AUDIT QUALITY REVIEW REPORT (AQRR)

AUDITOR: BSR AND ASSOCIATES LLP

(FIRM REGISTRATION NO.: No. 116231W/W-100024)

AUDITEE: IL&FS FINANCIAL SERVICES LTD.

FINANCIAL YEAR: 2017-2018

EXECUTIVE SUMMARY OF REPORT NO 1/2020

DATED: 17th August, 2020

NATIONAL FINANCIAL REPORTING AUTHORITY,

GOVERNMENT OF INDIA,

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EXECUTIVE SUMMARY

THE PROCESS

The Audit Quality Review (**AQR** Process) was commenced on 7th February, 2019. During the process, a very extensive and detailed correspondence was carried on with BSR and Associates, LLP, (**BSR**), answers were sought to many questions, and additional information was requested on many issues. NFRA's intermediate conclusions, along with the detailed reasoning in support of the same, was made available to **BSR** at two stages in the process, and **BSR** was afforded full opportunity to respond to the same. **BSR** was also invited for an oral discussion/presentation to NFRA on 27th July, 2020. Subsequent to this, **BSR** provided additional information/documents arising out of this discussion/presentation. All this material has been carefully scrutinised in the preparation of this AQR Report (**AQRR**).

THE FINDINGS

1. The appointment of **BSR** as the statutory auditor of IL&FS Financial Services Ltd. (**IFIN**) for the year 2017-18 was illegal, since **BSR** was not eligible to be appointed as such auditor due to violation of Sec 141(3)(e) (subsisting business relationships on the date of appointment) and Sec 141(3)(i) (provision of non-audit services directly or indirectly) of the Companies Act, 2013. **BSR**'s continuation as such statutory auditor was also violative of Sec 141(4).

2. Notwithstanding such lack of eligibility, and without prejudice to such finding, NFRA has conducted a full **AQR**. Some of the more important findings described in detail in the **AQRR** are mentioned below. Anyone interested in understanding the matters listed in the succeeding paras in more detail is requested to go through the full **AQRR**.

3. The instances of failure to comply with the requirements of the Standards of Auditing (**SA**s) that have been documented in the **AQRR** are of such significance that it appears to NFRA that **BSR** did not have adequate justification for issuing the Audit Report asserting that the audit was conducted in accordance with **SA**s.

4. In this connection, **NFRA** wishes to draw attention to Response 12 in the ICAI's Implementation Guide on Reporting Standards (November 2010 Edition) which 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).

5. **BSR** and other entities in its network de facto use the KPMG Trade Mark and Brand Name for all their audit and non-audit services, while making a clearly futile attempt to show a de jure separation from KPMG. This attempt will have to fail in view of the clear public perception of the BSR network entities being part of the larger KPMG global network, and also the legal agreements between them. **The non-audit services provided technically by the KPMG labelled entities of the network are clearly services indirectly provided by the BSR entities, and result in gross violations of the independence requirements for auditors laid down under the Companies Act, as well as the Code of Ethics mandated by the Institute of Chartered Accountants of India**.
6. **IFIN** was not compliant with the minimum Net Owned Funds (NOF) and Capital to Risk Assets Ratio (CRAR) prescribed for an NBFC of its type, as of 31st March, 2018. In fact, these numbers were actually heavily negative, (against a minimum positive requirement) and this non-compliance had continued since some time. The Financial Statements of an NBFC have to disclose these numbers. **IFIN**'s management contested the RBI's computation method and decided to show positive numbers nevertheless, according to its own definition. **BSR** was convinced that the **IFIN** management was clearly in the wrong. However, they went along with the wrong numbers disclosed in the Financial Statements, contenting themselves with only an Emphasis of Matter (**EOM**) para in the Auditor's Report, when such **EOM** is justified only when the disclosure requirements as per the **SA**s are fulfilled. **Thus, BSR failed to highlight a material misstatement of major magnitude and fundamental importance**.
7. **IFIN'**s reported Profit Before Tax for 2017-18 was Rs **201.96** crores. This was reported after taking credit/not providing for the following:
    a. **Reversal of General Contingency Provision: Rs 225 crores;**
    b. **Unjustified Valuation of a Derivative Asset: Rs 184 crores;**
    c. **Non-provision for Impairment in the value of Investments: Rs 200.20 crores. (This total excludes some investments in respect of which NFRA has not been able to arrive at a specific amount for the impairment)**

    In all the above cases, **BSR** has not obtained sufficient, appropriate audit evidence, as required by the **SA**s, to support the specific numbers finally reported in the Financial Statements. The total of the 3 items mentioned above alone have led to an inflation of the profits of **IFIN** by **Rs 609 crores.**

8. Numerous other violations of the **SA**s have been detailed in the **AQRR**. These deal with the assessment of the use of the Going Concern assumption by the management, the complete absence of the required communication with Those Charged With Governance, inadequate and improper evaluation of the Risk of Material Misstatements, determination of Materiality amounts on the basis of non-relevant factors, etc.
9. The Engagement Quality Control Review (**EQCR**) mechanism was found to be completely inadequate for the intended task.
10. NFRA has also extensively studied the IT processes and platform that are used by **BSR** for their Audit File documentation. **NFRA** found that the IT processes/platform have deficiencies that are systemic and structural in nature, and arise substantially from a complete disregard for basic principles of IT security in the software used. This renders the audit documentation completely unfit for the intended purpose.