapers. This is affirmed by paragraph 64 of SQC which states that "[An engagement quality control review] also **involves a review of selected working papers** relating to the significant judgments that the engagement team made and the conclusions they reached." **(Emphasis supplied)**." In this regard NFRA makes it clear that nowhere in the AQRR dated 12th December 2019 or in this SAQRR, has NFRA stated that the EQC reviewer should re-perform the audit or any of the Engagement Team's audit procedures, or that the EQC reviewer is required to review 100% of the audit risks and 100% of the audit workpapers. Whatever observations have been made by NFRA regarding EQCR in this SAQRR and in para 2.10 of the AQRR are all about either no review at all or absence of an independent (objective) evaluation of significant judgments made by the engagement team, and of the conclusions reached in formulating the auditor's report. NFRA also observes absence of

documentation of the work performed by the EQCR Team, as required by SAs. Any other contentions or arguments by the Audit Firm are totally out of context and presumably intended to divert attention of NFRA/readers to irrelevant details. In this regard, NFRA reiterates the following provisions of SAs that are relevant in the context of what is stated in the AQRR and SAQRR regarding EQCR.

i) Para 20 of SA 220 states "The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve: (a) Discussion of significant matters with the engagement partner; (b) Review of the financial statements and the proposed auditor's report; (c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and (d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate."

ii) With reference to para 20, Para A25 of SA 220 states inter alia that "Documentation of the engagement quality control review may be completed after the date of the auditor's report as part of the assembly of the final audit file. SA 230 establishes requirements and provides guidance in this regard".

iii) The above two paras read with observations of NFRA in para 2.10 of the AQRR make it absolutely clear that the work of EQCR shall be documented and such documentation shall be done in accordance with SA 230. As per para 1, the specific documentation requirements of other SAs (like para 25 of SA 220) do not limit the application of SA 230. Hence documentation of the work of EQCR including the professional judgments made, should be documented in accordance with SA 230.

iv) Para 8 (c) of SA 230 stipulates documentation of significant matters and related significant professional judgments. Para A10 of SA 230

states "Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant, the rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement."

v) Para 20 of SA 220 stipulates that "The engagement quality control reviewer **shall perform an objective evaluation** of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report." Para 21 of SA 220 stipulates "For audits of financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, **shall also consider** the following: (a) The **engagement team's evaluation of the firm's independence** in relation to the audit engagement..... (c) Whether **audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached**."(Emphasis added)

vi) As both para 20 and 21 of SA 220 provide a requirement that the auditor (in this case the EQCR) 'shall consider' certain significant information or factors, the professional judgment exercised should be documented in accordance with SA 230. Thus, the repeated contentions of the Audit Firm, without support of any documentation, that the EQCR applied professional judgment in evaluation the significant judgments made during the course of Audit, is not acceptable.

2.10.3 Thus NFRA reiterates its conclusions in the DSAQRR and concludes that:-

a. The EQCR has completely failed in documenting its working properly and separately from the work of the Audit team as required by SQC 1 and SA 230.

b. The EQCR has violated the provisions of SA 220 in preforming their works.

c. The conclusion, therefore is inescapable that such EQCR as was, if at all, performed, was so perfunctory as to render it a complete sham.

2.11 SQC 1 Compliance: Policies & Procedures

2.11.1 In the AQRR issued on 12th December, 2019, NFRA had concluded that:

a) NFRA is a body constituted under the Companies Act, 2013, to, inter alia, monitor and enforce compliance with auditing and accounting standards prescribed under the said Act. All auditors of companies that are registered under the Act will be monitored only with reference to standards in force in India. The supposed equivalence of International Standard to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA;

b) Both the inadequacies of the QC policies and processes on the one hand, and the non-compliance with such policies as exist on the other, have been clearly brought out in this AQRR. Specifically, NFRA wishes to draw attention to the large scale and serious violations of Independence requirements, the clear display of the lack of the required professional skepticism, the lack of insistence on obtaining sufficient appropriate Audit Evidence, the repeated assertions that there could be more than one EP for an engagement, the evident confusion in assessing the ROMM and its impacts on the Audit responses and evidence obtained, and the sham character of the EQCR, as evidence of the need to revamp the QC policies and processes of the Audit Firm;

c) The complete breakdown of QC system evident in this case is serious enough to support the suspicion that the Audit Firm had aligned itself completely with the interests of the Management of the Auditee Company;

d) NFRA, therefore, is of the opinion that the Audit Firm would be well advised to prepare a comprehensive, concise and systematically

structured policy document to conform to SQC 1, and to put in place mechanisms to rigorously enforce it and monitor compliance.

2.11.2 The above observations of NFRA have been supplemented by several additional findings that have been documented in the DSAQRR, as follows:

a) The section on Independence (Para 2.3 above) has clearly demonstrated how the acceptance of the engagement was itself in violation of the provisions of the Companies Act, and how the declaration of compliance with the qualification conditions, and absence of any of the disqualification conditions, was misleading and fraudulent. Clearly, no further proof of the inadequacy and ineffectiveness of the Audit Firm's SQC1 compliance needs to be provided.

b) Both the inadequacies of the QC policies and processes on the one hand, and the non-compliance with such policies as exist on the other, have been clearly brought out in the DSAQRR. Specifically, NFRA drew attention to the large scale and serious violations of Independence requirements, the clear display of the lack of the required professional skepticism, and the lack of insistence on obtaining sufficient appropriate Audit Evidence. Attention was also drawn towards failure of the Audit Firm to verify the investments of the Company and their valuation with valid, sufficient, appropriate and reliable Audit Evidences, failure to bring the completely unjustified matter of reversal of GCP to the notice of Central Government as required by Section 143 (12) of Companies Act, 2013, failure to carry out Analytical Procedures as required by SA 520, failure to check or collect substantive evidence regarding the compliance with legal requirements for Creation and Registration of Charges, the sham character of the EQCR, and failure to ensure even the minimum controls essential to meet the requirements of SQC 1, SA 220 and SA 230 as detailed in Para 2.9.1 as evidence of the need to revamp the QC policies and processes of the Audit Firm.

c) In the DSAQRR, NFRA, therefore, reiterated its opinion that the Audit

Firm would be well advised to put in place mechanisms to rigorously enforce the policy documents to conform to SQC 1, and monitor its compliance.

2.11.3 The Audit Firm has not offered any comments regarding para 2.11.1 (a). In their general reply to other observations in the DSAQRR, the Audit Firm did not agree with any of the NFRA's conclusions that the Audit Firm's SQC is inadequate or ineffective. All allegations are denied by the Audit Firm. The Audit Firm also suggested that NFRA should review its systems and processes for conducting the audit quality reviews.

2.11.4 The Audit Firm's responses to the observations of NFRA in the DSAQRR have been examined and NFRA's conclusions thereon are as follows.

a) In reply to para 2.11.2 (a) the Audit Firm refers to their submissions in respect of the observations on independence made by NFRA in paragraph 2.2 of the SAQRR. However, as shown in Para 2.2.15 above, the declaration of eligibility submitted by the Audit Firm in terms of Proviso to Section 139 (1) of the Act read with Rule 4 of the Companies (Audit and Auditors) Rules, 2014, was false and invalid, with full knowledge of such illegality. The other violations had undoubtedly fatally compromised the independence in mind and independence in appearance required of the Audit Firm. Independence in appearance stood completely destroyed since no unbiased person could conclude, on an objective assessment of the circumstances, that there had been no abridgement of the auditor's independence. The Audit Firm's compliance with the fundamental principles of the Code of Ethics was also undermined by the self-interest threat.

b) Regarding failure to verify investments mentioned in para 2.11.2(b), the Audit Firm refers to their responses to the observations in paragraph 2.3 of the SAQRR and submits that the Engagement Team performed appropriate audit procedures. The contentions are not acceptable in view of the conclusions documented in para 2.3 in the SAQRR that the ET and EQCR failed to verify the investments of the Company and their

valuation with valid, sufficient, appropriate and reliable Audit Evidences and failed to comply with the applicable Accounting Framework.

c) Regarding the matter of reversal of GCP mentioned in para 2.11.2(b), the Audit Firm refers to their response to paragraph 2.4 of the SAQRR and submits that the reclassification of GCP was based on the assessment of the Board of Directors that a portion of the GCP should be reclassified as specific provisions. These provisions simply moved from one line item to another. Further, IFIN transparently disclosed the information about GCP in its Annual Report and a similar reclassification in an earlier year was not objected by the RBI. Accordingly, there was no fraud. The contentions are not acceptable in the absence of any new evidence. NFRA observed in the SAQRR that the notes to the Financial Statements do not cover reasons for reversal of GCPs. The Company, instead of providing another ₹333.3 Crores (as per Company's Policy), wrote back ₹225 Crores from GCP and thus overstated the profit, which is completely unjustified and not based on any objective evidence and appears to be a calculated fraud in collusion with the management to inflate the profit.

d) Regarding the matters related to analytical procedures as mentioned in para 2.11.2(b) of SAQRR, the Audit Firm refers to their replies to para 2.6 of the SAQRR that the audit included performance of substantive analytical procedures as envisaged in SA 315 and SA 520, which procedures were determined and performed based on the Engagement Team's professional judgment. These replies are not acceptable in view of the established fact in para 2.2.6 that the Audit Firm failed to perform analytical procedures to achieve the objectives as mentioned in para 3(b) of SA 520.

e) Regarding the matter of creation of charges as mentioned in para 2.11.2(b) of SAQRR, the Audit Firm repeats their response to paragraph 2.8 of SAQRR and states that the Engagement Team performed appropriate audit procedures relating to the loans and had determined if

the loans for which charge on the security was not created were appropriately identified and disclosed as unsecured loans in the financial statements. The replies are not acceptable as it is established in para 2.8 of SAQRR that the Audit Firm failed to exercise due diligence and perform sufficient audit procedures in the matter of creation of charges and related matters on large loans.

f) Regarding performance of EQCR, the Audit Firm repeated the same arguments made during the DAQRR stage of the AQRR dated 12th December, 2019 and states in para 7 of their reply that "the EQC reviewer is not expected to be involved in the performance of the audit nor is he expected to work independently and he is expected to only review the work performed by the engagement team". The contentions of the Audit Firm are not acceptable. The argument of the Audit Firm that SA230 is not applicable to EQCR is completely erroneous as concluded in the AQR. The EQCR failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the Engagement Team, failed in documenting its working properly and separately from the work of the Audit team, and hence failed in complying with SAs and SQC1 as detailed in the AQR and SAQRR.

g) Regarding Audit Documentation, the Audit Firm submits that, as explained in their responses to paragraph 2.9 of the SAQRR, the audit documentation that is required to be maintained by the Audit Firm is fully in compliance with the requirements of SA 230. However, it is established beyond doubt in para 2.9 of this SAQRR that the Audit Documentation tool used by the Audit Firm has serious structural flaws and has security vulnerabilities, thereby seriously compromising the integrity of the underlying data, i.e., the Audit Documentation, which makes the IT tool unfit for the intended use.

h) Regarding lack of required professional skepticism, inadequacies and non-compliance with SAs in assessing the ROMM and its impacts on the Audit responses, and the designation of more than one partner as the

engagement partner, the Audit Firm refers to and repeats their earlier submissions made during the AQR stage in response to observations in the DSAQRR. However, as all these matters have already been addressed in the AQRR and SAQRR, the same is not reproduced here for the sake of brevity.

2.11.5 Thus NFRA reiterates its conclusions in para 2.11.1 above and concludes that the Audit Firm would be well advised to put in place mechanisms to rigorously enforce the policy documents to conform to SQC 1, and monitor its compliance.

Approved by the Executive Body of NFRA for Issue

Vivek Narayan

(Vivek Narayan)
Secretary, NFRA

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ANNEXURE A

Queries to Audit Firm during IT Systems and Procedures Review

S.No.	Requirement
1.	Rights Permission Matrix for EMS and AAT
2.	Global Support activities for EMS, access to India Instance
3.	Admin Access Logs for EMS and AAT
4.	Org Structure – IT
5.	Password Policies – Screenshots
6.	O365 & OneDrive, EMS, AAT - Server Locations / DRS
7.	SIEM Solutions / Security Op Centre - Alerts configured for events, integration with EMS & AAT applications, Rules configured for these integrations and when configured
8.	Role and Permissions changes in .xml file
9.	Certificate - ISO 27001 copy (including EMS)
10.	AAT Process document
11.	Privileges and Roles AAT Admin, WP Reviewer and Process Flow in AAT - Update, Retrieve, Delete and Resubmit
12.	Client Acceptance Process
13.	EMS, AAT Application Architecture, Network Architecture, SDLC Write up Policy and Process
14.	Privileges of Partner in EMS and AAT

15.	Write up on Log management policies for administrators, activity log for EMS / AAT Application & Server administrators
16.	VPN Access Control Review Frequency
17.	Explanatory Note - How do you ensure integrity of archived files w.r.t original archive
18.	Log of Access to Archived IFIN File
19.	EMS, AAT - VAPT Report, Config Review Report, Application Security Testing Report - Last Conducted / Frequency / Status of Closure
20.	AAT Restoration Procedure, Testing and Frequency
21.	Write up on Security Policies and Practices
22.	Listed Clients - last 3 years List of Opinion Date, Last Date of Archival as per Firm Policy, Actual Archival Date
23.	For all these listed clients whether a report or log of audit file documents last modified date is mapped with last reviewed sign offs maintained / available

ANNEXURE B

Chronology of events leading to the issue of the DSAQRR

Sl. No	Date	Event / Correspondence
1.	25.02.2019	Formal letter of NFRA letter sent to CA Udayan Sen requesting for the Audit file of IL&FS Financial Services Ltd for the Financial Year 2017-18.
2.	25.04.2019	NFRA's letter dated 25.04.2019 sent to CA Udayan Sen (Engagement Partner) seeking list of related parties and Audit/Non-Audit revenue in stipulated format under Affidavit.
3.	02.05.2019	NFRA's letter dated 02.05.2019 containing Questionnaire, sent via email on 02.05.2019 to CA Udayan Sen seeking replies to the same.
4.	08.05.2019	Reply of CA Udayan Sen to NFRA letter dated 25.04.2019 under affidavit and also sent via email by CA Shrenik Baid.
5.	13.05.2019	Email from CA Shrenik Baid in response to NFRA Letter No. 11013/2/2018 dated 02.05.2019
6.	28.06.2019	NFRA's letter dated 28.06.2019 to CA Udayan Sen conveying its prima facie observations/comments/conclusions on the various issues in the questionnaire.
7.	3.8.2019	Reply of CA Udayan Sen dated 02.08.2019 to NFRA's letter dated 28.06.2019.
8.	25.09.2019	Issuance of Draft AQR Report (DAQRR)
9.	21.10.2019	NFRA's letter dated 21.10.2019 containing Additional Questionnaire, sent to the Auditor seeking replies to the same.
10.	30.10.2019	Presentation to NFRA by CA Udayan Sen, CA Shrenik Baid and other team members from Deloitte Haskins & Sells LLP (Auditor).

11.	04.11.2019	Written replies furnished by CA Udayan Sen to NFRA's observations in the DAQRR.
12.	15.11.2019	Reply received from the Auditor to NFRA letter dated 21.10.2019 received
13.	12.12.2019	Issuance of the final AQR Report by NFRA.
14.	28.01.2020	Presentation given by the Deloitte Haskins & Sells LLP team regarding the IT application (used for maintaining Audit Files) at NFRA office
15.	29.01.2020	NFRA team with IT consultants visited to Deloitte Haskins & Sells LLP (Auditor) office at Gurugram for further detailed understanding of IT platform.
16.	21.02.2020	Reply received via letter from Shri V Balaji, Partner in Deloitte Haskins & Sells LLP related to the additional requirements.
17	01.05.2020	Issuance of Draft Supplementary AQR report dated 1st May, 2020.
18	25.07.2020	Reply of DHS for Draft Supplementary AQR report.
19	28.10.2020	Presentation (through video conferencing) made by the Audit Firm on issues raised in DSAQRR.
20	11.11.2020	Clarification letter dated 11th November, 2020 from DHS regarding matters discussed during presentation.