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

REPORT No.: 01 / 2020

DATED: 17th August, 2020

NATIONAL FINANCIAL REPORTING AUTHORITY,

GOVERNMENT OF INDIA,

7TH - 8TH FLOOR, HINDUSTAN TIMES HOUSE,

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nfra.gov.in

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LIST OF ABBREVIATIONS

AQR- Audit Quality Review

AQRR- Audit Quality Review Report

AASB- Auditing and Assurance Standards Board

AGM- Annual General Meeting

BOD- Board of Directors

BSR- BSR and Associates LLP (Audit Firm)

CRAR- Capital to Risk Assets Ratio

CAM- Credit Appraisal Memorandum

CARE- Credit Analysis & Research

CGM- Chief General Manager

DAQRR- Draft Audit Quality Review Report

EQCR- Engagement Quality Control Review

EP- Engagement Partner

EL- Engagement Letter ET- Engagement Team

EoM- Emphasis of Matter

EBITDA- Earnings Before Interest, Tax, Depreciation and Amortisation

FY- Financial Year

GCP- General Contingency Provisions

IFIN- IL&FS Financial Services Limited

ILFS- Infrastructure Leasing & Financial Services Limited

ITNL- IL&FS Transportation Networks Limited

ICFR- Internal Controls over Financial Reporting

ICAI- Institute of Chartered Accountants of India

IFAC- International Federation of Accountants Ind AS- Indian Accounting Standards

ICRA- Investment Information and Credit Rating Agency

IAASB- International Auditing and Assurance Standards Board

KAM- KPMG Audit Manual

KPMGI- KPMG International Cooperative KJC- Khandelwal Jain &Co.

NFRA- National Financial Reporting Authority

NOF- Net Owned Funds

NBFC- Non-Banking Financial Company

NPA- Non-Performing Asset

PCAOB- Public Company Accounting Oversight Board

PPT- Power Point Presentation

PPE- Property, Plant and Equipment

PY- Previous Year

PBTCO- Profit Before Tax from Continuing Operation

RBI- Reserve Bank of India

ROMM- Risk of Material Misstatement

RAPD- Risk Assessment and Planning Discussion

SQC- Standard on Quality Control

SA- Standards on Auditing SI-

Systemically Important SCN-

Show Cause Notice

TCWG- Those Charged with Governance

TTSL- Tata Tele Services Limited

WP- Work Paper

WCGW- What Can Go Wrong

Chapter 1: Introduction

1.1 Section 132(2)(b) of the Companies Act, 2013, requires the **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, **NFRA** may-

(a) Review working papers (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 **NFRA**, and the mandate given in this connection, **NFRA** has taken up the AQR of the Statutory Audit of IFIN for the FY 2017-18 (the **"Engagement"**) carried out by **BSR & Associates LLP (Firm Registration No.116231W/W-100024) ("Audit Firm").** This AQR has the objective of verifying compliance with the requirements of SA relevant to the performance of the **Engagement by the Audit Firm**. 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. The observations made here are restricted to some significant deficiencies noted in the Engagement; they do not cover all the deficiencies that may have occurred in the performance of the Engagement by the **Audit Firm**.

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 on10th May, 2019. The **Audit Firm** provided its response to the questionnaire on 6th June, 2019, detailing therein the relevant sections of the **Audit File** pertaining to the several questions. The matters raised in the initial questionnaire of **NFRA** dated 10th May, 2019, were examined by referring to the portion of the **Audit File** relevant as pointed out by the **Audit Firm.** Subsequently, **NFRA** conveyed its prime facie observations/comments/conclusions on the various issues in the questionnaire to the **Audit Firm** vide its letter dated 7th August, 2019. The **Audit Firm** provided

its detailed response to **NFRA**'s prime facie observations/comments conclusions vide its letter dated 30th August, 2019, followed by a subsequent response letter dated 10th September, 2019. **NFRA** also raised additional queries on 23rd October, 2019, which were responded to by the **Audit Firm** on 20th November, 2019. A **Draft Audit Quality Review Report (DAQRR)** was issued on 30th March, 2020. The **Audit Firm** submitted its written reply in response to the **DAQRR** on 30th May, 2020, and followed it up with a presentation to the NFRA on 27th July, 2020. During the presentation, and as a follow up to it, certain additional documents and information was asked for from the Audit Firm. This was provided by the Audit Firm under cover of their letter dated 8th August, 2020. All this has been examined and taken into account while preparing the final **AQRR**.

1.5 A detailed chronology of events mentioned in the above paragraph as well as the references to the correspondence in this connection is placed at **Annexure-I.**

CHAPTER 2: NFRA'S CONCLUSIONS

2.1 GENERAL

2.1.1 **NFRA** has gone through the responses of the **Audit Firm** sent vide their letters dated 30th August, 2019, 10th September, 2019, 20th November, 2019, 30th May, 2020, and 8th August, 2020, and all their enclosures, in detail 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 AQRR on individual issues refers 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 is of the opinion that the appointment of the **Audit Firm** as IFIN's Statutory Auditor was ab initio illegal, and, therefore, void, due to violation of Sections 141(3)(e) and 141 (3) (i) of the Companies Act, 2013. Consequently, the certificate provided by the **Audit Firm** in terms of Section 139 (1) was also fraudulent, having been provided despite such illegality.

2.1.4 Nevertheless, notwithstanding the above conclusion, and subject to such finding, NFRA has gone through the Audit File in order to evaluate the quality of this audit. NFRA's findings given below, on audit quality, are without prejudice to its conclusions on the legality of the **Audit Firm's** appointment as Statutory Auditor of IFIN.

2.1.5 The instances discussed below of failure to comply with the requirements of the SAs are of such significance that it appears to **NFRA** that the **Audit Firm** did not have adequate justification for issuing the Audit Report asserting that the audit was conducted in accordance with SAs. 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). 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 disclosed 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 there was no adequate basis to issue the report that it did.

2.1.6 The AQR is designed to identify and highlight non-compliance with the requirements of the SAs, and to bring out insufficiencies in the Quality Control System of the **Audit Firm** and the shortcomings in the documentation of the audit process. The AQR also evaluates the quality and adequacy of the supervisory procedures of the **Audit Firm.** The AQRR is, therefore, not to be treated as an overall rating tool.

2.2 COMPLIANCE WITH INDEPENDENCE REQUIREMENTS

2.2.1 Several stipulations and conditions to be fulfilled pertaining to the independence of Statutory Auditors are laid down in the following:

a) Companies Act, 2013: Section 141 pertaining to eligibility, qualifications and disqualifications of Auditors. Special note is to be taken of clauses (e) and (i) of Sub-section (3).

b) Companies Act, 2013: Section 144, which lists the non-audit services that an Auditor is prohibited from providing.

c) Companies Act, 2013: Explanation to Section 144 which provides the exact scope of the meaning of the phrase "directly or indirectly".

d) The Chartered Accountants Act, 1949: Sub-section (2) of Section 2, which defines the kind of activities undertaken by a member of the Institute that will result in his being deemed to be in practice. Special note needs to be taken of clause (iv) of Sub- section (2) of Section 2 which empowers the Council of the Institute to specify what services (other than accountancy, auditing, etc.) can be rendered by a Chartered Accountant in practice

e) Regulation 190A of the Chartered Accountants Regulations, 1988: This lays down that a Chartered Accountant in practice shall not engage in any business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council.

f) S1 which provides that the SQC is to be read in conjunction with the requirements of Chartered Accountants Act, 1949, the Code of Ethics, and other relevant pronouncements of the Institute (such as the Guidance Note on Independence of Auditors). It is to be noted that the SQC1 forms part of the SA and hence has the force of law in terms of Section 143 (10) of the Companies Act, 2013. SA 200 (Overall Objectives of the Independent Auditor) also requires that the Auditor comply with relevant ethical requirements, including those pertaining to independence, relating to Financial Statements audit engagements. This requirement also encompasses the need to comply with the Code of Ethics of the ICAI, and SQC1.

2.2.2 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)
>
> *There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance.*
>
> *The Code of Ethics for Professional Accountants, issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:*
>
> *"Independence is:*
>
> *(a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and*
>
> *(b) Independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised."*
>
> *Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly, he is himself satisfied about his independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the auditors' independence.*
>
> *In all phases of a Chartered Accountant's work, he is expected to be independent, but in particular in his work as auditor, independence has a special meaning and significance.*

Not only the client but also the stakeholders, prospective investors, bankers and government agencies rely upon the accounts of an enterprise when they are audited by a Chartered Accountant. As Statutory Auditor of a limited company, for example, the Chartered Accountant would cease to perform any useful function if the persons who rely upon the accounts of the company do not have any faith in the independence and integrity of the Chartered Accountant. In such cases he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do so."

2.2.3 All the above provisions of law have to be read together as a coordinated and integrated whole, in a harmonious manner. On doing so, the following position emerges:

a) The need to maintain independence in mind, and also independence in appearance, is paramount. The provisions of law should be understood keeping in view this paramount consideration.

b) The five categories of threats to independence, as explained by the Code of Ethics, need to be kept in mind. All cases involving provision of any non-audit service to an audit client must be passed through the tests of these threats. In a situation of even the slightest doubt, the conclusion must be that the threat exists and is real.

c) 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 need to maintain 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.

d) Amongst the prohibited services listed in Section 144, the one entry that is the most widely defined is that of "Management Services". This is also not confined to the functional areas of finance and accounting to which all the other entries at clauses (a) to (g) are clearly related. There is no definition of "Management Services" provided in the Act; hence it is to be understood in its literal meaning. "**Management Services" has to be taken as 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 management for the performance of those actions/functions.

e) Reading Section 2 (2) (iv) of the Chartered Accountants Act, 1949, subject to Section 144 of the Companies Act, the conclusion is that as far as any Statutory Audit client is concerned, a Chartered Accountant cannot provide any service falling even under the category of "management consultancy" services, since all such services would be encompassed by the broader category of "Management Services" that stands prohibited by Section 144 of the Companies Act, 2013.

f) As far as any other service, not falling within the scope of the prohibited services listed under Section 144, is concerned, the **Audit Firm** needs to be put to strict proof that the service provision does not attract any of the threat categories.

g) Section 177 of the Companies Act vests with the Audit Committee the responsibility for reviewing and monitoring the independence of the auditor. It is in pursuance of this provision that the non-audit services to be provided by the Statutory Auditor have to obtain the prior approval of the Audit Committee, as laid down by Section 144. This function of the Audit Committee cannot be usurped by the BOD.

2.2.4 In order to examine the extent to which these statutory provisions have been complied with, the Audit Firm was asked to provide details of any services rendered to the client company or its holding company or subsidiary company either directly or indirectly. A list of several services thus provided has been furnished by the Audit Firm.

2.2.5 Keeping the legal principles outlined above in view, NFRA had examined certain engagements where services had been provided by the Audit Firm and its related entities (as defined by the Explanation to Section 144) to either IFIN, or its holding company, ILFS. In all these cases, the Audit Firm was found to have, either directly or indirectly, provided prohibited services to the Auditee Company, or its holding company.

2.2.6 NFRA, in its letter dated 17th January, 2020, asked for the following:

a) Attested copies of ELs along with the Audit Committee Approvals relevant to each engagement for services provided by the **Audit Firm** in respect of invoices of Non- Audit

Fee revenue.

b) Description of deliverables in respect of invoices of Non-Audit Fee revenue.

c) Justification of the assertion that there is no violation of Section 144 as the **Audit Firm**, in its response dated 17th May, 2019, had stated that none of the services provided by them under the invoices violate the provisions of Section 144 of the Companies Act, 2013.

2.2.7 Response of the **Audit Firm** dated 25th January, 2020, is as follows:

a) Several services listed in Annexure of non-audit services of the Affidavit in response dated 17th May, 2019, list out services rendered by KPMG, which is not related to BSR & Associates LLP in the manner provided under Section 144 of the Act. As stated in the Affidavit, the information related to services provided by KPMG was provided only in good faith basis. None of the tests laid down in Section 144 of the Act are satisfied in this regard. BSR does not even use the KPMG name. Accordingly, Section 144 of the Act is wholly inapplicable in so far as the KPMG services are concerned. Hence, none of the services or invoices listed in said Annexure which relate to KPMG are within the scope or purview of Section 144 of the Act.

b) Several invoices listed in Annexure of non-audit service of the Affidavit relate to services that were provided before our tenure as Statutory Auditor. It is pertinent to note that we were appointed by IFIN as a Statutory Auditor on 27th November, 2017, and we resigned on 19th June, 2019. It is our humble submission that all the services that were provided prior to or after our tenure are not covered by the scope and purview of Section 144 of the Act.

2.2.8 NFRA has examined the above contentions of the **Audit Firm** and had concluded as follows in **DAQRR**:

a) The **Audit Firm**'s assertion that KPMG is not related to BSR & Associates LLP in the manner provided under Section 144 is factually incorrect. Also, the claim "*BSR does not even use the KPMG name*" is completely wrong and misleading in light of following:

i. Home page of the eAudit File submitted by BSR & Associates LLP to NFRA itself uses the logo of KPMG.

ii. There are multiple other references to KPMG in the eAudit File of BSR & Associates LLP including the answer to the question "Is this the first period that this KPMG member firm will audit this entity?" in the affirmative.

iii. BSR & Associates LLP has referred to **"KAM"** at various places in its eAudit File.

iv. **Office Address** of Gurugram KPMG and Mumbai KPMG is same as of Gurugram BSR & Co. LLP and Mumbai BSR & Associates LLP respectively.

v. Besides, NFRA has examined the Annual Report in Form 2 for Reporting Year 2018-2019 filed by BSR & Co. LLP to PCAOB (which is available on PCAOB website). In the said filing, BSR & Co. LLP states that it has a) an affiliation with KPMGI that licenses or authorizes audit procedures or manual or related materials, or the use of a name in connection with provision of audit services or accounting services; b) affiliation with KPMG network that markets or sells audit services or through which joint audits are conducted; and c) arrangement with KPMG through which the Firm employs or leases personnel to perform audit services.

As per the filing, KPMGI establishes, and facilitates the implementation and maintenance of, uniform policies and standards of work and conduct by constituent firms and **protects the use of the KPMG name and brand.** (emphasis added). The filing also discloses that BSR & Co. LLP is a member of a network of eight Indian Chartered Accountant LLP/firms (BSR & Affiliates), one of which is BSR & Associates LLP, the **Audit Firm** whose work is now under review. The network is said to have been set up in accordance with the guidelines of the ICAI. The object of the network is said **to be to pool the common resources and exhibit them together before the service user as those belonging to one particular set of professionals.** (emphasis supplied). The network also claims that it complies with all applicable ethical requirements prescribed by the ICAI from time to time.

All the above facts in this sub para, read with the facts disclosed in sub paras to (iv) above, show that the audit network of BSR & Affiliates clearly is a KPMG network of entities, when substance over form is considered. The technical distinction sought to be made, that only BSR & Co. LLP, out of the eight firms/LLPs that are part of

BSR & Affiliates, is a network member of KPMG, is a fig leaf that does not cover anything. Read together with all the above facts, and the requirements of the ethical guidelines, and how they are to be applied, as described above, it is clear that the arrangements explained above are clearly intended only to mislead and deceive. All entities in the BSR & Affiliates network clearly hold themselves out as part of the KPMG network. In summary, it is crystal clear that any entity providing any non-audit services under the KPMG brand name is to be regarded as BSR & Associates LLP providing the said non-audit services indirectly, as contemplated by the explanation to Section 144 of the Act.

Section 144 of Companies Act, 2013, lists the non-audit services that an Auditor is prohibited from providing. It also states that the **Audit Firm** should provide only such other services as are approved by BOD or Audit Committee, as the case may be. Explanation (ii) to Section 144 of the Companies Act, 2013, says:

"*in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or* ***whose name or trade mark or brand is used by the firm or any of its partners.****"*

The **Audit Firm** in the initial response, under affidavit, gave details of various Audit Fee and Non-Audit Fee revenue generated by KPMG from IFIN and its related parties. However, when NFRA asked for ELs for the same services, the **Audit Firm** changed its view and misled NFRA by stating that KPMG is not related to the **Audit Firm**. The **Audit Firm** is not only using the Audit Manual of KPMG but also the Trade Mark and Brand name of KPMG. Thus, KPMG is related to BSR & Associates LLP in the manner provided under Section 144. Therefore, in light of the above, services provided by any entity using the KPMG Trade Mark/Brand Name clearly comes within the scope of directly or indirectly providing non-audit services in the manner contemplated by Section 144 of the Companies Act, 2013.

b) 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 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.

c) The **Audit Firm**, during their tenure as Statutory Auditor, provided non-audit services directly and indirectly for a total sum of **₹2,00,47,554** and **₹6,94,29,520** in FYs **2017-18** and **2018-19** respectively (as shown in below table).

Table 2.2

Non-Audit Service providing firm	FY	Amount (₹)
BSR & Associates LLP	2017-18	22,30,637
BSR & Co LLP	2017-18	10,51,943
KPMG (Registered)	2017-18	88,13,135

KPMG Advisory Services Private Limited	2017-18	26,47,200
KPMG India Private Limited	2017-18	53,04,639
TOTAL		**2,00,47,554**
KPMG India Private Limited	2018-19	5,91,53,083
BSR & Associates LLP	2018-19	10,82,296
BSR & Co LLP	2018-19	15,45,776
KPMG (Registered)	2018-19	76,48,365
TOTAL		**6,94,29,520**

All the above services were either being provided as on 27th November, 2017, the date of appointment as the Statutory Auditor, or were provided during the tenure of such appointment. The **Audit Firm** had earlier submitted five ELs for non- audit services. An analysis of these ELs showed that following three engagements were carried out during the tenure of the **Audit Firm** as Statutory Auditor apart from those listed in Table 2.2 above.

S. No.	Engagement Details
(A)	EL Date: 30th November, 2017 (after appointment as Statutory Auditor) EL Amount: ₹37,50,000 Engagement Servicing Firm: KPMG (Registered) Client Company: IL&FS Limited (Holding Company of IFIN) Services as per EL submitted by the **Audit Firm**: i. Evaluate conformity to investment and divestment process through the transaction lifecycle. ii. Carry out independent post facto review for the transactions identified by the Company. iii. Report deviations in the transactions with no judgement or subjectivity on the impact.
(B)	EL Date: 21st February, 2018 (after appointment as Statutory Auditor) EL Amount: ₹12,50,000 Engagement Servicing Firm: KPMG (Registered) Client Company: IFIN Services as per EL submitted by the **Audit Firm**: i. Current state Assessment and Recommendation on industry leading practices for the following: • Business Continuity Management (BCM) Policy • Business Impact Analysis (BIA) • Business Continuity Plan • Threat Assessment Report and Risk Treatment Plan • Recovery strategies of critical processes identified in the BIA • Functional Recovery Plans for critical processes • BCM sessions to BCM teams

	• BCM Drill calendar ii. Review report of One Table Top Exercise which consist of 5 scenarios. iii. Gaps Report of Evacuation Drill.
(C)	EL Date: 26th July, 2018 (after appointment as Statutory Auditor) EL Amount: ₹2,00,000 Engagement Servicing Firm: KPMG (Registered) Client Company: IFIN Services as per EL submitted by the **Audit Firm**: i. Assist in conducting trainings for the staff from time to time. ii. Training for its client facing staff across levels on key aspects of KYC Direction by RBI and applicable sections of Prevention of Money Laundering Act, 2002.

The observations of NFRA in this regard are as follows:

i. The services are agreed upon and rendered during the course of statutory audit engagement.

ii. The services are clearly in the nature of "Management Services" and are prohibited under Section 144 of the Companies Act, 2013.

iii. Moreover, the services provided did not have the approval of the Audit Committee of the Auditee Company, as required vide Section 144 read with Section 177 of the Companies Act, 2013, even assuming, but not admitting, that the said services did not violate the prohibition under Section 144.

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. This was compounded by further violations of Section 144 of the Act as explained above. The declaration of eligibility submitted by the **Audit Firm**, under Section 139 (1) of the Companies Act, 2013, is therefore, fraudulent.

d) The total revenue generated by BSR & Affiliates from the Auditee Company, its Holding Company and other related companies in the last five years is as follows:

Table 2.3

FY	IFIN	IL&FS Limited	Other Related Entities of IFIN	Total (₹)
2014-15	0	0	64,09,744	**64,09,744**
2015-16	3,34,770	0	52,21,244	**55,56,014**
2016-17	3,28,473	40,734	1,31,13,078	**1,34,82,285**
2017-18	0	28,21,882	1,72,25,672	**2,00,47,554**
2018-19	15,71,128	10,43,284	6,68,15,108	**6,94,29,520**
Total	**22,34,371**	**39,05,900**	**10,87,84,846**	**11,49,25,117**

It may be noted that this revenue does not include services provided by BSR & Affiliates to other group companies of the Auditee Company. This brings out the financial interest of the **Audit Firm** in the client group and also showcases the dependence of the **Audit Firm** on total fees generated from the client group. The **Audit Firm's** compliance with the fundamental principles of independence was completely compromised by the self-interest threat which occurred due to the financial interest and dependence on fees as stated above.

e) Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly, he is himself satisfied about his independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the auditors' independence. Receipt of non-audit services fees amounting to ₹11.5 Crores in a period of 5 years, as opposed to Audit Fee revenue of ₹2 Crores, raises serious doubts over the Independence of the **Audit Firm**.

2.2.9 On consideration of all the above evidence, NFRA concluded as follows in **DAQRR**:

a) 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 144 (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** had grossly violated the provisions of Section 144 of the Companies Act, 2013.

d) The **Audit Firm** had been in serious breach of the Code of Ethics.

e) The 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.

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

g) 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 applicable Accounting Standards.

2.2.10 The **Audit Firm** has responded to the observations of NFRA in their written response dated 30th March, 2020. This has been examined by NFRA carefully and NFRA's final conclusions on each of the issues are as follows:

A **Non-audit Services indirectly rendered by KPMG Entities**

2.2.11 On this subject, the Audit Firm has made the following points:

a) Several services listed in Annexure of non-audit services of the Affidavit, list out services rendered by KPMG, which is not related to BSR & Associates LLP in the manner provided under Section 144 of the Act. The Audit Firm contends that "BSR takes care not to use the name, brand or trademark 'KPMG' for purposes of the professional services that it provides

(including audit services) including on its stationery, letter heads, visiting cards or in its email ids". References to "KPMG" on the eAudit file do not constitute "use" in the sense intended under Section 144. There is a clear difference between the "use" of a name, brand or trademark for the user's external commercial and trade purposes, and the internal use of tools or software which has the owner's brand affixed to it. BSR considers that it is the former meaning that is intended in Section 144. Accordingly, the presence of KPMG's logo in the eAudit file on an eAudit tool that is owned by KPMG International is not "use" by BSR of the "KPMG" name or brand or trademark in the sense intended by Section 144

b) Three other factors are referred to by the NFRA as indicating that there is a relationship between BSR and the KPMG Entities which is relevant to Section 144, which are as follows:

i. Common Mumbai and Gurugram office addresses;

ii. Reference to the PCAOB filing to suggest that 'BSR & Affiliates' network is part of the KPMG network of entities; and

iii. BSR's use of 'KAM' i.e. KPMG Audit Manuals in the eAudit file.

BSR submits that the language in Explanation (ii) to Section 144 does not make these matters relevant to a determination of whether BSR is providing services 'indirectly' to IFIN through a KPMG Entity.

2.2.12 NFRA has examined the above contentions of the Audit Firm and concluded as follows:

a) The Audit Firm's claim that BSR and Affiliates LLP cannot be held to be indirectly providing the services rendered by KPMG in terms of Explanation (ii) to Section 144 is based on the argument that explanation to Section 144 covers within its ambit only the use of the said brand/trade mark for external purposes, and that they do not make such use of the brand/trade mark. This stand is discordant with what is stated in para 2.2.8.v above, based on the filing made by BSR & Co with the PCAOB. The Audit Firm claims that "BSR has access to certain knowledge, tools and databases of KPMG International pursuant to its contractual arrangements with that entity". On being asked during the oral presentation on 27th July, 2020, the Audit Firm confirmed that all the eight constituents of the BSR & Affiliates Network (registered with ICAI) were individually parties to

Tripartite Agreements between KPMGI, KPMG (Registered) India, and the respective BSR entity.

A copy of the Sub License Agreement between KPMGI, KPMG India, and BSR and Associates LLP, has been provided.

KPMG, on their global website, describes itself as a "global network of independent member firms offering audit, tax and advisory services". It is also described as a "global network of independent member firms affiliated with KPMG International Cooperative" All KPMG Member Firms are affiliated with KPMG International. According to KPMG's 2019 Transparency Report, "Audit is the foundation of the KPMG brand and has been the backbone of our business for over 100 years".

An examination of the Sub License Agreement clearly brings out the following:

i. KPMG India is, without doubt, an associate entity of the BSR Network firms in terms of Explanation (ii) to Sec 144.

ii. The objective of the sub license agreement is the "greatest possible protection of the KPMG Marks". The Agreement declares that "effective defense of the KPMG Marks makes it desirable that the KPMG Marks be subject to uniform policies of protection and quality standards".

iii. The sub license agreement is "for the purpose of controlling the use of the KPMG Marks by the sub licensee and defining the relationship of the sub licensee with KPMG International".

iv. Though in very narrow, technical, terms, the sub licensee is not a Member firm of KPMG International, it has "to comply with the obligations of a Member firm under the Statutes and the Policies and the Regulations as if it were a Member firm". It has to "implement and observe all Policies and Regulations necessary or desirable to further the objectives of KPMG International".

v. While numerous obligations on the part of the sub licensee have been spelt out in extensive detail in the Agreement, there is **NOTHING** in the said Agreement about what the sub licensee gets back in return, except for the right to use the Trade Mark/Brand name.

vi. If at all BSR has any access to "knowledge, tools and databases of KPMG International", this is only for the purpose of ensuring protection of the KPMG Brand, the foundation of which, in the words of the Global Head of Audit of KPMG, is Audit, which has been their backbone for over 100 years.

vii. In substance, the sub license agreement is an agreement mainly for the use of the KPMG Brand for audit purposes.

viii. BSR, in effect, admits all the above when it says that even though the sub license agreement allows them to do so, the BSR Firms do not use the KPMG Trade mark or Brand Name due to the restrictions imposed by ICAI. While BSR may be thus complying with the letter of the law, in a very narrow, technical, sense, the real fact is that all BSR entities clearly use the KPMG Brand Name, for both obtaining Audit business, and thereafter to provide them, as is clearly brought out in subsequent paras.

ix. KPMG (India) is also clearly the parent entity of the BSR firms, in terms of explanation (ii) to Sec 144, because the sub license agreement clearly makes it the obligation of KPMG (India) "to cause each of its sub licensees .to comply with the terms and conditions of the sub license agreement and the Policies and Regulations and has further agreed that it shall be fully and unconditionally liable for any non-compliance by such sub licensees with their obligations hereunder and thereunder".

x. Besides, the Operating Territory of a sub licensee can be (unilaterally) expanded or reduced by KPMG International from time to time.

The Audit Firm has also nowhere referred to any public declaration that they are not part of the KPMG network. On the contrary, the filings with the PCAOB extracted above clearly show that the exact opposite is indeed the position. All the instances which clearly mention the affiliation between the audit network of BSR & Affiliates and KPMG network of entities, and the use of the brand name of the latter by the former will have to be considered as conclusive proof of the "Use" of the KPMG brand name within the ambit of Explanation (ii) to Section 144 of the Companies Act, 2013.

Considering the details of the arrangements explained above, all the instances detailed

below further make it clear that the Audit Firm, BSR and Associates LLP, is part of the KPMG Network, and that the entire said Network would come under the purview of explanation to Section 144:

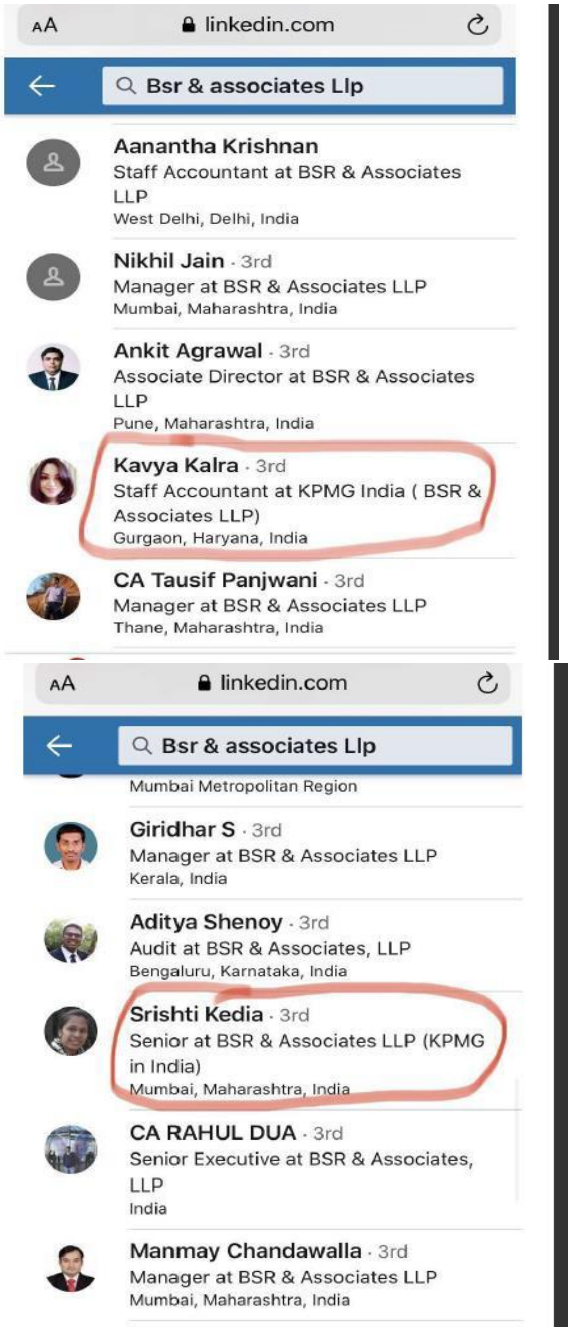
i. When NFRA asked the Audit Firm in its communication dated 25th April, 2019, to submit the details of various Audit Fee and Non-Audit Fee revenue generated directly or indirectly by the Audit Firm from IFIN and its related parties during the FYs 2014-15 to 2018-19, the Audit Firm had itself provided the details of KPMG entities. BSR could not have had access to this information unless KPMG is related to BSR.

ii. Participation of a KPMG Partner, Mr. Shailesh Chaudhary (having an official KPMG email id) as representative of BSR Affiliates in Auditor's Meet at NFRA explicitly clarifies the relationship between the KPMG and BSR Affiliates. (BSR & Associates LLP is part of the BSR Affiliates network)

iii. Several other instances mentioned in **DAQRR** which the Audit Firm has not attempted to refute, such as similar Office Address, affirmative answer of Audit Firm to the question of first period of audit of KPMG member firm, PCAOB filing by BSR & Co., very clearly explain the relationship between the two.

All the above facts show that the audit network of BSR & Affiliates clearly is a part of the KPMG network of entities. All entities in the BSR & Affiliates network clearly hold themselves out as part of the KPMG network. NFRA reiterates its conclusion as mentioned in **DAQRR**, that any entity providing any non-audit services under the KPMG brand name is to be regarded as BSR & Associates LLP providing the said non-audit services indirectly, as contemplated by the explanation to Section 144 of the Act.

b) The **Audit Firm** states that the "use" of the "KPMG" logo on the eAudit file of BSR& Associates LLP is for internal purposes only so as to reflect the ownership of KPMG on the eAudit tool. But in the public perception, BSR & Associates LLP is itself a part of KPMG group. Clearly, even the employees of BSR & Associates LLP do not buy into the position that the use of "KPMG" is only for internal purposes as is shown by the following information available in the public domain.


AA
linkedin.com
Bsr & associates Llp
Aanantha Krishnan
Staff Accountant at BSR & Associates LLP
West Delhi, Delhi, India
Nikhil Jain · 3rd
Manager at BSR & Associates LLP
Mumbai, Maharashtra, India
Ankit Agrawal · 3rd
Associate Director at BSR & Associates LLP
Pune, Maharashtra, India
Kavya Kalra · 3rd
Staff Accountant at KPMG India (BSR & Associates LLP)
Gurgaon, Haryana, India
CA Tausif Panjwani · 3rd
Manager at BSR & Associates LLP
Thane, Maharashtra, India

AA
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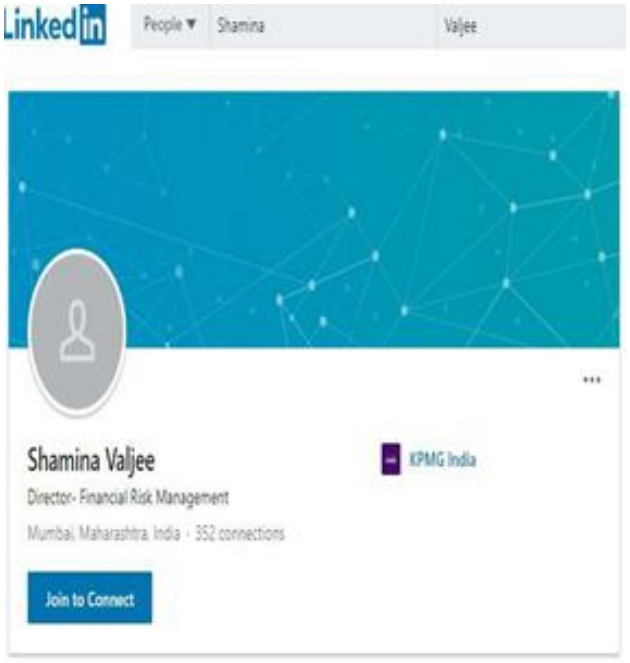
Bsr & associates Llp
Mumbai Metropolitan Region
Giridhar S · 3rd
Manager at BSR & Associates LLP
Kerala, India
Aditya Shenoy · 3rd
Audit at BSR & Associates, LLP
Bengaluru, Karnataka, India
Srishti Kedia · 3rd
Senior at BSR & Associates LLP (KPMG in India)
Mumbai, Maharashtra, India
CA RAHUL DUA · 3rd
Senior Executive at BSR & Associates, LLP
India
Manmay Chandawalla · 3rd
Manager at BSR & Associates LLP
Mumbai, Maharashtra, India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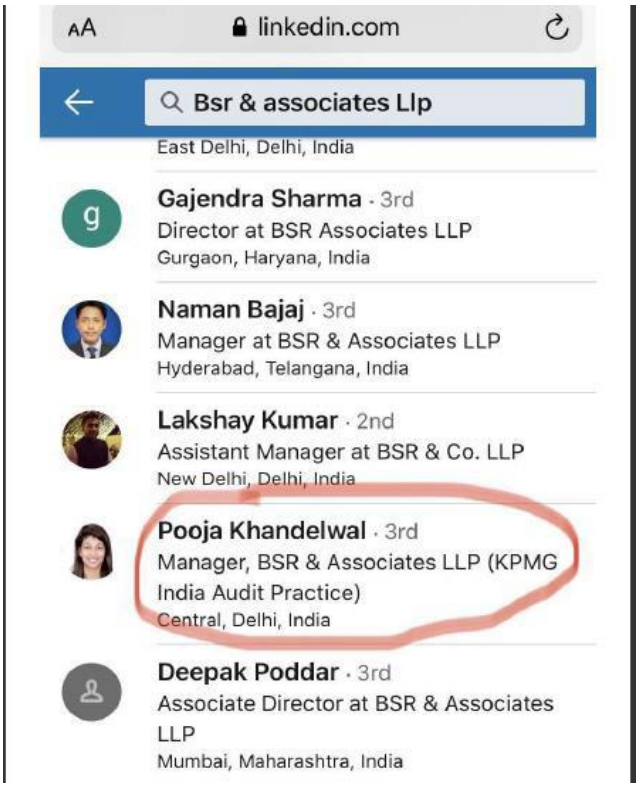
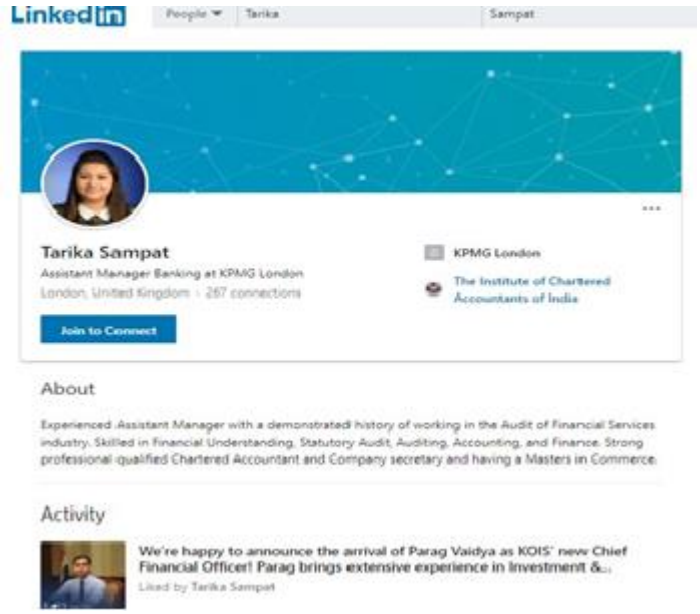
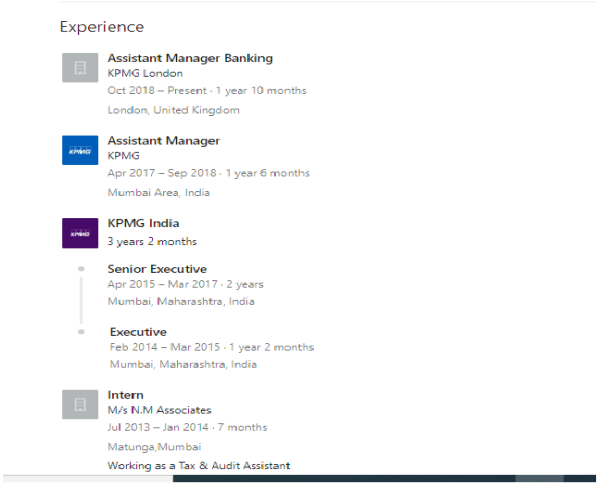
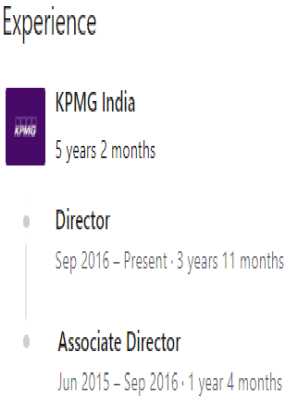
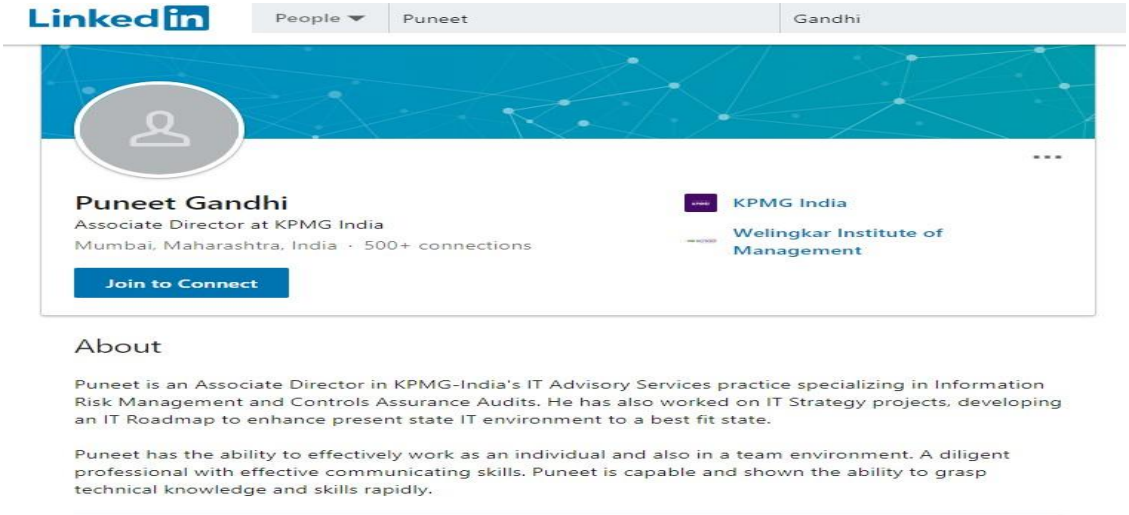
Shamina
Valjee
Shamina Valjee
Director- Financial Risk Management
Mumbai, Maharashtra, India · 352 connections
KPMG India
Join to Connect


AA
linkedin.com
Bsr & associates Llp
East Delhi, Delhi, India
Gajendra Sharma · 3rd
Director at BSR Associates LLP
Gurgaon, Haryana, India
Naman Bajaj · 3rd
Manager at BSR & Associates LLP
Hyderabad, Telangana, India
Lakshay Kumar · 2nd
Assistant Manager at BSR & Co. LLP
New Delhi, Delhi, India
Pooja Khandelwal · 3rd
Manager, BSR & Associates LLP (KPMG India Audit Practice)
Central, Delhi, India
Deepak Poddar · 3rd
Associate Director at BSR & Associates LLP
Mumbai, Maharashtra, India


Linked in
People
Tarika
Sampat
Tarika Sampat
Assistant Manager Banking at KPMG London
London, United Kingdom · 267 connections
Join to Connect
KPMG London
The Institute of Chartered Accountants of India
About
Experienced Assistant Manager with a demonstrated history of working in the Audit of Financial Services industry. Skilled in Financial Understanding, Statutory Audit, Auditing, Accounting, and Finance. Strong professional qualified Chartered Accountant and Company secretary and having a Masters in Commerce.
Activity
We're happy to announce the arrival of Parag Vaidya as KOIS' new Chief Financial Officer! Parag brings extensive experience in Investment &...
Liked by Tarika Sampat


Experience
Assistant Manager Banking
KPMG London
Oct 2018 – Present · 1 year 10 months
London, United Kingdom
Assistant Manager
KPMG
Apr 2017 – Sep 2018 · 1 year 6 months
Mumbai Area, India
KPMG India
3 years 2 months
Senior Executive
Apr 2015 – Mar 2017 · 2 years
Mumbai, Maharashtra, India
Executive
Feb 2014 – Mar 2015 · 1 year 2 months
Mumbai, Maharashtra, India
Intern
M/s N.M Associates
Jul 2013 – Jan 2014 · 7 months
Matunga,Mumbai
Working as a Tax & Audit Assistant


Experience
KPMG India
5 years 2 months
Director
Sep 2016 – Present · 3 years 11 months
Associate Director
Jun 2015 – Sep 2016 · 1 year 4 months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Gandhi
Puneet Gandhi
Associate Director at KPMG India
Mumbai, Maharashtra, India · 500+ connections
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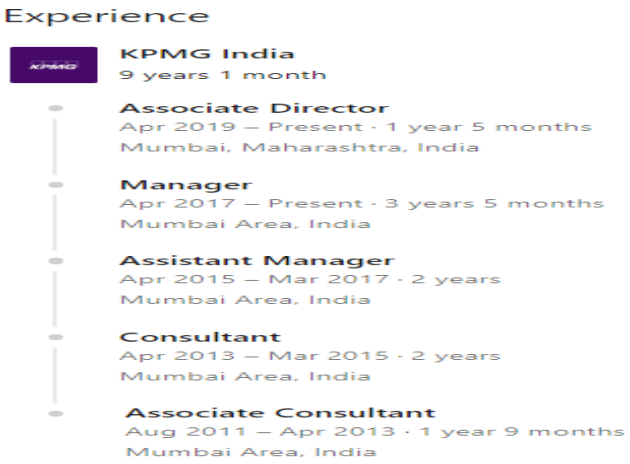
KPMG India
Welingkar Institute of Management
About
Puneet is an Associate Director in KPMG-India's IT Advisory Services practice specializing in Information Risk Management and Controls Assurance Audits. He has also worked on IT Strategy projects, developing an IT Roadmap to enhance present state IT environment to a best fit state.
Puneet has the ability to effectively work as an individual and also in a team environment. A diligent professional with effective communicating skills. Puneet is capable and shown the ability to grasp technical knowledge and skills rapidly.



Even the numerous members of the IFIN audit team for FY 17-18 considers themselves to be a part of KPMG group only, including the Team in charge (Tarika Sampat), FRM Partner (Shamina Valjee), IRM Manager (Puneet Gandhi) and many more. It is also to be noted that some personnel (Shamina Valjee, Bhagyashree Karnik, and Saaransh Kulkarni, have KPMG email ids, contrary to BSR's assertions).

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c) More important is how the Audit Committee of IFIN perceived the matter. In its meeting on 25th April, 2017, the Committee took up the subject of appointment of Statutory Auditors for IFIN, keeping in view the need to rotate out the earlier auditors DHS. The minutes record the following: "The Committee was informed that considering the extensive expertise and experience of M/s BSR & Associates LLP, Chartered Accountants, (**Member of KPMG**) in the audit of companies in the financial services space, it was proposed to appoint M/s BSR & Associates LLP as the Concurrent Auditors". (emphasis supplied). This followed a decision taken at the level of ILFS, the holding company. At the 73rd Audit Committee of ILFS held on 27 February, 2017, the following was recorded: "The Board advised that SRBC & Co LLP (EY), Chartered Accountants, be appointed as Statutory Auditors for Infrastructure Group and BSR & Associates LLP **(KPMG)**, Chartered Accountants, to be appointed as Statutory Auditors for Financial Services". (emphasis supplied).

Given all this, it would be futile for BSR to now contend that they do not obtain audit assignments and provide audit services under the KPMG brand, even if it is assumed for the sake of argument, but not admitting, that the Explanation to Sec 144 applies only to such "external" use of the brand name.

As per Para 3 of Revised Guidelines of Network issued by the ICAI

The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.

Considering all the above facts and circumstances, NFRA is of the clear opinion that BSR & Associates LLP uses the KPMG brand name for the provision of audit services.

B. Non Audit Services Provided in violation of Sec 144 of the Companies Act

2.2.13 As far as this issue is concerned, the Audit Firm has made the following points:

a) Several services listed in the annexure of non-audit services of the Affidavit are services provided by BSR (BSR and Associates LLP) and BSR & Co (BSR & Co LLP) were provided to IFIN's fellow subsidiary and Associate Company of IFIN respectively, and not to the company, its holding company or any of the company's subsidiaries. Therefore Section 144 does not apply in respect of these services. Therefore, there was no requirement to obtain audit committee/ board approval under Section 144.

By BSR **Table (A)**

Sr. No	Non-audit services provided by BSR to	Relationship to IFIN	Type of non-audit service
1	IL&FS Investment Managers Limited	IFIN's Fellow Subsidiary	Accounting advisory under Indian GAAP
2	Mahidad Wind Energy private limited		Indirect related tax services advisory
3	Sipla Wind Energy Private Limited		Indirect related tax services advisory
4	Sabarmati Capital One Limited		RERA related advisory services and GST related advisory services

By BSR & Co **Table (B)**

Sr. No	Non-audit services provided by BSR to	Relationship to IFIN	Type of non-audit service
1	Syniverse Technologies India Private Limited	Associate Company	Assistance in proceedings before income tax Authorities Transfer pricing services; and Assistance in preparing and filing corporate income tax returns

b) All the non-audit services provided by BSR or BSR & Co are in the nature of professional services which are permitted to be rendered by an auditor / Audit Firm under the Chartered Accountants Act, 1949 and the non- audit services provided by BSR or BSR & Co in the relevant period were provided to IFIN's Fellow subsidiaries or Associate Company of IFIN respectively and are not prohibited under Sec 144 of the Companies Act, 2013 as they do not come under the scope of Sec 144.

c) None of the services listed in Annexure of non-audit services of the Affidavit rendered by KPMG Entities in the Relevant Period to IFIN, or the holding or subsidiary companies of IFIN, falls within any category of "prohibited services" which are listed in Section 144.

As per, the ICAI Code of Ethics 2019

"*A firm or a network firm shall not assume a management responsibility for an audit client. Further, under Section 144 of the Companies Act, 2013, where applicable, the restriction also applies to the holding company and subsidiary company of such audit client*." "*Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility."*

Therefore, the understanding of ICAI seems to be that management services prohibited under Section 144 are those that involve assumption of management responsibility.

Based on information provided by the KPMG Entities, BSR understands that the services which were provided by the KPMG Entities to IFIN or its holding company or its subsidiary company in the Relevant period are as follows:

i. Conducting pre-employment background checks on existing employees and applicants being considered for appointment.

ii. Conducting a current state assessment of the IFIN's Business Continuity Management process and providing observations and recommendations basis leading practices.

iii. Carrying out an independent post facto review to check compliance with the client's investment and divestments processes for certain transactions identified by the client.

iv. Providing training to employees on key aspects of KYC Direction by RBI and applicable sections of Prevention of Money Laundering Act, 2002.

As is clear from the descriptions above, such services did not involve assumption of any management responsibility or exercise of any management function or decision-making on behalf of management. In each case, a deliverable or recommendation was provided to the client to enable management, within the client, to take any judgment or decisions that were the proper responsibility of management.

2.2.14 NFRA has examined the above arguments of the Audit Firm and its conclusions are as follows:

i. Admittedly, the term "management services" has not been defined in the Companies Act, 2013. In such situations, the settled principles of statutory construction require that the words used in the statute must be understood in their normal or dictionary sense and be given their literal and direct meaning. While doing so, the context in which the words are used will clearly be important. At the same time, the principles of interpretation would require that no extraneous matter should be brought in as part of the interpretation. Similarly, all the words used in the statute would have to be given their full meaning and no part of the statute can be rendered otiose.

ii. Using these principles, it is clear that the context, which is one of prohibition of provision of non-audit services by the auditor of a company, would mean that "management services" should be interpreted only as services that can be, or potentially can be, provided by the auditor to the management of the company. **Hence, 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 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.**

iii. The Audit Firm's reference to the ICAI Code of Ethics 2019, is not in order, since it did not apply to the relevant period. Nevertheless, considering the facts detailed above, the understanding drawn by the Audit Firm from this Code is clearly incorrect and inapplicable. The argument of the Audit Firm that the term "management services" is the same as "management responsibilities" is unacceptable. If it were indeed the intention of the legislature to prohibit the provision of "management responsibilities" by the statutory

auditor, the term "management responsibilities" would have been directly used instead. It is not anybody's case that there was no widespread ongoing debate about the provision of non audit services, and that the concept of "management responsibilities" was not examined threadbare. If after all this debate, the legislature, in its wisdom, has chosen to use the term "management services", it must have done so for good reason. This choice appears to have been made given the obvious absurdity that would accompany the use of "management responsibilities" because "management responsibilities" mean actions to be done/functions to be undertaken/ responsibilities to be discharged by management, and not services rendered to management, which is what is required by the context in which the term appears. "Management responsibilities" have to be discharged only by management and cannot be done so by others. All others, including auditors, can only help management in discharging such responsibilities by providing them services of various kinds. The Audit Firm cannot derive any support by quoting the Code of Ethics 2019 to say that "*Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility."* That is not NFRA's argument either. However, "*Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities"* is clearly provision of a "management service".

Therefore, NFRA's concludes that

i. The KPMG entities would be covered by the categories of "parent" and "associate" entity as per explanation (ii) to Sec 144 of the Act;

ii. BSR entities make use of the KPMG Brand name/trade Mark for the audit and non-audit services provided by them;

iii. the non-audit services provided by BSR Entities and KPMG entities both come within the purview of the prohibited services, including management services, covered under Section 144 of the Companies Act, 2013.

C. <u>Self Interest Threat</u>

2.2.15 On this subject, the Audit Firm has made the following points:

a) The **DAQRR** does not point to which specific independence requirement under the Code

of Ethics has been breached and how.

b) Paragraph 290.31 of the ICAI Code of Ethics specifically states that the firm should be independent of the audit client during the period of the audit engagement and the period would start when the audit team begins to perform audit services and ends when the audit report is issued.

Paragraph 290.32 of the ICAI Code of Ethics adds that in the case of a financial statement audit engagement, the engagement period includes the period covered by the financial statements reported on by the firm.

Based on the principles in the Code of Ethics we consider that the period comprising of financial years 2017-18 and 2018–19 is the relevant period instead of span of 5 years from FY 2014-15 to 2018-2019 mentioned by NFRA in **DAQRR**.

c) Paragraph 290.21 of the Code of Ethics states that in the case of a financial statement audit client that is a listed entity (as would be the case with IFIN), the firm and any network firms are required to consider the interests and relationships that involve the client's related entities as well. ('related entities' as defined in the Code of Ethics in paragraph (zd) of the definitions section).

The Code of Ethics by itself does not automatically prohibit provision of non-audit services to the audit clients or its related entities (although such prohibitions may exist under other laws, for instance, under Section 144 of the Act).

d) Considering the conclusion by NFRA that a self-interest threat existed because of financial interest and dependence on the non-audit fees from IFIN, IL&FS and other related parties of IFIN, amounting to a total of approximately INR 1,149 Lacs earned by BSR Entities and KPMG Entities over a period of 5 years, we do not consider it as reasonable as this figure represents less than 0.97% of the overall revenues of the BSR Entities for the financial year 2017-2018 and less than 0.85% for the financial year 2018-2019.

Considering only the relevant period and BSR entities, the total fees earned from non-audit services provided to IFIN and all the related entities of IFIN did not exceed INR 59.2 Lacs which is much lower than the audit fee (INR 246 Lacs). The level of fees earned by the BSR Entities from non-audit services in the Relevant Period comply with the ICAI's Notification of 2002 and the ICAI's Guidelines on Networking, 2011, which provide for

fee caps.

2.2.16 NFRA has examined the above contentions of the Audit Firm and has concluded as follows:

a) The **DAQRR** has specifically mentioned the breach of 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.

b) As per Paragraph 290.32 of the ICAI Code of Ethics, the firm should also consider any independence threats created by:

Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or Previous services provided to the audit client

The above statement makes the period beginning from FY 2014-15 to FY 2018-19 as a relevant period instead of what has been claimed by Audit Firm. Audit Firm has only considered the partial meaning of the ICAI Code of Ethics.

Moreover, 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" **is ineligible to be appointed** as the auditor of the company. As BSR Entities were engaged in providing prohibited services under Section 144 on the date of appointment as auditor, it makes the span of FY 14-15 to FY18-19 relevant. Furthermore, as KPMG Entities and BSR Entities have already been shown, in the earlier paragraphs, to be covered as related entities as per Explanation to Section 144 of the Companies Act, 2013, the non-audit revenue of both BSR Entities and KPMG Entities is relevant.

c) The **Audit Firm**, during the oral submission made to NFRA on 27th July, 2020, stated that the revenue from the non-audit services for the FY 18-19 provided by KPMG India Private Limited to IL& FS Transportation Networks Limited (amounting to ₹5.9 Crores), does not belong to the relevant year. Even though no such point was raised in any of the written communications from the Audit Firm earlier (and it was clearly explained to the Audit Firm that no new issues should be raised in oral hearings as three opportunities had already been given), NFRA, nevertheless, has examined the point and observes as follows:

i. The information regarding the audit and non-audit revenue of KPMG Group was provided by the Audit Firm itself. Clearly, when the information was given, the Audit Firm itself had conceded that the same was relevant.

ii. The revenue amounting to Rs 5.9 Crores belongs to a common audit service, *Advisory assistance in relation to asset sale bid.* There were multiple invoices raised for the service which started from 26th June, 2018, the date before the signing of Consolidated Financial Statement, which makes the engagement relevant.

iii. NFRA in its previous communications (letter dated 29th September, 2018) had asked for the engagement letters related to all audit and non-audit revenues, but the Audit Firm did not provide the same.

iv. It may be noted that the Audit Firm resigned from IFIN on 19th June, 2019. Hence, they were still the Auditor for the Firm at the time of accepting the engagement.

v. NFRA would also like to draw attention to the extract from ICAI's Guidance Note on the Independence of Auditors that has been provided in para 2.2.2 above which reads as follows: "*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".***

d) The Audit Firm's use of definition of related entities as per the ICAI Code of Ethics is not relevant in view of Sections 141 and 144 of the Companies Act, 2013. As shown by Table 2.2 in the **DAQRR**, non-audit fee income over the five years ending with the audit period was many times higher than the statutory audit fees and was significant enough to pose a major self-interest threat. Receipt of non-audit services fees amounting to ₹11.5 Crores in a period of 5 years, as opposed to Audit Fee revenue of ₹2 Crores, raises serious doubts over the Independence of the **Audit Firm**.

D. Ineligibility to be appointed as Auditor of IFIN

2.2.17 In the light of the detailed examination made above, NFRA's conclusions on the validity of the appointment of the Audit firm as IFIN's auditor are summarised below:

a) What is comprehended by the term "management services" has already been gone into at great length and the Audit Firm has not brought out any new point to counter the NFRA's stand.

b) Sec 141(3)(e) prohibits the appointment of an auditor who, whether directly or indirectly, has a "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. Read in the context of Sec 141(3)(i), the prohibition imposed by Sec 144, and Rule 10(4) of the Companies (Audit and Auditor) Rules, 2014, the non-audit services provided by the BSR network and the KPMG entities demonstrate a business relationship which disqualifies BSR and Associates LLP, from initial appointment as auditor, for violation of Sec 141(3)(e) and from continuing as such for violation of Sec 141(4).

Moreover, the services provided did not have the approval of the Audit Committee of the Auditee Company, as required vide Section 144 read with Section 177 of the Companies Act, 2013, even assuming, but not admitting, that the said services did not violate the prohibition under Section 144.

It renders the appointment of the Audit Firm as auditor of the company void ab initio.

2.2.18 **In view of the above, NFRA is reinforced in its views that:**

a) 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 144 (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** had grossly violated the provisions of Section 144 of the Companies Act, 2013 by the indirect provision of prohibited services.

d) The **Audit Firm** had been in serious breach of the Code of Ethics.

e) The 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.

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

g) 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 applicable Accounting Standards.

2.3 COMMUNICATION WITH TCWG

2.3.1 The prima facie conclusion of **NFRA** on the above matter, vide its communication dated 7th August, 2019, was that:

a) There is no evidence of the Audit Plan having been communicated to TCWG.

b) The requirements of Para 10 & 11 of SA-230, amongst other applicable standards, have not been met.

c) No reference or evidence was produced in eAudit File to show that "what matter/audit observation was discussed and when" with TCWG/Audit Committee/Management, prior to the date of signing of Audit Report and Financial Statements. Further, there was a single WP attached i.e. 4.7.2.30 relating to discussions of significant matters with management dated 28th May, 2018, i.e. the Financial Statements signing date. The documentation was merely for record purpose, and not in line with Paras 9,14,15,16 and 21 of SA-260 and other SAs.

d) The statement about "…. management representations obtained…." relate to the requirement of SA 580, not to SA 230.

2.3.2 The **Audit Firm,** in its response dated 30th August, 2019, had stated as follows:

a) This was the first year of audit of the company and the **Audit Firm** was appointed only around the end of November 2017. Further, it required preliminary work before the scope and timing of audit could be planned and postulated.

After accepting the engagement and communicating with the Joint **Audit Firm**, the audit commenced in January 2018 and the ET took time to understand the entity, its business and perform its risk assessment procedures and therefore they could not present the same at the meeting of TCWG held on 29th January, 2018. There was no meeting of TCWG until 28th May, 2018. The scope was communicated to TCWG vide their presentation in meeting dated 28th May, 2018 (Slide 6 to 10).

b) During engagement, the **Audit Firm** complied with the SA 230 and other applicable SAs

and the same were documented in the WP no. 4.7.2.30, 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20 of eAudit File.

c) Nothing was identified that triggered an earlier communication with TCWG and hence the same was not done [Para A50 of SA 260 (revised)], although, Para 23 of SA 260 (Revised) was complied with and the communication with Audit Committee (TCWG) was documented in the Audit File in WP no.4.7.2.30. In this WP, analysis was made regarding the complaint received through RBI, and the report of KJC. The key matters discussed with the Management (MD, CFO and Director) regarding the NOF/CRAR, identified loans and transaction relating to Tata Tele and Siva Green are recorded/documented in WP no. 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20 of eAudit File.

d) The management representation sought and obtained from the Management is also 'correspondence'. Further, in accordance with the requirement of Paras 13 and A15 of SA 580, a written representation from the Management as on the date of signing of the Financial Statements was taken as added evidence/confirmation for various verbal representations that the Management has made throughout the audit process. Further, the preamble in page 1 of the representation letter clearly mentioned that '*These representations are made to you to supplement the information obtained by you from the books and records of the company and to confirm the information given to you'.*

e) Practically the issues or matters of communications are collated over the period of audit and confirmed by the Management towards the closure. And in highly exceptional cases, communication regarding significant matters with Audit Committee is through a presentation made just before the accounts are approved by the Audit Committee/BOD.

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

a) The **Audit Firm** has admitted that they have failed to communicate an overview of the planned scope and timing of the audit to TCWG. It clearly indicates that the **Audit Firm** has been negligent in compliance with SA 260 revised and SA 300.

b) Further, the **Audit Firm** has mentioned that they discussed the complaint letter and report of KJC along with other matters communicated by RBI with TCWG through WP 4.7.2.30. The presentation in WP 4.7.2.30 summarizes the findings in the report of KJC, which the **Audit Firm** wished to discuss with the Audit Committee, as follows: -

- KJC has submitted their report on the above review in May, 2018. Following are the key observations which we would like to discuss with the Audit Committee:
  - Security cover was not maintained per sanction norms;
  - Sanctions to some of the identified groups despite withdrawal of credit rating by rating agencies and comments of CRMG & Risk;
  - Unavailability of CIBIL scores in some cases;
  - Delays in regularization of disbursement memos 2 cases;
  - Report on financial/ appraisal required sanction terms not on record, compliance of covenants per sanction terms pending;
  - Certain periodic reports stipulated in sanction terms not obtained.

However, none of the Audit Documents show what the findings and views of the **Audit Firm** were on the report of KJC. It was incumbent on the **Audit Firm** to critically examine the findings of KJC by gathering sufficient appropriate audit evidence and not merely accept the same at face value. The Audit File does not indicate any such examination/evaluation/gathering of the evidence by the **Audit Firm**. The Audit File does not also record what was actually discussed with TCWG and how the **Audit Firm** satisfied itself that the concerns raised by KJC were appropriately addressed by the Management. Just reiterating all the issues raised by KJC in the presentation does not absolve the **Audit Firm** from its duty to obtain sufficient appropriate audit evidence about what actions were taken by the Management or the Audit Committee in those matters.

Further Para 23 of SA 260 (Revised) states that: -

Documentation

Para 23. Where matters required by this SA to be communicated are communicated orally, the Audit Firm shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the Audit Firm shall retain a copy of the communication as part of the audit documentation. (Ref: Para. A54)

Para A54. *Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication.*

Therefore, the **Audit Firm** while preparing the WP no. 4.7.2.30 did not comply with **Para 23 of SA 260 (Revised).**

c) The **Audit Firm** has contended that key matters discussed with the Management (MD, CFO and Director) are recorded and documented in Five Working Papers viz. 4.7.2.30, 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20. **NFRA** has gone through each of these WPs and has found the following:

i. WP 4.7.2.30: This is the PPT of Presentation to the Audit Committee on 28th May, 2018. For the reasons already explained above, this cannot be construed as communication with TCWG, so as to satisfy the requirements of SA 260.

ii. WP 2.5.2.10: This is the minutes of a meeting with Mr. Ramesh Bawa, MD and CEO, in which the matters regarding RBI Inspection Report, ever greening, general contingences and other related issues were discussed. Apart from summarizing the views of the MD on these issues, the conclusions of the **Audit Firm**, if any, and their communication to TCWG etc. are not to be found in the said minutes.

iii. WP 2.5.2.20: This is the minutes of a meeting with Mr. Deepak Pareekh, CFO of IFIN, in which same matters as mentioned in WP 2.5.2.10 were discussed, and the same replies were given by CFO. Apart from summarizing the views of the CFO on these issues, the conclusions of the **Audit Firm**, if any, and their communication to TCWG etc. are not to be found in the said minutes.

iv. WP 2.5.2.30: This is the minutes of a meeting with Mr. Arun Saha, CRO of IFIN, in which the same matters regarding NOF/CRAR as mentioned in WP 2.5.2.10 WP 2.5.2.20 were discussed. CRO had referred most of the issues for discussion with MD or CFO. Apart from summarizing the views of the CRO on these issues, the conclusions of the **Audit Firm**, if any, and their communication to TCWG etc. are not to be found in the said minutes.

v. WP 4.2.1.20: This is the minutes of a meeting with Mr. Ramesh Bawa, MD and CEO, in which the matters regarding RBI, ever greening and other related issues were discussed. Apart from summarizing the views of the MD on these issues, the conclusions of the **Audit Firm**, if any, and their communication to TCWG etc. are not to be found in the said minutes.

Thus, as seen above, all the four documents at (ii) to (v) above were minutes of meetings held with Management. These documents were prepared in a very casual manner. For example, in all the documents, it was noted that the meeting **was to be held;** after **every para the reply of management to the issue** was included. No evidence in the audit documentation was found that proves that the meeting had actually taken place. Therefore, these minutes of meetings between the **Audit Firm** and the Management cannot be construed as Communication with TCWG.

d) WPs- 4.7.2.30, 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20 of eAudit File had a major discussion on RBI Matters which directly affected the existence/ going concern assumption of the organization. There were many other serious issues which have been discussed in other parts of this **DAQRR**. Therefore, the statement of **Audit Firm** that "*In the course of our audit, we did not identify anything that caused us to trigger an earlier communication and hence this was not done*" clearly shows very poor judgement on the part of the ET.

e) Para 9 (c) and 21 of SA 260 emphasize the **timely** communication of significant matters to the appropriate person or the authority. Therefore, the statement of **Audit Firm** that "in practicality the issues or matters of communications are collated over the period of audit and confirmed by the Management towards the closure. And in highly exceptional cases, the **Audit Firm** communication regarding significant matters with Audit Committee is through a presentation made just before the accounts are approved by the Audit Committee/BOD" shows clear non-compliance with SA 260.

f) The **Audit Firm** has not considered the provision of Para A21 of SA 300 which provides for the additional considerations in case of initial audit engagements. The **Audit Firm** in their response has admitted that they were unable to communicate with the TCWG any time before the date of signing of audited Financial Statements. The **Audit Firm** has failed to document the additional matters, including any major issues (including the application of accounting principles or of auditing and reporting standards), discussed with the Management in connection with the initial selection as **the Audit Firm**, the communication of these matters to TCWG and how these matters affected the overall audit strategy and audit plan in accordance with Para A21 of SA 300.

g) **NFRA** has examined all the working papers mentioned by the **Audit Firm** and observes that all these documents were modified after the completion of audit. Hence, it is difficult to rely on these working papers –

Working Paper No.	Created by and date of creation	Meeting date	Modified on
2.5.2.10	Ruchi Telang 23rd January, 2018	3rd April, 2018, at 12.30 pm.	24thJuly, 2018
2.5.2.20	Ruchi Telang 23rd January, 2018	3rd April, 2018, at 10.30 am	24thJuly, 2018
2.5.2.30	Ruchi Telang 23rd January, 2018	3rd April, 2018, at 11.30 am.	24th July, 2018
4.2.1.20	Tarika Sampat 24th May, 2018	16th May, 2018 on Call	25thJuly, 2018

2.3.4 **NFRA**, therefore, concluded as follows in **DAQRR**:

a) The **Audit Firm** has not complied with SA 260 and SA 300 by failing to communicate an overview of the planned scope and timing of the audit to TCWG.

b) The WPs quoted by the Management are either the presentation made to the Audit Committee or minutes of meetings with Management. These cannot be construed as communication with TCWG, so as to satisfy the requirements of SA 260.

c) The **Audit Firm** has clearly shown very poor judgement by concluding that they did not find anything to trigger a communication with TCWG. The **Audit Firm** was grossly negligent in the discharge of its professional duties.

d) The **Audit Firm** has failed to communicate significant matters in a timely manner to appropriate persons or TCWG and has thus failed to comply with Para 9 (c) and 21 of SA 260.

e) The **Audit Firm** has failed to document the additional matters including any major issues discussed with the Management in connection with the initial selection as Auditor, the communication of these matters to TCWG and how these matters affect the overall Audit Strategy and Audit Plan in accordance with Para A21 of SA 300.

f) All the documents quoted by the **Audit Firm** were modified after the completion of audit creating a doubt on the integrity of the Audit File.

g) In the absence of any documentation that conforms to the requirements of the SAs, **NFRA**

concludes that there has been virtually no communication with TCWG, and that, therefore, the **Audit Firm** has completely failed to comply with the requirement of SA 260.

2.3.5 After examining the responses of the Audit Firm to the DAQRR, NFRA concludes as follows:

a) The objective of the SA 260 (Revised) is to communicate with TCWG on timely basis and to provide timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process. The **Audit Firm** has not been able to show a single communication with TCWG in this regard.

Further, the Audit Firm itself has admitted that except for the engagement letter given to the company as acceptance to be a joint auditor, and the final presentation made to the Audit Committee on 28th May, 2018, there was no other communication that was made to the Audit Committee/Management/TCWG. The Audit Firm has also admitted that they have failed to communicate an overview of the planned scope and timing of the audit to TCWG.

Though each slide of the PPT in WP 4.7.2.30 has a heading reading "Significant Matter Discussed with the Management" none of the slides have any judgements and estimates on any matter that were provided by the auditor. They only have details/information about management estimates and Auditee representation. Therefore, the argument of the **Audit Firm** that "*The ET had also communicated in writing the …… ……..., **key judgements and estimates and all significant accounting and auditing matters (in response to our planned audit work)** to TCWG in the meeting held on 28 May 2018*."is not valid. Therefore, the **Audit Firm** while preparing the WP no. 4.7.2.30 did not comply with Para 23 of SA 260 (Revised).

b) In eAudit File, no Working papers were found where the ET had reviewed the responses provided by Management to the various issues which were highlighted in the KJC report. **It was incumbent on the Audit Firm to critically examine the findings of KJC by gathering sufficient appropriate audit evidence and not merely accept the same at face value. The Audit File does not indicate any such examination/evaluation/gathering of the evidence by the Audit Firm. The Audit File does not also record what was actually discussed with TCWG and how the Audit Firm satisfied itself that the concerns raised by KJC were appropriately addressed by the Management.**

The assertion made by the **Audit Firm** that "*The ET had reviewed the responses provided by Management to the various issues which were highlighted in the KJC report (Refer "6. Special Purpose Review Khandelwal Jain & Company Report (Pg S630 to Pg S645)" in folder "5. IFIN March 2018 File no. S – Others" in folder "Other workpapers" in our Audit File).* ***Based on the said responses, ET had concluded that the matters highlighted did not have a material effect on financial statements"*** is clearly a false statement knowingly and deliberately made to mislead the NFRA. All the 16 pages referred to (S630 to S645) are only the Report of KJC. That this finds a place in the Audit File is the only matter that can be asserted. There is no evidence that this was even read in its entirety by any responsible person in the **Audit Firm**, leave alone reviewing the responses provided by Management (since no such responses find place in the pages quoted in support) and thereafter concluding, on the basis of such responses that the matters highlighted did not have a material effect on the financial statements.

c) While examining WP 2.5.1.10 of eAudit file, NFRA observed that it is an Excel sheet with summary of all minutes of meetings of different committees where the matters under consideration in different paras of this report were discussed in the respective committees. Based on above mentioned WP the argument of the **Audit Firm** that "TCWG were aware of these matters and hence the ET believed that there was no trigger for an earlier communication without forming our opinion" is only to be read as an admission of total failure to comply with the requirements of SA 260 (Revised). As per SA 260 (Revised) and other relevant SAs, it is the responsibility of the auditor to share its observation on significant issues to the TCWG on timely basis, for example: issues arising out in the RBI's inspection report that needed to be brought to the attention of TCWG and discussed with them before final decisions on audit evidence, presentation and disclosure in the financial statement etc. were taken . It should also be reckoned that TCWG comprises of all the members of Board and The Management. The **Audit Firm**, by referring to its single presentation, and that also to the Audit Committee, is trying to showcase the same as Communication with TCWG. This is just an eye wash, an afterthought and an attempt to mislead NFRA.

d) The opinion of NFRA on WP 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20 is same as given at **DAQRR** stage as no new evidence is provided by the **Audit Firm**.

e) The argument given by the auditor related to compliance with Para A21 of SA 300 is completely unrelated to the opinion/conclusion /observation of NFRA provided in the

DAQRR. In **DAQRR**, the matter highlighted by the NFRA was related to the communication with the TCWG as described in Para A21 of SA 300: *"Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.*". Therefore, the reference of WPs and explanation given by the Auditor have no connection at all with the above opinion in the **DAQRR**.

f) In Para 6a of SA 230, the definition of Audit documentation is – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "workpapers" are also sometimes used). So, when the document used as audit evidence on which the conclusions of the auditor is based, it becomes a critical duty for the ET to prepare them very neatly and carefully. The casual approach of the ET while preparing these WPs 2.5.2.10, 2.5.2.20, 2.5.2.30 and 4.2.1.20 can be easily noticed. Thus, the explanation provided by the **Audit Firm** for the modification in documents with reference to SA 230 is completely baseless because sorting, collating, cross-referencing final audit documentation for completing the documentation and assembling the audit evidence into the Audit File will not change the document creation date. Further, the **Audit Firm** has also not made any attempt to show that no "*new audit procedures or drawing new conclusions"* was carried out on the date of modification creating a doubt on the integrity of the Audit File.

2.3.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm** has not complied with SA 260 and SA 300 by failing to communicate an overview of the planned scope and timing of the audit to TCWG.

b) The WPs quoted by the Management are either the presentation made to the Audit Committee or minutes of meetings with Management. These cannot be construed as communication with TCWG, so as to satisfy the requirements of SA 260.

c) The **Audit Firm** has clearly shown very poor judgement by concluding that they did not find anything to trigger a communication with TCWG. The **Audit Firm** was grossly negligent in the discharge of its professional duties.

d) The **Audit Firm** has failed to communicate significant matters in a timely manner to appropriate persons or TCWG and has thus failed to comply with Para 9 (c) and 21 of SA 260.

e) The **Audit Firm** has failed to document the additional matters including any major issues discussed with the Management in connection with the initial selection as Auditor, the communication of these matters to TCWG and how these matters affect the overall Audit Strategy and Audit Plan in accordance with Para A21 of SA 300.

f) All the documents quoted by the **Audit Firm** were modified after the completion of audit creating a doubt on the integrity of the Audit File.

g) In the absence of any documentation that conforms to the requirements of the SAs, **NFRA** concludes that there has been virtually no communication with TCWG, and that, therefore, the **Audit Firm** has completely failed to comply with the requirements of SA 260.

2.4 RBI INSPECTION MATTERS– NOF/CRAR

2.4.1 In its communication dated 7th August, 2019, **NFRA** had conveyed its prime facie conclusions as follows:

a) **Policy Document:** The policy document approved by the BOD in October 2007 is absent in the Audit File. The WP referred to by the **Audit Firm** is not a policy document but a letter written by the Management. In light of Para 9 of SA 500, the ET has failed to obtain sufficient appropriate Audit Evidence.

b) **Definition: With regard to definition of companies under the same group–**

i. Explanation (II) to Section 45-IA of the RBI Act, 1934 provides that 'subsidiaries' and 'companies in the same group' shall have same meaning as assigned in Companies Act, 1956. The extract from the Board's decision is in contravention of this explanation.

ii. The Companies Amendment Act, 1999, inserted one clause each in Sections 370 and 372. The clauses made the respective sections inoperative. However, neither of the two sections was repealed or deleted and other Acts continued to contain valid references to these sections.

iii. In 2002, the Expert Committee of the ICAI opined that the requirement to report under Sections 370 or 372 in Schedule VI to the Companies Act, 1956, or MAOCARO, 1988, remained unaffected. The same logic would apply in the present case with respect to definition of 'companies in the same group'.

iv. Section 465 (2) (c) of the Companies Act, 2013, states that any rule of law shall not be affected by the repeal of the erstwhile Act.

v. Clause 3(vi) of NBFC (SI-ND) RBI Directions, 2016, includes a definition of 'companies in the same group' that is in pari materia with the earlier definition.

vi. The **Audit Firm** accepted the Management's position in contravention of the true legal position as enumerated above.

c) **EoM**: As per Para A3 of SA 706, the EoM paragraph is not a substitute for a qualified, or adverse, or disclaimer of opinion, and for appropriate disclosures in the Financial Statements. As a result, the EoM was inappropriate and soft reporting of a serious matter.

d) **Financial Impact:** NOF/CRAR ratios are important to users of the Financial Statements. The Management calculated these ratios in a different form, non- compliant with the RBI Inspection Reports. This method of calculation resulted in a significant variation from the actual. The impact of this non-compliance ought to have been disclosed. The **Audit Firm** failed in this respect. Further, the **Audit Firm's** own admitted view that the Auditee needs to follow RBI's instructions on its reporting of NOF/CRAR (Response of **Audit Firm** to Question No 12.3 in its letter dated 6th June, 2019) was not appropriately expressed in the Audit Report. This can be observed from an absence of NOF/CRAR calculation as per RBI in the Audit Report.

e) **Management Bias and a Lack of Independent Analysis:** With respect to the **Audit Firm**'s discussion with the Senior Management about NOF/CRAR, the former failed to consider possible bias in latter's judgements as per Para 12 of SA 700. The RBI's inspections and their directions were of utmost importance for the business of the Auditee. It was incumbent upon the EP to comprehensively analyze and examine the audit processes, judgements and conclusions of the ET relating to this matter and exhaustively document his own judgements and conclusions giving the detailed reasoning therefor.

f) **Minutes of Purported Meeting with RBI:** NFRA has assessed the Auditor's submission vide Annexure 5, despite the fact that such Annexure does not form part of the true copy of Audit File as submitted to the Authority. It is noted that these documents are nothing but the company's internal documentation of matters discussed in the RBI office. In no circumstances can these be construed as approved minutes of the meetings since the counter-party, i.e. RBI's officials, have not signed these documents. Therefore, in light of Paras 9 and 11 of SA 500, as stated above, these WPs cannot be construed as valid evidence. Thus, the argument of the **Audit Firm** that "In November 2017, the RBI provided the Company time till 31st March, 2019, to reduce its group exposures so as to be in line with the RBI's views on how group exposures should be reckoned for the purposes of NOF computations", cannot be accepted at all. This shows gross negligence and the total lack of

due diligence on part of the ET.

g) **Conclusion:** Hence, the evidence on record goes on to conclusively prove that the **Audit Firm** has:

i. Failed to disclose material facts known to them which are not disclosed in the Financial Statements, but disclosure of which is necessary in making such Financial Statements where they are concerned in a professional capacity.

ii. Failed to report material misstatement known to them to appear in the Financial Statements.

iii. Not exercised due diligence, and have been grossly negligent in the conduct of their professional duties.

iv. Failed to obtain sufficient information which was necessary for the expression of opinion, or its exceptions negate the expression of an opinion.

v. Failed to invite attention to any material departure from the generally accepted procedure of audit applicable in the circumstances.

2.4.2 The **Audit Firm** in its responses dated 30th August, 2019, and 10th September, 2019, has stated as follows:

a) **Policy Document**

i. The **Audit Firm** has stated that they had cited and examined the "extracts" of the Company Policy in the letter to RBI dated 24th May, 2016.

ii. Further, the **Audit Firm** has quoted Para 5(c) of SA 500 and stated that the above-mentioned letter can be taken as Audit Evidence which is obtained from other sources.

iii. Referring to Para 11(b) of SA 500, the **Audit Firm** has stated that nothing came to their attention to have doubts over the reliability of the letter (extract of the Auditee's policy which was reproduced in the Auditee's letter to the RBI).

iv. The **Audit Firm** goes on to indicate that the Joint Auditor who had significant understanding and knowledge of the history of the Auditee did not bring to their attention the fact that the letter could not be relied upon.

v. Quoting Para A31 and A33 of SA 500, the **Audit Firm** has stated that considering the fact that the source and the nature of the document relied upon by them is one which was submitted to the RBI, in their view, it was not essential to obtain and keep a certified copy of the original BOD resolution.

vi. Accordingly, the **Audit Firm** believes that they have obtained sufficient appropriate Audit Evidence.

b) **Definition of Companies under the Same Management**

i. The **Audit Firm** has stated that the BOD adopted their own definition, which was being used for the last several years, for 'companies under the same management'. Further, the Board argued that since Section 370 (1B) was no longer applicable, they had the discretion to define the term on the basis of prudence and judgement.

ii. The RBI Inspection Report made the observation that the methodology followed by the Auditee was incorrect and that it should follow definition as per RBI. The Auditee, on the other hand, based its argument on Section 372A since Section 370 (1B) was no longer applicable in their view.

iii. In its report dated 1st November, 2017, the RBI had stated that the Auditee shall use the former's definition for group exposure while computing NOF/CRAR. Further, the RBI allowed the Auditee time until 31st March, 2019, to be compliant with the above requirement and to submit a road- map.

iv. The **Audit Firm** has stated that the matter was contentious and that there were several discussions between the Auditee and the RBI officials. After detailed discussions, the Auditee decided to implement RBI's views and comply with it by 31st March, 2019. In its meeting of 28th May, 2018, the Board resolved to not lend to "group companies" and to reduce its existing group exposure.

v. The **Audit Firm** has said that certain interpretational matters arose out of the definition of the term 'companies under the same management' and the RBI did not raise a concern until 2015. Further the aspect was disclosed in detail in the Financial Statements and accordingly no reporting was required under SA 705 / SA 250.

c) **Emphasis of Matter**

i. The **Audit Firm** stated that EoM Para and exception reporting to RBI was done for the first time in the year they became the Joint Auditor and not earlier.

ii. The **Audit Firm** has taken a view that the Auditee shall follow RBI's advice on NOF/CRAR.

iii. The **Audit Firm** insisted that a detailed note be given in the Financial Statements so that readers are aware of change in method of NOF/CRAR computation. However, when the **Audit Firm** recognised that the Auditee had decided to change the method of computation, the former decided to issue a report in the form of an EoM Para.

iv. The **Audit Firm** took a considered decision in the matter and in doing so, they obtained sufficient information necessary for expression of opinion. The **Audit Firm** further submitted that they did not identify any sufficiently material exception in this regard. Further in their view, the **Audit Firm** has not been grossly negligent in conduct of their professional duties.

v. Through EoM Para, the matter was brought out in the audit opinion in accordance with the requirements of SA 706.

vi. From the point of view of the **Audit Firm**, the disclosure/information was appropriate and sufficient for the users of the Financial Statements especially since these were General Purpose Financial Statements.

vii. The **Audit Firm** has quoted Paras 1 and 6 of SA 706 and said that based on their professional judgement and skepticism, they had taken a view that the Auditee shall report on NOF/CRAR by way of appropriate note in the Financial Statements and

that they themselves shall highlight the same by way of EoM Para and Exception Report to RBI.

viii. The **Audit Firm** had no reason to arrive at an adverse or modified opinion.

d) **Financial Impact**

i. Vide letter dated 16th May, 2018, the Auditee conveyed to the Regulator that it would make appropriate disclosures in its Annual Report in line with its communication and discussions. Audit Committee was informed about the whole matter on the date of signing the Audit Report. Also, all discussions and meeting with RBI were appropriately informed to TCWG.

ii. The Auditee has made detailed and appropriate disclosure in Note 4 of the explanatory notes to Annexure I and II of the Financial Statements and this was done on the insistence of the **Audit Firm**.

e) **Management Bias and Lack of Independent Analysis**

i. Based on a letter dated 17th April, 2018, the Management informed the **Audit Firm** that RBI had given an extension until 31st March, 2019. The **Audit Firm** relied on Management's representation and enquiries made of Management.

ii. The **Audit Firm** has quoted Para 12 of SA 700 and stated that the Financial Statements were prepared in accordance with the applicable Financial Reporting Framework. Their evaluation on this includes consideration of the qualitative aspects of the Auditee's accounting practices. Further, they had no reason to suspect any possible bias in Management's judgment on this matter.

iii. The **Audit Firm** believes that they have obtained sufficient appropriate Audit Evidence in relation to the matter and have not placed reliance only on Management representation and they have shown professional skepticism as required by SA 200.

f) **Minutes of Purported Meeting with RBI**

i. The **Audit Firm** has pointed out that the Management's Letter to RBI dated 16th

May, 2018, which contained the minutes of the meeting, bore the acknowledgement of RBI.

ii. As per the **Audit Firm**, there was no difference in views between the Regulator, the Auditee and the **Audit Firm** on the date of signing of the Audit Report.

iii. Based on the information available at the relevant time there was no reason to believe that the various notes of meetings that were held with the RBI did not reflect accurately the discussions that had occurred with the RBI. Further, the **Audit Firm** believed that the RBI does not generally confirm or sign the minutes of discussion with the regulated entity.

g) **Conclusion:** Based on responses to Para 6.1 and 6.2, the **Audit Firm** asserted that they had:

i. Not failed to disclose material facts, known to them, which are not disclosed in the Financial Statements, but disclosure of which is necessary in making such Financial Statements where they are concerned in a professional capacity.

ii. Not failed to report material misstatement known to them to appear in the Financial Statements.

iii. Exercised due diligence in the conduct of their professional duties.

iv. Not failed to obtain sufficient information which was necessary for expression of opinion or its exceptions were sufficiently material to negate the expression of an opinion.

v. Not failed to invite attention to any material departure from the generally accepted procedure of audit applicable in the circumstances.

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

a) **Policy Document:**

The **Audit Firm** themselves have drawn attention of the users of the Financial Statements to the Board Policy of 2007 without first having verified it themselves. Hence, the viewing of purported extracts only in this particular case shows negligence on the part of **Audit Firm**. The fact that the **Audit Firm** relied on the Joint Auditor for such an important element of Audit Evidence shows the lack of independent analysis by the firm. The **Audit Firm** is trying to mislead the Authority by stating that the extract which was provided by Management was obtained from other sources. Thus, in view of Para 9 of SA 500, the **Audit Firm** has failed to obtain sufficient appropriate Audit Evidence.

b) **Definition of Companies under the Same Management**

i. In the initial observations sent by **NFRA**, it was pointed out that the **Audit Firm** had failed to take note of the definition of "companies in the same group" as mentioned by the Regulator, i.e. RBI, in its inspection report. The RBI Master Direction 2016, Direction 3(vi) gives a clear definition of "companies in the same group" which is consistent with the legal position as well as consistent with the stand taken by RBI. This clearly shows that the **Audit Firm** wanted to hide the fact that they had not performed sufficient enquiries in respect of matters highlighted in the RBI Inspection Report.

ii. Section 45-IA (7) of the RBI Act, 1934, provides that the term "companies in the same group" shall have the same meaning as assigned to it in the Companies Act, 1956. Sections 370 and 372 of Companies Act, 1956, clearly define the said term. These sections were made in-operative by the Companies (Amendment) Act, 1999. But, they were neither repealed from the Act nor were the references to those sections in other parts of Companies Act, 1956, or RBI Act, 1934, deleted. Further, Section 465 (2) (c) of the Companies Act, 2013, lays down that any rule of law, inter alia, shall not be affected by the repeal of the Companies Act, 1956, notwithstanding that such rule of law had been derived from the repealed enactment.

iii. The argument that the definition of "companies in the same group" is an interpretive issue is completely misleading. The auditor has failed in exercising due diligence and professional skepticism while examining the Management argument. As far as the Regulator is concerned, RBI has time and again clarified the matter of "companies in the same group", which has significant implications for NOF/CRAR, and, consequently, for the presentation of Audited Financial Statements. The RBI in its

Inspection Report of FY 2015 dated 6th May, 2016, has clearly stipulated how the "companies under the same management" should be considered and had assessed NOF as negative. The RBI report has stated that due to this the CRAR was negative and that the company has not maintained adequate capital. Despite the presentation given by the company, RBI in its report dated 14th September, 2016, had again reiterated its stand and had assessed NOF/CRAR as negative. Further, the RBI in its email dated 27th March, 2017, had clearly stated that the compliance submitted by the company "pertaining to major issues like group exposure, etc. are not accepted". This clearly shows that RBI had taken a final view even in March, 2017, and not in November, 2017. In fact, the inspection report issued by RBI in November, 2017, was pertaining to FY 2016 and had used the same definition as used earlier for the 2015 report.

iv. As stated above, the RBI in its email dated 27th March, 2017, had clearly stated that they had not accepted the various arguments given by the company in its letter dated 30th November, 2016. In fact, the company, in its letter of 16th May, 2017, addressed to RBI Deputy Governor, had stated that the increase in exposure to group companies was due to factors beyond the company's control. Thus, the Management had already accepted the definition given by RBI. This clearly shows that the **Audit Firm** had unquestioningly accepted the Management's so called explanation to the **Audit Firm** without considering the clear stand taken by the Regulator and accepted by Management.

v. The **Audit Firm** should have understood that a letter written by the Auditee to the Regulator on a final Inspection Report does not convert matters that have reached finality into ones still under discussion. Furthermore, supervisory concerns that are repeated in the Inspection Report for every succeeding year do not make it an ongoing correspondence or matter under discussion either. RBI/DNBR/2016-17/45 Master Direction DNBR.PD.008/ 03.10.119/2016-17 dated 1st September, 2016; Chapter – XV; Interpretations, provides as follows: "**122. For the purpose of giving effect to the provisions of these Directions, the Bank may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these directions given by the Bank shall be final and binding on all the parties concerned"** (emphasis added). The cavalier attitude of the Auditee Company was such that the RBI had to specifically point out in its letter dated 4th December, 2017 that "*We would like to emphasise that*

regulatory/supervisory directions are required to be acted upon promptly by the regulated entities and not to be subjected to review by them. You may also note that the instructions contained in our above letter were issued after a process of due approval by the Bank and the timelines stipulated in our letter needed to be strictly adhered to." This stand of the RBI should have informed the decisions of the **Audit Firm**.

vi. Thus, the **Audit Firm** had ignored the overwhelmingly clear legal position as brought out by Companies Act, 1956, Companies Act, 2013, RBI Act, 1934, RBI Master Directions, 2016, and RBI Inspection Reports and chose to accept the stand taken by the Management without questioning it even once. The **Audit Firm** did not critically evaluate the Management response in the light of the applicable law and the regulatory directions. Further, the **Audit Firm's** own admitted view that the Auditee needs to follow RBI's instructions on its reporting of NOF/CRAR (Response of the **Audit Firm** to Question No 12.3 in its letter dated 6th June, 2019) was not appropriately expressed in the Audit Report. The **Audit Firm** failed to exercise due diligence and professional skepticism, as required by the SAs.

c) **Emphasis of Matter**

i. As mentioned in the prima facie observations of **NFRA**, the EoM Para is not a substitute for a qualified, or adverse, or disclaimer of, opinion and for appropriate disclosures in the Financial Statements. According to Para 6 of SA 706 "the auditor shall include an EoM paragraph in the auditor's report **provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the Financial Statements**". **(emphasis supplied).** Hence, irrespective of the fact that it was the first time that the Para was used in reporting, it was under-reporting by the **Audit Firm**.

ii. The **Audit Firm**, has stated that they did not identify any sufficiently material exception. Yet, the **Audit Firm**, has taken credit for Exception Reporting to the RBI for the first time. And this is despite the fact that there did exist sufficiently material exception warranting serious reporting.

iii. On one hand, the **Audit Firm** says that the Management should have given a detailed note in the Financial Statements so that the readers are aware of the change in method of NOF/CRAR. On the other hand, the **Audit Firm** says that the disclosure of information was appropriate for the users/readers of General Purpose Financial

Statements, even though the Management did not heed the auditor's advice of giving a detailed note about NOF /CRAR as per RBI calculation. Clearly, the internally inconsistent view taken by the **Audit Firm** is established here and this establishes that the **Audit Firm** knew that the disclosure was both inappropriate and insufficient.

d) **Financial Impact**

i. As noted earlier, the company's internal documentation of matters discussed in the RBI office cannot be construed as valid evidence for matters discussed between the RBI and the Auditee. The fact is that the Financial Statements never disclosed the calculation of NOF/CRAR, as per the RBI's method. As a result, the financial impact of the significant variation could not be ascertained.

ii. **NFRA** has perused Note 4 of the Explanatory Notes to Annexure I and II of the Financial Statements. "This impacts computation of NOF and CRAR of the Company" is the only disclosure made to make the reader aware of the financial impact. No user of the Financial Statements could have had any clue as to the magnitude or the seriousness of the financial impact. The note proves that, contrary towhat the **Audit Firm** claims, the Management prevailed in not making a detailed disclosure.

e) **Management Bias and Lack of Independence**

i. Management was continuously trying to buy time to comply with the instructions of RBI. This clearly indicates bias in their judgement. The **Audit Firm** failed to evaluate this indicator.

ii. The **Audit Firm** did not place any reliance on RBI communications and Inspection Reports. The **Audit Firm's** contention that they obtained sufficient appropriate Audit Evidence is false as they relied solely on enquiries with, and representations by, the Management.

iii. The RBI's inspection reports and directions were of utmost importance to the business of the Auditee. It was incumbent upon the **Audit Firm** to comprehensively analyze, examine and document the audit process, judgement and conclusion of the ET in the matter.

iv. Para 12 of SA 700 (Revised) requires the auditor to evaluate whether the Financial Statements are prepared and presented, in all material respects, in accordance with the requirements of the applicable Financial Reporting Framework. Para A10 of SA 450 states that this evaluation includes consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in Management's judgments. The **Audit Firm** has failed to carry out such evaluation.

f) **Minutes of Purported Meeting with the RBI**

i. The acknowledgement of a letter cannot be construed as Approved Minutes of the Meeting. In absence of reliable evidence, the **Audit Firm** should have obtained Audit Evidence about the accuracy and completeness of the information.

ii. There was a major difference in view of the RBI on one hand, and the Auditee and the **Audit Firm** on the other. The difference, as has been stated in above, was on account of NOF/CRAR computation method and the date of compliance. This is exactly contrary to what the **Audit Firm** has stated.

iii. The minutes of the meeting were presented by the "Management". Topic relating to Management Bias and the Auditor's failure to notice the same has been discussed above.

iv. Therefore, in light of Paras 9 and 11 of SA 500, these WPs cannot be construed as valid evidence. To consider these as evidence shows gross negligence and lack of due diligence on the part of the **Audit Firm**.

2.4.4 **NFRA**, therefore, concluded in **DAQRR** that:

a) The **Audit Firm** has failed to obtain sufficient appropriate Audit Evidence as required by Para 9 of SA 500. The **Audit Firm** has not exercised due diligence, and have been grossly negligent in the conduct of their professional duties.

b) The **Audit Firm** ignored the overwhelmingly clear legal position and chose to accept the stand taken by the Management without questioning it even once. The **Audit Firm** failed

to exercise due diligence and professional skepticism, as required by the SAs.

c) The EoM was inappropriate and soft reporting of a very serious matter. The **Audit Firm** has failed to obtain sufficient information which was necessary for expression of opinion.

d) The Financial Statements did not disclose the calculation of NOF/CRAR as per the RBI's method. As a result, the financial impact of the significant variation could not be ascertained. Thus, the **Audit Firm** failed to disclose material facts known to them which were not disclosed in the Financial Statements.

e) The **Audit Firm** knew that the disclosure made by the Management regarding NOF/CRAR was both inappropriate and insufficient. Clearly, the preconditions for an EoM Para as laid down by Para 6 of SA 706, were not met. This clearly indicates the bias in Management's judgement, which the **Audit Firm** intentionally chose to ignore. The **Audit Firm** has failed to carry out the evaluation of Management bias as required by Para 12 of SA 700 (Revised) and Para A10 of SA 450. The **Audit Firm** failed to report material misstatement known to them to appear in the Financial Statements.

f) The **Audit Firm** has failed to evaluate the reliability, accuracy and completeness of Audit Evidence as required by Paras 9 and 11 of SA 500, This shows gross negligence and lack of due diligence on the part of the **Audit Firm**.

2.4.5 In response to the observations of NFRA in the **DAQRR**, the **Audit Firm's** responses have been examined and NFRA's conclusions thereon are as follows:

a) ***Policy Document***

i. The **Audit Firm** has argued that "*Considering the fact that the source and nature of the document relied on by us was one which was submitted to the RBI, the primary regulator of the Company, and the RBI itself had relied upon it, in our view was sufficiently reliable and thus constituted sufficient appropriate evidence. Our procedures for obtaining audit evidence included discussions (inquiry) with the Management and joint auditors (who were also long-standing predecessor auditors of the Company)".*

ii. The contention of the auditor to consider a document submitted to the RBI as received from another source (Para A26 of SA 500) i.e. from previous Auditor (DHS) cannot be considered as evidence as it is merely an extract of the document submitted by the Management to RBI. Further, the words of auditor that "***the RBI itself had relied upon it"*** is a vague statement because mere submission of any document/letter/ communication to the RBI is no proof that the RBI had relied upon it. Looking at the significance of the document (board policy) it was important for the **Audit Firm** to obtain the original document and to verify any misstatement observed during the Audit. In eAudit file, no evidence or communication were found where the document was requested by the Auditor from the Management. Therefore, it is clear that the auditor failed to exercise professional skepticism and relied only on "Letter to RBI" provided by the Joint Auditor.

iii. Para A14 of SA 500 is reiterated below:

A14. ***Inspection involves examining records or documents, whether internal or external,*** *in paper form, electronic form, or other media, or a physical examination of an asset.* ***Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and****, in the case of internal records and documents, on the effectiveness of the controls over their production.*

The above Para, clearly states that the reliability of Audit Evidence depends upon the nature and source of records and documents. In this case, the Board Policy was an internal document and even the joint auditor *who were a long-standing predecessor auditor of the Company* had not submitted the copy of original policy. This shows the failure of **Audit Firm** to obtain sufficient appropriate Audit Evidence.

iv. The Auditor has quoted Para 4 and Point c of Para 5 of SA 299 and argued that the **Audit Firm** did not solely rely on the joint auditor for NOF/CRAR matter and had independently evaluated the Policy of the Company. However, no working paper in support of this contention was disclosed by the Auditor in any of their replies about the procedure of evaluation of policy for NOF/CRAR.

v. The **Audit Firm** has also stated that "*The policy of compliance with NOF and CRAR*

requirements in the context of the RBI inspection was also discussed by us with the Board in their meeting held on 28 May 2018. In all the said discussions…upon.". This, in fact, proves the point that the **Audit Firm** has not obtained any Audit Evidence independently and simply relied on the Management and the Joint Auditor.

b) ***Definition of Companies under the Same Management***

i. The Auditor has repeated the same line of argument as earlier without any other/additional evidence or workings in support of the argument. The argument that the definition of "companies in the same group" is an interpretive issue is completely misleading. The RBI Master Direction 2016, Direction 3(vi) gives a clear definition of "companies in the same group" which is consistent with the legal position as well as consistent with the stand taken by RBI. As far as the Regulator is concerned, RBI has time and again clarified the matter of "companies in the same group", which has significant implications for NOF/CRAR, and, consequently, for the presentation of Audited Financial Statements. Thus, the **Audit Firm** had ignored the overwhelmingly clear legal position as brought out by Companies Act, 1956, Companies Act, 2013, RBI Act, 1934, RBI Master Directions, 2016, and RBI Inspection Reports and chose to accept the stand taken by the Management without questioning it even once. The **Audit Firm** did not critically evaluate the Management response in the light of the applicable law and the regulatory directions. Further, the **Audit Firm's** own admitted view that the Auditee needs to follow RBI's instructions on its reporting of NOF/CRAR was not appropriately expressed in the Audit Report.

ii. The RBI in its email dated 27th March, 2017, had clearly stated that the compliance submitted by the company "pertaining to major issues like group exposure, …, etc. are not accepted". This clearly shows that RBI had taken a final view even in March, 2017, and not in November, 2017. Further, as mentioned previously, timeline given by the RBI is not the criteria to validate that the Management's view was correct.

c) ***Emphasis of Matter***

i. As per Para A2 of SA 706, para 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial statements.

Para 6

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an ***Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements****. Such a paragraph shall refer only to information presented or disclosed in the financial statements.*

Para 6, clearly explains that Auditor shall use ***Emphasis of Matter para in the auditor's report only when the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.*** In the present case, Auditor has not obtained sufficient appropriate audit evidence that the matter is not materially misstated. Therefore, the use of EOM para is not appropriate.

The **Audit Firm** has given three arguments to support the statement, "*the matter did not require a qualification/ adverse opinion/ disclaimer of opinion.*" However, the claim is not tenable due to following reasons:

- As brought out above, the stand taken by the Management ignored the overwhelmingly clear legal position as brought out by Companies Act, 1956, Companies Act, 2013, RBI Act, 1934, RBI Master Directions, 2016, and RBI Inspection Reports. Thus, to state that, "Though the method of computation was different from that adopted by the RBI, the disclosures were in line with the principles set out in the Accounting Standards" is not acceptable and brings out gross negligence and lack of due diligence on the part of the **Audit Firm**.

- Timeline given by the RBI is not the criteria to validate the argument that the Management's view was correct.

- The calculation of NOF/CRAR is part of presentation or disclosure in financial statement and also important for the understanding of the users of the Financial Statement. EoM Paragraph is not a substitute for a qualified, or adverse, or disclaimer of opinion, and for appropriate disclosures in the Financial Statements (Para A3 of SA 706).

ii. On one hand, the **Audit Firm** says that the disclosure of information was appropriate for the users/readers of General Purpose Financial Statements and on the other hand it says that the Management should have given a detailed note in the Financial Statements. Clearly, the **Audit Firm** knew that the disclosure was both inappropriate and insufficient.

iii. With respect to significant audit procedures claimed to have been carried out by the **Audit Firm** (*which is nothing but internal records of minutes of meeting with RBI and a letter written to RBI*), it is again reiterated that the company's internal documentation of matters discussed in the RBI office cannot be construed as valid Audit Evidence for matters discussed between the RBI and the Auditee.

iv. Based on the letter submitted to RBI and discussion with the Joint Auditor, the **Audit Firm** has stated that "*Nothing came to our attention that caused us to believe that the above information was not reliable".* The **Audit Firm** has, thus, again failed to show that they have obtained any Audit Evidence independently besides relying on the Management and the Joint Auditor.

v. The **Audit Firm** has stated that '*The issue is whether an Exception Reporting to the RBI should be made only if there is a qualification/ adverse opinion/ disclaimer of opinion in the Audit Report."* The **Audit Firm** has agreed that there was divergence from clarifications/ guidelines/ directions issued by the RBI which required an Exception reporting to RBI. The issue is when an Exception Reporting to the RBI is made, (especially when the Management ignored the overwhelmingly clear legal position as brought out by Companies Act, 1956, Companies Act, 2013, RBI Act, 1934, RBI Master Directions, 2016, and RBI Inspection Reports), has the **Audit Firm** obtained sufficient appropriate audit evidence (as required by Para 7a of SA 705) to conclude that the financial statements as a whole are free from material misstatement. There is no Audit evidence to support this claim.

vi. The **Audit Firm** has, in its reply to question on Analytical Procedure has stated that they were not able to find the Credit Rating Agency ICRA's report published on 28th March, 2018. Now, they are relying on the CARE report dated 16 August 2018, which was issued after the Audit Report was signed, to state that, "the report *considered the*

significance of this disclosure in the audited financial statements for the year ended 31 March 2018 in forming its view regarding the Rating for the Company". In fact, given the same analogy, if the **Audit Firm** had issued a Qualified opinion, when it was due, many investors would have been forewarned about the ILFS crisis which unfolded in the ensuing weeks.

d) ***Financial Impact***

i. The **Audit Firm** has referred to Paragraph 96 of IAS 1, which is not part of Ind AS 1, the applicable law in India. Hence, the **Audit Firm** is trying to mislead NFRA by reiterating same facts without any substantive evidence and quoting wrong provisions of the Accounting Standards.

ii. The fact remains that the Financial Statements never disclosed the calculation of NOF/CRAR, as per the RBI's method. As a result, the financial impact of the significant variation could not be ascertained. No user of the Financial Statements could have had any clue as to the magnitude or the seriousness of the financial impact. This proves that, contrary to what the **Audit Firm** claims, the Management prevailed in not making a detailed disclosure.

iii. A key consideration regarding the disclosure of the NOF/CRAR numbers as per the RBI definition would have been the materiality of the misstatement involved in not doing so. By all standards of materiality, the misstatement was monumental. However, CA N Sampath Ganesh maintained, at the hearing, that he did not consider the non-disclosure to be a material misstatement. Not only is this stand in direct contradiction to the conclusion of the Audit Firm that the RBI method should be followed, but this staggering conclusion raises serious questions about the capacity and the overall judgement of the EP.

e) ***Management Bias and Lack of Independence***

i. The argument of the **Audit Firm** is that *"While most of the communications between the Company and the RBI (including the inspection report dated 6 May 2016, 14 September 2016 and letter dated 1 November 2017) took place prior to the commencement of our field work in 2018 for the audit of the year ended 31 March 2018, we understoodthe issue in detail from management and examined the relevant*

underlying documents including the RBI Inspection Reports – refer WP attachment 2.5.3.70 of eAudit file." So, the reason given by the Auditor that communications between Auditee and the RBI took place prior to the commencement of their work gives no relief to the **Audit Firm** from its duties. It is the duty of the auditor to gain/inspect/ inquire and get all the knowledge about any materially significant transaction, whether it happened during the year of audit or in past years, which can change the opinion of the Auditor. It was evident from the trail of correspondence that the Management was continuously trying to buy time to comply with the instructions of RBI. This clearly indicates bias in their judgement. The **Audit Firm** failed to recognize this bias. The **Audit Firm** did not place any reliance on RBI communications and Inspection Reports. The **Audit Firm's** contention that they obtained sufficient appropriate Audit Evidence is false as they relied solely on enquiries with, and representations by, the Management.

Further, the contention of the auditor that "By that time the Company had also accepted to implement the RBI's views on computation of group exposures. Thus, it provided support that the risk of possible management bias was minimized effectively." clearly reflects the poor judgement of the Auditor as there was no evidence to indicate the acceptance of RBI's view by the Management. The **Audit Firm** did not place any reliance on RBI communications and Inspection Reports.

ii. The **Audit Firm** has accepted that they did not communicate with RBI to get a clearer view and relied only on Management Representation and the document shared by the Joint Auditor.

iii. On examining the WP attachment 2.5.1.10 (As referred by the **Audit Firm**- Refer Cell G62 and G67 of tab: "BM Aug-Dec and Mar 18" and cell G31 and G32 of tab: "ACM Aug-Dec and mar18" in WP attachment 2.5.1.10 of eAudit file.) it is observed that AC and Board discussed how the after effects of adopting the RBI Directions to reduce the group exposure would affect the funds and projects of the Auditee Company. On the other hand, the **Audit Firm** has stated that the Management should have given a detailed note in the Financial Statements. This was an indicator of management bias, completely ignored by the **Audit Firm**.

iv. Para A10 of SA 450 requires the Auditor to evaluate indicators of possible bias in Management's judgments. The **Audit Firm** has failed to carry out such evaluation.

f) ***Minutes of Purported Meeting with the RBI***

The Auditor has adopted the same line of argument in its reply which is already considered at **DAQRR** stage. The argument that "The aforesaid letter was duly acknowledged by the RBI and there was no negative response from the RBI to the letter" cannot be construed as Approved Minutes of the Meeting. Discussion in Audit Committee or with Joint Auditors cannot suffice for due Audit Procedure as there was a major difference in view of the RBI on one hand, and the Auditee on the other. No independent analysis has been carried out by the **Audit Firm**. The minutes of the meeting were presented by the "Management" indicating Management Bias and the Auditor's failure to notice the same. Therefore, the conclusion of NFRA that these WPs cannot be construed as valid evidence, in light of Paras 9 and 11 of SA 500, gets reaffirmed.

2.4.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm** has failed to obtain sufficient appropriate Audit Evidence as required by Para 9 of SA 500. The **Audit Firm** has not exercised due diligence, and have been grossly negligent in the conduct of their professional duties.

b) **The Audit Firm** ignored the overwhelmingly clear legal position and chose to accept the stand taken by the Management without questioning it even once. The **Audit Firm** failed to exercise due diligence and professional skepticism, as required by the SAs.

c) The EoM was inappropriate and soft reporting of a very serious matter. The **Audit Firm** has failed to obtain sufficient information which was necessary for expression of opinion.

d) The Financial Statements did not disclose the calculation of NOF/CRAR as per the RBI's method. As a result, the financial impact of the significant variation could not be ascertained. Thus, the **Audit Firm** failed to disclose material facts known to them which were not disclosed in the Financial Statements.

e) **The Audit Firm** knew that the disclosure made by the Management regarding NOF/CRAR was both inappropriate and insufficient. Clearly, the preconditions for an EoM Para as laid

down by Para 6 of SA 706, were not met. This clearly indicates the bias in Management's judgement, which the **Audit Firm** intentionally chose to ignore. The **Audit Firm** has failed to carry out the evaluation of Management bias as required by Para 12 of SA 700 (Revised) and Para A10 of SA 450. The **Audit Firm** failed to report material misstatement known to them to appear in the Financial Statements.

f) The **Audit Firm** has failed to evaluate the reliability, accuracy and completeness of Audit Evidence as required by Paras 9 and 11 of SA 500, This shows gross negligence and lack of due diligence on the part of the **Audit Firm**.

2.5 RBI INSPECTION MATTERS: TTSL

2.5.1 In its communication dated 7th August, 2019, NFRA had conveyed its prime facie conclusions as follows:

a) RBI's Inspection Report dated 14th September, 2016, had recommended a provision of ₹253.55 Crores as on 31st March, 2015, (i.e. full value) against the shares of TTSL held by IFIN. Similarly, the same direction was reiterated by the RBI in its Inspection Report dated 1st November, 2016. There is no mention of this in the Audit WPs.

b) The TTSL shares had clearly only zero value even on the date of transfer of the same to IFIN as settlement against loans of ₹323.15 Crores outstanding against Siva Group. In addition, the so called put option backing the shares was not even a fig leaf. The option writer, SREPPL, was not creditworthy. The Shareholder's Agreement and Option Agreements in this case were not examined. The option contract was not a standard contract traded on a stock exchange.

c) The Guidance Note on Derivatives issued by the ICAI did not apply to the derivatives on the TTSL shares for the reasons explained.

d) The entire recovery of the amount on the derivative contract was solely predicated on the expected sale of property by HCPL at a price of ₹3000 Crores. The **Audit Firm** had not subjected the so-called recoverability to any degree of challenge and had not displayed the required professional skepticism. The **Audit Firm** had not:

i. verified the Financial Statements of Shanmuga Real Estate and Properties Private Limited (SREPPL) who was the option writer and, therefore, the principal debtor;

ii. examined the title to the land based on which the entire security structure was set up;

iii. had not subjected to any degree of scrutiny, the valuation model, assumptions inherent in the model, and the source from which input data for the model were obtained; and

iv. ensured that the disclosures required in such case were provided by the company.

e) The valuation of the derivative asset (in the form of the put option) of ₹184.3 Crores is completely unjustified and appears to be a calculated fraud acting in support of the Management to inflate the profit. This value of the derivative is 90% of the years' Profit before Tax.

f) **Conclusion:** The ET had not done any due diligence and required audit verification for examining the company's response to the RBI's conclusion quoted above. It was also clear that the ET had actively assisted the Auditee Company to desist from providing for the loss of ₹190 Crores on the OCDs as advised by the RBI. The ET had, therefore:

i. failed to disclose material facts known to them which are not disclosed in a Financial Statement, but disclosure of which is necessary in making such Financial Statement where they are concerned with that Financial Statement in a professional capacity;

ii. Failed to report material misstatements known to them to appear in a Financial Statement with which they are concerned in a professional capacity.

2.5.2 The **Audit Firm,** in its responses dated 30th August, 2019, and 10th September, 2019, has stated as follows:

a) Both the above quoted **RBI Inspection Reports** are attached in zip file embedded in attachment 2.5.3.70. Besides the RBI conclusions have been placed before the Audit Committee in the presentation made on 28th May, 2018 (Slide 14). While a 100% provision against the shares was made as of 31st March, 2018, the put option against those shares were valued at ₹184 Crores. Thus, a net provision of ₹70 Crores (₹254 Crores – ₹184 Crores) was made in the Profit and Loss account.

b) BSR was appointed as auditors of the Company for the first time for the year 2017-18 and therefore had not performed the audit of the Company for any of the PYs. BSR focused its audit effort on the valuation of the equity shares of TTSL and not its acquisition cost. The aforesaid Put Option was written by SREPPL which was guaranteed by Chennai Properties India Limited ('CPIL'). The Shareholder's and Option agreement was obtained and reviewed -refer Pg. I2.559-I2.600 of file Sr. No. 17 Tata Teleservices Ltd. (I2.484-I2. 638) in file 2. 2 IFIN March 2018 File no. I2 - Investment in folder other WPs of our Audit File.

c) The put option valuation was done as per the Guidance Note on Accounting of Derivatives

that requires valuation of derivatives. The Guidance Note applies to Option contracts regardless of whether they are for listed or unlisted securities.

d) The recoverability of the put option value was predicated on the expected cash flows from the contract between CPIL, who was the guarantor and Hill County Properties Ltd (HCPL), wherein CPIL was entitled to a fee for services to be rendered. HCPL, who was the counterparty to the agreement with CPIL, was a related party of IL&FS. The details of the land parcels of HCPL that were covered by the agreement that entitled CPIL to the revenues was listed as part of the agreement. The assumptions for the earnings on sale of developed property appeared reasonable - copy of the workings provided to us by the Company was included in 'Pg. I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other Work Papers'. As per the information provided to us by management, the Company planned to collect the cash flows underlying the put option as and when the cash flows accrued from the aforesaid agreement. The information was also provided in the Annexure II to the letter to RBI dated 16th May, 2018, in response to RBI's communication of 13th March, 2018.

e) The key inputs considered in the option valuation model included fair value of the share, cash flows from the underlying contract, time of maturity, strike price, risk free interest rate, volatility, etc. The basis of underlying cash flows was the projected revenue from the contract between CPIL and HCPL which minimized risk of diversion of these proceeds due to the Hypothecation and Escrow arrangement of these receivables and the fact that the payer was a group company of IL&FS. BSR did not rely upon the work that may have been done by 'Internal Valuation Team of M/s. Deloitte Haskins & Sells LLP' and had performed its own work. Accordingly, impairment of independence, if any, of Deloitte had no effect on its opinion. In the given situation, the relevant input was the estimated cash flows from the developed property and its timing (rather than valuation of land parcels) which was obtained and reviewed by the ET -refer 'Page I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other work papers' and the same were considered reasonable.

f) Based on the explanation provided, the **Audit Firm** believed that it had:

i. NOT failed to disclose material facts known to them which are not disclosed in a Financial Statement, but disclosure of which is necessary in making such Financial Statement where they are concerned with that Financial Statement in a professional capacity;

ii. NOT failed to report material misstatement known to them to appear in a Financial Statement with which they are concerned in a professional capacity.

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

i. The principal debtor (put option writer) in this case was SREPPL. Their financials were not examined by the **Audit Firm**. In fact, the **Audit Firm** has not even made any such claim. While the Financial Statements of the principal debtor may not reveal the full story about its creditworthiness, the requirement of having to obtain sufficient appropriate evidence to assess the credit risks involved in this case required that the Financial Statements of SREPPL should have been examined. The **Audit Firm** has, therefore, completely failed in its duty to obtain and evaluate sufficient and appropriate Audit Evidence that was absolutely essential to assess the valuation of the Put Option.

ii. Reference has been made to a Guarantee Agreement in which CPIL (a Siva Group Company) had provided a guarantee to IFIN that 2 companies of the Siva Group namely, Siva Green Power and SREPPL, would comply with their obligations to IFIN. The total liability of CPIL in the guarantee had been capped at ₹300 Crores. This was in a situation where the liability of SREPPL under the put option was ₹253 Crores and the liability of Siva Green Power for OCDs was ₹190 Crores, totalling ₹443 Crores in all. Clearly, the cap on the guarantee amount was grossly inadequate and this was itself an indicator that the recoverability of the Put Option was clearly in doubt.

iii. NFRA has reviewed the referred WP at 'Page I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder ‘Other work papers’. It is noted that there are NO assumptions for the earnings on sale of developed property found documented in the working. In fact, the working referred at 'Page I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other work papers' is a very inadequate and vague tabular presentation of figures with unknown source or headings. Clearly, the **Audit Firm** has utterly failed in obtaining sufficient and appropriate audit evidence.

iv. The **Audit Firm** has stated, “the assumptions for the earnings on sale of developed property appeared reasonable”. However, no sufficient appropriate evidence has been provided on the basis of which the **Audit Firm** had arrived at such a sweeping conclusion.

v. It is understood that the **Audit Firm** based the assurance of recoverability of the value of the put option on the revenue generated from the entity's own Related Party, i.e. HCPL. However, the **Audit Firm** has not gone through the basic requirement of checking the charges that had been registered against the properties of HCPL and the extent to which balance, if any, of the asset values on realisation would be available to meet HCPL's obligations to CPIL. It is very clear that the **Audit Firm** has completely failed to obtain sufficient appropriate audit evidence to satisfy itself about the credit risk associated with the fulfilment of the put option by SREPPL.

vi. As far as the applicability of the ICAI Guidance Note on Accounting for Derivative Contracts (GN), to the put option in this case is concerned, the statement of the **Audit Firm** that the valuation of the put option changes in response to the underlying change in the price of TTSL shares, is found to be factually incorrect. With the TTSL share being unquoted and unlisted at any Stock Exchange, the valuation or price of those shares is not objectively discoverable. The **Audit Firm** has also drawn attention to the Para 11 of the GN to the effect that "this list is meant to be illustrative only and not exhaustive". All the items listed in the said Para 11 are examples of instruments traded on stock exchanges. Therefore, the statement that the list is illustrative only and not exhaustive, cannot be interpreted to mean that instruments which do not share the tradability characteristic of the instruments in the list, could be included. The statement that the list is only illustrative and not exhaustive has to be read ejusdem generis with the items in the list above. The GN in question, therefore, does not apply to the put option.

It is pertinent to note that the "Scope" of the GN covered under paragraphs 8- 11, is summarised in Paragraph 11, which states that "*The Guidance Note, **thus**, applies…"*, describing the final scope of the GN after taking into account everything which precedes it.

Even assuming for the sake of argument, but not admitting, that the GN is applicable to present put option, the **Audit Firm** had ignored the stipulation of Para 17 of the said GN. This paragraph defines the fair value in the context of derivative contracts as the "exit price" i.e. the price that would be received when transferring an asset to a knowledgeable and willing counter party. The fair value should also incorporate the effect of credit risk associated with the fulfilment of future obligations. The extent and availability of collateral should be factored in while arriving at the fair value of a derivative contract. For the reasons explained in NFRA's prima facie conclusions (the past credit record of the borrower group,

the opacity and complexity of the credit support agreements, and the **Audit Firm** not having scrutinised and evaluated all the relevant documents and valuation reports), NFRA concludes that the **Audit Firm** has not obtained sufficient, appropriate audit evidence for this "exit" price. Therefore, this GN does not apply to the financial instrument under discussion which does not share the tradability characteristics of the instruments listed in Para 11 of the GN.

vii. The **Audit Firm** has claimed that the impairment of joint-auditor's independence had no consequence on the working of the **Audit Firm**. "We would like to state that we did not rely upon the work that may have been done by 'Internal Valuation Team of M/s. Deloitte Haskins & Sells LLP' and we have performed our own work." However, the **Audit Firm** has failed to provide any WP reference of claimed "own work" in reference to valuation of the so- called 'derivative' asset. Further, NFRA has carefully gone through all the WP references quoted in the responses and also could not find any work done by the **Audit Firm**. Therefore, the response of the **Audit Firm** cannot be accepted as the **Audit Firm** has failed to document sufficient appropriate audit evidence.

The WP referred at 'Page I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other work papers' fails to provide any working supporting the **Audit Firm's** claim that "the relevant input was the estimated cash flows from the developed property and its timing (rather than valuation of land parcels)". There is no evidence of any observations made by the reviewer in the said WP. The WP is merely a table of some unexplained figures with no background or reasoning to support even an iota of the **Audit Firm's** stated conclusion.

viii. The statement, "our Firm was appointed as auditors of the Company for the first time for the year 2017-18 and we had not performed the audit of the Company for any of the PYs," doesn't befit a responsible auditor. NFRA would like to draw to the **Audit Firm's** attention to the fact that the SAs do not distinguish between first-time auditor or otherwise. On the contrary, SA 510 lays additional and specific requirements upon the auditor for initial audit engagements. Further specific attention is drawn to Para 10 of SA 510, which states, "If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705." Accordingly, it is noted that the auditor has failed to gather sufficient appropriate evidence regarding opening balances of investments and therefore, as such, the explanation of the auditor is not acceptable under the circumstances.

If the argument of the **Audit Firm** that the option had a value of around ₹180 Crores was to be accepted, there was no reason why this was not reflected in the Balance Sheets as of 31st March, 2016, or 2017**.** The fact that this option contract was brought into the books as of 31st March, 2018, only served to confirm the prima facie conclusion of the NFRA that this action was only a method used by the Management to inflate the profit, and that the **Audit Firm** did not display the required professional skepticism and challenge the evidence produced by the Management.

ix. Para 18 of SA 700, which states, "If Financial Statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705."

On Slide 14 of the Audit Committee presentation made on 28th May, 2018, the **Audit Firm** has mentioned, "Company's holding of TTSL shares at a value of ₹253 Cr and OCDs of Siva Green @ ₹190 Cr was identified by RBI as loss asset; Company's response to the above and current status is covered in the 'Investment' section of this presentation".

On Slide 23 – 'Management Estimates – Investments', the **Audit Firm** has mentioned: Tata Teleservices Ltd (Equity) – "The Company has made full provision against TTSL shares".

Siva Green (OCD) – "Specific provision of ₹400 Million made as additional standard asset provision. Financial statements and valuation not available. Shortfall, if any to the extent of ₹1,500 million, covered through receivable from Affordable Housing Joint Venture between Shiva Group and ITUAL. Signing of binding agreements expected by June 2018."

Derivative Asset – "IN accordance with Guidance note issued by ICAI on Derivative transaction, During the year, the Company has fair valued Put option whereby SREPPL has obligation towards the Company to buy TTSL share at the Company's cost and accordingly MTM of ₹1,843 Million recognized".

Clearly, the **Audit Firm** has failed to gather any evidence in this matter to arrive at the stated understanding or conclusion. Consequently, the **Audit Firm's** duty/responsibility does not

get completed by merely highlighting the matter to the Audit Committee; it is further apparent in light of Para 18 of SA 700 that depending on the requirements of the applicable financial reporting framework and how the matter is resolved, the **Audit Firm** determines whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705.

x. The SAs define 'Professional judgment' as "The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement"; and 'Professional Skepticism' as "An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence." ***Fraud*** is "an intentional act by one or more individuals among the management, those charged with governance, employees, or third parties, involving the use of deception to obtain unjust of illegal advantage''.

The **Audit Firm's** submission that "such decisions are purely business decisions for the Management of the Company to take," is indicative of the casual attitude adopted by the **Audit Firm** in a situation where the **Audit Firm** had to exercise its professional skepticism and judgement. This is reinforced by the fact that **Audit Firm** has not noted that the carrying of restructured dead investments in TTSL, year-after-year, at a value not supported by any evidence, was a clear example of fraud.

The **Audit Firm** has stated, "the matter was also under RBI's consideration as at the date of our opinion," which is factually NOT correct. In light of RBI's Inspection Reports as observed and noted by NFRA in its Prima-facie observations/comments/remarks, RBI's letters were conclusive in nature. Merely writing back in response to the regulator's directions does not in any manner tantamount to the matter continuing to be under consideration by the RBI.

NFRA reiterates its view that the complicated nature and multi-layered character of these agreements that supposedly provided the assurance that there would be no counterparty risk required very convincing evidence to be demanded, and rigorous challenge to such evidence and the Management by the **Audit Firm**. This set of agreements also called for the exercise of a high degree of professional skepticism. There is no evidence whatsoever in the Audit File that such evidence was called for, or such evidence as was in fact provided

was subject to even an iota of challenge or skepticism. On the contrary, the Audit Files clearly indicate a meek, and when the totality of the evidence is considered, disclose what might even be described as an eager, willingness to accept the explanations provided by the Management.

2.5.4 **NFRA**, therefore, concluded as follows in **DAQRR**:

a) The **Audit Firm** has failed to obtain sufficient appropriate Audit Evidence as required by Para 9 of SA 500. The **Audit Firm** has not exercised due diligence, and have been grossly negligent in the conduct of their professional duties.

b) The **Audit Firm** ignored the overwhelmingly clear legal position and chose to accept the stand taken by the Management without questioning it. The **Audit Firm** failed to exercise due diligence and professional skepticism, as required by the SAs.

c) The **Audit Firm** has failed to evaluate the reliability, accuracy and completeness of Audit Evidence as required by Paras 9 and 11 of SA 500. This shows gross negligence and lack of due diligence on the part of the **Audit Firm**.

d) The valuation of put option and equity shares of TTSL was inappropriate and misleading reporting of a very serious matter. The **Audit Firm** has failed to obtain sufficient information which was necessary for expression of opinion.

2.5.5 The **Audit Firm's** replies in response to the observations of NFRA in the **DAQRR** have been examined and NFRA's conclusions thereon are as follows:

a) In response to **para 2.5.3 (i)** the **Audit Firm** claims to disagree with the NFRA's conclusion stating that the Management's expectation was to realise cash flows from the agreement between HCPL and CPIL and not from SREPPL's existing assets or business. This is clear from the Company's letter to the RBI dated 16 May 2018 (refer S610 to S612 of file '4.RBI (Page S470 to S623)' in Folder '5. IFIN March 2018 File No. S-Others' in 'Other work papers' of our audit file) wherein the Company had provided the Put Option agreement and the CPIL Guarantee document in support of its recoverability assessment for the TTSL and Siva Green exposures.

The **Audit Firm's** contention that the Management's expectation was allegedly only to realise cash flows from the agreement between HCPL and CPIL and not from SREPPL

existing assets or business, does not change the fact that the principal debtor (put option writer) in this case was SREPPL and that their financials were not examined by the **Audit Firm**. In fact, this appears to a cover-up of the **Audit Firm's** negligence because the books of IFIN stated SREPPL as the principal debtor.

b) In response to Para 2.5.3(ii), the **Audit Firm** asserts that the recovery of the amount of ₹ 253 Crores, at which the TTSL shares were carried in the balance Sheet, was secured by the Put Option written by SREPPL that was guaranteed by CPIL. As per the terms of the guarantee of CPIL, CPIL's liability was capped at 60% of its realisation from the MoU with HCPL. The Management's assessment of CPIL's realization from its MoU with HCPL was approx. ₹436 Crores and thus it was expected to realise ₹253 Crores under the Put Option with SREPPL. The **Audit Firm** also claims that for the dues of ₹190 Crores, IFIN had access to the cash flows from the Affordable Housing Project to the extent of ₹150 Crores that were hypothecated to IFIN which was available for its exposure to Siva Green. The **Audit Firm** further claims that this was in addition to the amount guaranteed by CPIL under the guarantee to the extent of ₹300 Crores as would be clear from a reading of the documents. The Company had made an additional Standard Asset provision of ₹40 Crores to the extent of the shortfall.

It is seen that the **Audit Firm** has tried to manipulate the facts by asserting that the value of TTSL shares, of ₹ 253 Crores, was secured by the Put Option written by SREPPL that was guaranteed by CPIL, and for the dues of ₹190 Crores, IFIN had access to the cash flows from the Affordable Housing Project to the extent of ₹150 Crores that were hypothecated to IFIN. NFRA has analysed the WP referred by the **Audit Firm** and reconfirms its view that CPIL (a Siva Group Company) had provided a guarantee to IFIN for two companies of the Siva Group namely, Siva Green Power and SREPPL, to comply with their obligations to IFIN. The total liability of CPIL in the guarantee had been capped at ₹300 Crores against the stated liability of ₹443 Crores (₹253 Crores plus ₹190 Crores). Consequently, the **Audit Firm's** arguments regarding recoverability of the Put Option and exposure of Siva Green are not found tenable.

c) In response to Para 2.5.3(iii) and (iv), the **Audit Firm** states that they obtained sufficient and appropriate evidence as the key information in the working referred to is the amount that was expected to be realised from sale of land parcels. The **Audit Firm** refers to the agreement between CPIL and HCPL (Refer Pg. I2.601- I2.616 in file Sr. No. 17 Tata Teleservices Ltd. (I2.484-I2. 638) in folder 2. 2 IFIN March 2018 File no. I2 – Investment

in folder Other work papers of the Audit File and the workings of the cash flow Refer Pg I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other Work papers' of the Audit File), and states that the total land area was 623 Acres. The **Audit Firm** states that the assumption by management was a total realisation of Rs. 2,637 Crores out of 560 acres of the said land which translates to a realisation per Acre of about ₹4.71 Crores which was in line with the rates prevailing in those areas as at the balance sheet date. Based on the above, the total revenue estimated for CPIL was ₹436 Crores which was sufficient to meet CPIL's guarantee obligation to IFIN against the Put Option.

NFRA has again examined Page I2.601- I2.616 in file Sr. No. 17 Tata Teleservices Ltd. (I2.484-I2. 638) in folder 2. 2 IFIN March 2018 File no. I2 – Investment in folder Other work papers of the Audit File and the workings of the cash flow (Refer Pg I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2-638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other Work papers' of the Audit File) as referred to by the **Audit Firm**. Based on reassessment, it is seen that there is one estimate for sales realisation but NO assumptions for the earnings on sale of developed property found documented in the working. The quality of WP, as already stated, remains very inadequate and vague. No sufficient appropriate evidence is still found to support the **Audit Firm's** sweeping conclusion that "the assumptions for the earnings on sale of developed property appeared reasonable".

d) In response to Para 2.5.3(v), the **Audit Firm** has stated that HCPL's secured borrowings was mostly from IFIN, IL&FS and its group companies (₹1,688 Crores) and had very little secured external borrowings (₹130 Crores) (Refer tab: 'HCPL Security Value' in WP attachment 2.260 of the eAudit file) and most of HCPL's land parcels that were part of the MoU between HCPL and CPIL were charged to IL&FS and IFIN on a pari-passu basis (Refer table starting from row 53 in sheet "HCPL Group" in WP attachment 2.260 and cell no. "Q75 to Q142" in sheet "Loan Classification" of the file embedded in tab: "Secured & Unsecured Loan" in WP attachment 2.330). Based on the above, the cash flows estimated would have been sufficient to meet the obligations to lenders of HCPL as well as for CPIL dues.

In the **Audit Firm's** statement that HCPL's secured borrowings was mostly from IFIN, IL&FS and its group companies (₹ 1,688 Crores) and had very little secured external borrowings (₹130 Crores), very critical points are found missing, such as (i) whether the land parcels of HCPL were stock held in trade or fixed assets, (ii) whether HCPL would

give preference to clear dues of Siva group company over its own group companies and (iii) whether any other charges had been registered against the properties of HCPL and (iv) the extent to which balance, if any, of the asset values on realisation would be available to meet HCPL's obligations to CPIL. In any circumstances, and as has already been pointed out earlier, this elaborate "security" arrangement was nothing but the ILFS group picking up the tab for the loans given to the Siva group. Under RBI pressure, IFIN had been forced to provide for the entire outstanding loan. To offset this blow to a substantial extent, the "put option", that was clearly of zero value, was taken into the balance sheet at an unjustified value. The transaction clearly was a deliberate attempt to mislead the users of the financial statements, and hence, the argument of the **Audit Firm** is not found acceptable.

e) In response to Para 2.5.3 (vi), the **Audit Firm** refers to para 13 of the GN and states that the key criteria are whether the value of the derivative changes in response to change in the underlying which in this case is the price/ value of the equity shares of TTSL. The **Audit Firm** claims that in the instant case the value of the derivative (using any of the pricing models such as Black Scholes, Binomial etc.) would indeed change if there is a change in the price of TTSL shares. The **Audit Firm** goes on to state that in case where the underlying asset is not traded, the price/ value of the same could be determined using acceptable valuation techniques.

The **Audit Firm** disagrees with NFRA regarding applicability of Guidance Note on Accounting for Derivatives issued by ICAI to derivatives where the underlying shares are unquoted/unlisted, and states that para 8 of the GN sets out the principles underlying the Scope of the GN by a clear statement that '*This Guidance Note covers all derivative contracts that are not covered by an existing notified Accounting Standard.*' The other parts of para 8 and para 9 to 13 of the GN are clarificatory and illustrative.

The **Audit Firm** further states that the ET had performed appropriate procedures on the valuation of Put Option by assessing the validity of the inputs and variables used in the pricing model including those relating to credit risk.

NFRA has already clarified its view on the applicability of the GN at the **DAQRR** stage. The **Audit Firm** has not advanced any new arguments. This GN does not apply to the financial instrument under discussion which does not share the tradability characteristics of the instruments listed in Para 11 of the GN. The **Audit Firm's** claim that the ET had performed appropriate procedures on the valuation of Put Option by assessing the validity

of the inputs and variables used in the pricing model including those relating to credit risk is not found tenable in the absence of any sufficient appropriate audit evidence. NFRA, thus, reiterates that the **Audit Firm** has not obtained sufficient, appropriate audit evidence for this "exit" price.

f) In response to Para 2.5.3 (vii) of **DAQRR**, the **Audit Firm** has stated that the Put Option valuation particulars can be found in page I2.493 in file 'Sr. No. 17 Tata Teleservices Ltd. (I2.484- I2. 638)' in folder '2. 2 IFIN March 2018 File no. I2 – Investment' in folder 'Other work papers of the Audit File. These are also included in the embedded email in Cell No. C105 and D105 in the Worksheet titled 'TTSL' in work paper attachment 1.310. A summary of the document is also provided.

NFRA examined this. The **Audit Firm** previously referred to the WP at 'Page I2.617' of File 'SR.No.17 Tata Teleservices Ltd. (I2.484-I2- 638)' in file '2.2 IFIN March 2018 File No. I2-Investments' in Folder 'Other work papers' and now refers to 'page I2.493' of the Audit File. It also states that the key assumptions were Stock price as on date, compounded risk-free interest rate, standard deviation, Probability of Default (PD) and Loss Given Default (LGD) and refers to 'page I2.488' to justify that standard deviation was derived from the comparable volatility of Tata Teleservices Maharashtra for 1 years (which is similar for a period of 2 years & 8 months). However, as per the text of document which shows an email, the ET appears to be asking for such confirmation and the confirmation of stated assumption is found wanting in the stated WP. A further re-examination of the WP also reveals that the **Audit Firm's** expert advised Binomial Model to be more appropriate to circumstances than Black Scholes model. Further, the Probability of Default (PD) "was calculated basis actual historical data which was not available on a public data base and hence could not be verified" (email from Saaransh Kulkarni to Anuj Rawat Page I2 485). The PD was taken at 10.04 % as given by the Auditee, without any verification/evidence. For the Loss given Default (LGD), the Audit firm has now come up with some RBI instructions relating to Banks which was clearly not part of the original audit evidence. Therefore, the **Audit Firm's** argument that PD considered by the client based on its own portfolio corresponded to PD for a similar tenor for a credit rating of BB which is the last notch for investment grade rating is not found to be supported by the **Audit Firm's** contentions and submission.

g) In response to Para 2.5.3 (viii) of the **DAQRR**, the **Audit Firm** has stated that although the issue of provisioning on TTSL shares was raised by the RBI in earlier years, in the year

they were appointed as auditors, a full provision for TTSL shares was made at their insistence. This was done after taking into account the findings in the previous RBI inspection reports and the facts and circumstances. This demonstrates the professional skepticism and challenge of management by the ET.

However, as noted by NFRA in its prima facie conclusion, the provisioning in TTSL shares was countered by completely unjustified valuation of the derivative asset (in the form of the put option) of ₹184.3 Crores which appears to be a calculated fraud acting in support of the Management to inflate the profit. This value of the derivative was 90% of the years' Profit before Tax**.** The fact that this option contract was brought into the books as of 31st March, 2018, and was not reflected in the Balance Sheets as of 31st March, 2016, or 2017, only served to confirm the prima facie conclusion of the NFRA that this action was only a method used by the Management to inflate the profit. It is also clear that the ET had actively assisted the Auditee Company to desist from providing for the loss of ₹190 Crores on the OCDs as advised by the RBI.

Further, the **Audit Firm** has argued that as per Para A2 of SA 510, '*the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period.*' As part of verification of opening balances, the **Audit Firm** has claimed, perusal of the annual report for the previous year indicated that the audit report was unmodified. However, Para A2 of SA 510 also states that the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, ***except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.*** As stated above, unjustified valuation of the derivative asset (in the form of the put option) of ₹184.3 Crores appeared to be a calculated fraud and the **Audit Firm** should have gathered sufficient appropriate evidence regarding opening balances of investments.

The argument made by the **Audit Firm** that, " While acquisition of TTSL shares was made in the year ended 31st March, 2015, the RBI Inspection Reports for the year ended 31st March, 2015, or for later period did not raise any issues on the accounting treatment upon invocation of shares or classified the same as restructuring" is also baseless because the option contract was valued for the first time in 2017-18. RBI's Inspection Report dated 14th September, 2016, had recommended a provision of ₹253.55 Crores as on 31st March, 2015, (i.e. full value) against the shares of TTSL held by IFIN. Similarly, the same direction was

reiterated by the RBI in its Inspection Report dated 1st November, 2016. However, no write-off was done till 2017-18 and which was countered by the introduction of option contract and also by not providing for the loss of ₹190 Crores on the Siva Green OCDs.

h) In response to Para 2.5.3 (ix) of **DAQRR**, the **Audit Firm** has stated that the matters were highlighted to the AC because these involved significant judgements and as required by para 16 of SA 260 (Revised). The **Audit Firm** has further stated that based on the audit procedures performed and responses as above to matters raised in para 2.5.3 (i) to (viii) of the **DAQRR**, the ET did not believe it was necessary to modify the opinion in the auditor's report in accordance with SA 705.

As clearly showed in **DAQRR** (Para 2.5.3 (ix)), the **Audit Firm** has failed to gather any evidence in this matter. Just by highlighting the matter to the Audit Committee, without any evidence of the discussion held and conclusions reached, the **Audit Firm** cannot be absolved from its duty/responsibility. Further, in view of the discussion above, in light of Para 18 of SA 700 and failure to obtain sufficient appropriate audit evidence regarding the opening balances, the **Audit Firm** should have determined whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705.

i) In response to Para 2.5.3 (x), the **Audit Firm** has stated that their response that "such decisions are purely business decisions for the Management of the Company to take" was in response to the NFRA's comment in para 3.2.1 of its letter dated 7 August 2019 that *'the securities (TTSL shares) should have been sold in the beginning itself to close the loss asset, however, the Company has entered into further agreements with the defaulter group'*. NFRA, as observed in the **DAQRR**, reiterates that considering the nature of transaction and as also understood from previously highlighted "Annex V - Norms on Restructuring of Advances by NBFC" of the "RBI/DNBR/2016-17/45 Master Direction DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016", the **business decision of the Management** clearly appears to be questionable. However, the **Audit Firm**, failed to gather any evidence in this matter to arrive at the stated understanding or conclusion.

Further, the statement that "BSR was for the first time appointed as auditors of IFIN for the year ended 31 March 2018. Thus, BSR was not even the auditor of the Company in the year in which the aforesaid decision was made" does not befit a responsible auditor. In fact, the SAs do not distinguish between first- time auditor or otherwise.

Further, the **Audit Firm** has again referred to RBI's letter dated 13 March 2018 and Response of the Company dated 16 March 2018 and letter dated 16 May 2018 sent to the RBI wherein, it had included 'Put Option and Guarantee documents for the Siva Group exposures' in Annexure II of the said letter (refer S610 to S612 of file '4.RBI (Page S470 to S623)' in Folder '5. IFIN March 2018 File No. S-Others' in Audit File). The **Audit Firm** has further stated that no response was received from the RBI until the date of opinion (28 May 2018) on the standalone financial statements. All these letters were earlier examined by NFRA at **DAQRR** stage. Merely writing back again and again to the regulator does not mean that the clear-cut directions of RBI can be avoided. The RBI's Inspection Reports and RBI's letters, as observed, were conclusive in nature.

2.5.6 NFRA, therefore, reiterates its conclusion that:

a) The **Audit Firm** has failed to obtain sufficient appropriate Audit Evidence as required by Para 9 of SA 500. The **Audit Firm** has not exercised due diligence, and have been grossly negligent in the conduct of their professional duties.

b) The **Audit Firm** ignored the overwhelmingly clear legal position and chose to accept the stand taken by the Management without questioning it. The **Audit Firm** failed to exercise due diligence and professional skepticism, as required by the SAs.

c) The **Audit Firm** has failed to evaluate the reliability, accuracy and completeness of Audit Evidence as required by Paras 9 and 11 of SA 500. This shows gross negligence and lack of due diligence on the part of the **Audit Firm**.

d) The valuation of put option and equity shares of TTSL was inappropriate and misleading reporting of a very serious matter which had a huge impact on the reported profits. The **Audit Firm** has failed to obtain sufficient information which was necessary for expression of opinion.

2.6 EVALUATION OF RISK OF MATERIAL MISSTATEMENT (ROMM) MATTERS

2.6.1 In its communication dated 7th August, 2019, NFRA had conveyed its prime facie conclusions as follows:

a) Having examined WP 2.14.1.20 for Risk Assessment and Planning Discussion (RAPD), NFRA had observed discrepancies in the documentation required in accordance with SA 300. The **Audit Firm** had claimed the date of discussion on a date by which a large number of hours had actually been logged in as per the log details separately submitted by the **Audit Firm**. The **Audit Firm** had undertaken ROMM assessment at a very late stage after completion of 40% of the total hours logged on the engagement.

b) The **Audit Firm** had concluded in WP 2.14.1.20 that the "the presumed fraud risk of revenue recognition was rebutted" at the very planning stage. This was done without performing any tests of controls or any Audit Procedures as per the relevant SAs. The **Audit Firm** had failed to comply with the requirements of Para 47 of SA 240 which, inter alia, require the auditor to state the reasons if the ROMM due to fraud related to revenue recognition is not applicable in the circumstances of engagement. The WP mentioned above itself contains statements made by the **Audit Firm** that are contradictory to their outright conclusion of rebuttal of fraud risk. The statements made by the **Audit Firm** in WP prove that either the documentation of RAPD is fictitious or the audit documentation in entirety is dubious.

c) Given the fact that the Auditee is an NBFC, generating its major revenue from interest income on loans and advances, the ET should have suspected that revenues would be fundamentally inflated by recognizing revenues that should not be recognized either because of (a) NPAs, that were suppressed, and defaults ignored; or (b) NPAs that were made 'regular' by ever-greening of loans. The WP no. 2.14.1.10 does not contain any evidence to substantiate the Audit Strategy and the Audit Plan needed to build in special procedures to verify the cases in light of Section 143 (1) (a) of the Companies Act, 2013.

d) On the basis of sample cases i.e. Best and Crompton Engineering Ltd. and Monnet Power Co. Ltd., it was observed that the ET did not verify the documents submitted by the borrower as a security against the loans and advances given. The WP No. 3.230 does not contain any information to substantiate that the ET had either seen the original title deeds

of the properties mortgaged or at least considered the claims of the other pari-passu charge-holders. Also, the **Audit Firm** had not checked, on a sample basis, the actual revenue generation or repayment capacity and consequent credit worthiness of the Company's borrowers and instead just relied upon the collaterals attached to the loans disbursed by the Company.

e) The **Audit Firm** had failed to comply with the requirements of Para 19 of SA 330. The Auditor had not performed sufficient external confirmation procedures, especially with respect to RBI. They simply relied upon the document (purported minutes of meeting with RBI) which holds no legal value, and was provided by the Management (Annexure 5 to the **Audit Firm's** Response dated 6th June, 2019).

f) The **Audit Firm** had not complied with the requirements of SA 610 (R). The Internal Auditor's Report did not form part of the Audit File. Also, the **Audit Firm** had not complied with the requirement of Para A11 of SA 315 that requires the auditor to enquire with appropriate individuals within the internal audit function to assist in identification of ROMM due to fraud or error.

g) The ET had not complied with the requirements of Para 6 read with Paras A7- A10 of the SA 315 which, inter alia, requires the risk assessment in the beginning to include the Analytical Procedures in order to provide a basis for identification of ROMM at the Financial Statements and Assertion level.

2.6.2 The **Audit Firm** in its response dated 10th September, 2019, has stated as follows:

a) In response to the NFRA's observation that ROMM assessment had been conducted at a very late stage, the **Audit Firm** had clarified that the RAPD was actually held on 16th and 21st March, 2018 and not on 15th April, 2018. The same was discussed between the EQCR Partner and the ET on 4th April, 2018. The discussion during the aforesaid meetings was summarized on 15th April, 2018 in the WP 2.14.1.20. The **Audit Firm** has further clarified that their remark in WP 2.14.1.20 regarding significant matters to be discussed with the EQCR partner (even after his presence in the said meeting) were recorded mainly to ensure that EQCR inputs are taken before work on key areas commences and also to agree with the plan for the EQCR's review of audit documentation.

b) Regarding the ET's conclusion of rebutting the presumed fraud risk related to revenue recognition, the **Audit Firm** has stated that the ET had collectively spent a fair amount of time understanding the business and risk assessment before the ROMM discussion. ROMM is required to be determined at the planning stage. Further the **Audit Firm** has referred to attachment 2.14.2.10 to support their conclusion of rebutting of presumed fraud risk related to revenue recognition in accordance with Para 47 of SA 240. The **Audit Firm** has also clarified that their statement under the heading "Emphasis on the risk of fraud" was just a reminder to the participants of the RAPD to remain vigilant to the risks of fraud and was not contradictory to the fraud risk assessment captured in the discussion. The **Audit Firm** has submitted additional documents as Annexure 6 with their submission.

c) The **Audit Firm** has stated that the presumed fraud ROMM on revenue recognition was rebutted. The possible suppression of NPAs by ignoring defaults or by making NPA's 'regular' by ever-greening are risks associated with the treatment of loans and directly linked to the risk of valuation of loans. The **Audit Firm** has further submitted that their performance of procedures on loans (with regard to their status as NPAs or otherwise) is in WP 4.160.

d) In response to the NFRA's observation on the Audit Procedures performed by the **Audit Firm** on the security given by the borrower as a security against the loans and advances given, the **Audit Firm** has referred their working on the internal control system in WP 2.130 and submitted that they relied on the Internal Auditor reports that did not identify issues in this regard. Regarding the Audit Procedures on the actual revenue generation or repayment capacity and consequent credit worthiness of the company's borrowers, the **Audit Firm** has not referred to any WP in their response and stated that most of the lending by the Auditee Company pertains to infrastructural projects which are long term projects and do not have current earning. Therefore, collateral is an important basis for such lending. Regarding the past track record of borrowers, the **Audit Firm** has mentioned that this was their first year as the auditor of the Company and no concern was raised by the joint auditor in this regard who had cumulative experience for many years.

e) Considering the fact that Mr. Arun Kumar Saha's and Mr. Deepak Pareek's communications with the RBI Officials was going to be placed before the Audit Committee meeting on 28th May, 2018 i.e., the date of signing of Audit Report itself and the other available information, the **Audit Firm** did not find any reason to disbelieve the recording of the various notes of meetings with RBI (Annexure 5 to the **Audit Firm's** response dated

6th June, 2018). The **Audit Firm** has referred to SA 240 which lists the circumstances where the auditor has reason to question the authenticity of the document. The auditor mentioned that they did not come across any such reasons including the fact that RBI had not made any further communication before the date of signing of Audit Report that raised doubts on the acceptability of the documents given by the Management.

Regarding the discussion with the Management on the matter of NOF/CRAR raised by the RBI, the **Audit Firm** has referred to certain WPs in their audit documentation. The firm further reiterated that the matter on NOF/ CRAR was a long pending issue with the RBI and it pertained to a period before their appointment as the Statutory Auditors of the Company and mentioned that even the EoM Para in the Audit Report and the exception report to RBI on this matter was done for the first time for FY 2017-18 after their appointment as the Statutory Auditors. The **Audit Firm** has further stated that the RBI had never raised any question on the methodology adopted by the Company till the year ended 31st March, 2015 and no penalty or any other action was initiated by RBI till that time.

f) Regarding NFRA's observation on the requirements of SA 610 i.e., "Using the Work of Internal Auditor" the **Audit Firm** had stated that "ET *did not use the work of Internal Auditor- refer documentation in eAudit Screen 2.7.4 of our eAudit File".* Further, at page 59 of its response dated 10th September, 2019, the **Audit Firm** has stated that WP 2.14.2.10 on Risk Assessment is based on certain procedures performed up to that stage including enquiries with management, consideration of findings from Internal Audit Reports, etc.

g) The **Audit Firm** has submitted that Analytical Procedures were part of their planning process. Drawing attention to Screen 2.4.1 (Planning Analytical Procedures), they have stated that they used figures of Interim Unaudited Financials initially and it eventually got updated with the final figures. The **Audit Firm** has further stated that based on the analysis of Interim Unaudited Financials presented to the Board, the **Audit Firm** had concluded that there were no significant trends or matters arising therefrom that would have caused the ET to amend its risk assessment.

2.6.3 The NFRA had examined the above contentions of the **Audit Firm** and had concluded as follows in **DAQRR**:

a) Having examined WP 2.14.1.20 "Risk Assessment and Planning Discussion", WP 2.14.3.1.0010, WP 2.14.2.10, and the Annexure 2 to the Response by the **Audit Firm** dated

6th June, 2019, NFRA concludes as below:

i. As per the details of number of hours logged on the audit engagement, the EP had first logged into the engagement on 26th April, 2018, and the EQCR Partner had first logged on 4th April, 2018, while the WP on the RAPD demonstrates their presence during the discussion which clearly questions the validity of the documentation.

ii. The firm has not complied with the requirement of Para 4 of SA 300 which requires the EP and Other Key Members to be part of the planning discussion.

iii. The **Audit Firm** itself has made a contradictory statement vis-à-vis what is stated in the WP. While the WP demonstrates the date of discussion to be 15th April, 2018, the **Audit Firm** has submitted that the discussion has actually been undertaken on 16th March, 2018 and 21st March, 2018.

iv. This brings out the gross negligence of the **Audit Firm** in documenting important matters relating to ROMM.

b) Para 47 of SA 240 requires that:

"When the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion".

NFRA has examined WP 2.14.1.20 thoroughly. The document does not contain any evaluation on the presumed ROMM due to fraud in revenue recognition. The document broadly contains the snapshot of Assets and Revenue. The **Audit Firm** has failed to document the reason for their conclusion in support of rebutting the presumed ROMM due to fraud related to revenue recognition and has failed to comply with the requirement of the Para 47 of SA 240. NFRA reinforces its observation on the "Emphasis on the risk of fraud" documented in the WP 2.14.1.20 as a contradiction to their initial conclusion of rebutting the presumed fraud ROMM of revenue recognition. The **Audit Firm's** own observation under the heading "Emphasis on the risk of fraud" was completely ignored while rebutting the presumed fraud risk related to revenue recognition without documenting the reasons for the rebuttal. The **Audit Firm**, thus, failed to exercise due diligence, was grossly

negligent, and failed to comply with the requirement of Para 47 of SA240.

c) The presumed ROMM in revenue recognition due to fraud has been rebutted by the **Audit Firm** on the grounds of "professional judgement". However, as per Para 26 of SA 240, "When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks." No such documentation has been provided by the **Audit Firm**. No analysis with respect to the Revenue Recognition Policy of the Company has also been carried out. Further, in accordance with Para 12 of SA 240 and Para 15 of SA 200, the auditor should have maintained professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist.

The **Audit Firm** has failed to provide reference to any WP that substantiates their working in the light of requirements under Section 143 (1) (a) of the Companies Act, 2013. NFRA would like to reproduce the requirements of Section 143 (1) (a) as: *"(a) 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."* The Auditee Company is a NBFC with major revenue from interest income on loans and advances sanctioned. Hence, the Audit Strategy and Audit Plan should have built in special procedures, especially in light of Section 143 (1) (a) of the Companies Act, 2013.

The **Audit Firm** in their response has tried to mislead NFRA by making an unacceptable statement that *"The possible suppression of the NPA's by ignoring defaults or by making NPA's 'regular' by ever-greening are risks associated with treatment of loans and directly linked to the risk of valuation of loans".* The possible suppression of NPAs or evergreening are income recognition issues primarily apart from being loan classification and valuation issues.

NFRA has examined WP 4.160 referred by the **Audit Firm** in their response as their performance of procedures on loans with regard to the status as NPA. The said WP does not contain any evidence of the performance of any Audit Procedures except the arithmetical verification of the interest computation.

The **Audit Firm** has, thus, failed to comply with the requirements of Para 12 and Para 26

of SA 240, Para 15 of SA 200, and Section 143 (1) (a) of the Companies Act, 2013.

d) The **Audit Firm** has admitted that no evaluation has been done to check the actual revenue generation or repayment capacity and consequent credit worthiness of the Company's borrowers and that it had, instead, just relied upon the collaterals. Para 5.25 and 5.26 of ICAI Technical Guide on Audit of NBFCs, gives detailed guidelines regarding Audit Procedures related to loans and recorded provision for loan losses. Para 5.25 also refers to RBI's prudential norms regarding guidance to NBFCs on recognition and measurement of loans, establishment of loan loss provisions, credit risk disclosure in Financial Statements and related matters. Para 5.26 further states that the major audit concern is the adequacy of the recorded provision for loan losses. In establishing the nature, extent and timing of the work to be performed, the auditor should, besides collateral coverage, also look at KYC procedures performed, credit approval process, loan documentation, internal credit rating assigned to borrower, credit monitoring by credit committee, scope and extent of work performed by internal audit, verify window-dressing/ever greening, etc. Thus, the Audit Procedures performed by the **Audit Firm** are completely insufficient when compared with the stipulations in Paras 5.25 and 5.26 included in Chapter 5 "*Areas of Audit Concern*" of the Technical Guide on Audit of NBFCs issued by *ICAI*.

The **Audit Firm's** statement that *"With regard to past track record, this was the first year for us as auditors of the Company"* cannot relieve them from the performance of any Audit Procedures required, especially in the light of multiple adverse inspection reports from the Regulator.

As part of risk assessment, the **Audit Firm** did a Walkthrough of the lending process (WP 11.1.10). While performing the Walkthrough, the **Audit Firm** examined only one CAM, which was attached to the walk-through. The CAM was pertaining to short-term loan facility of ₹270 Crores to New India Structures Private Limited. In the CAM, following observations have been noted: "*A). Proposed loan is 29 times of EBITDA. B). External credit rating is BB-. C). Though source of repayment is internal accruals/group resources, refinancing appears to be the only route"*. Thus, so many risk factors were identified "*in the only CAM*" examined by the **Audit Firm** as part of risk assessment. The **Audit Firm** did not raise these issues with the Management and obtain an understanding about how the Management granted the loans notwithstanding such adverse reports. The **Audit Firm** failed to obtain appropriate Audit Evidence through designing and implementing responses for the risk identified (as required by SA 330).

e) The **Audit Firm** in the RAPD memo (2.14.1.20) had identified Capital Adequacy of the Company, RBI Inspection Report and NOF/CRAR issue as significant risk items. As far as the regulator is concerned, RBI had time and again clarified the matter of "companies in the same group" which has significant implications for NOF/CRAR and, consequently, for the presentation of Audited Financial Statements. The RBI in its Inspection Report of 2015 dated 6th May, 2016, has clearly stipulated how the "companies under the same management" should be considered, and had assessed NOF as negative. The RBI report has stated that, due to this, the CRAR was also negative and the company has not maintained adequate capital. Despite the representation given by the company, RBI in its report dated 14th September, 2016, had again reiterated its stand and had assessed NOF/CRAR as negative. Further, RBI in its email dated 27th March, 2017 had clearly stated that the compliance submitted by the company **"pertaining to major issues like group exposure, … etc. are not accepted".** This clearly shows that RBI had taken a final view in March 2017. Further, RBI vide its letter dated 13th March, 2018, had clearly rejected the Company's request for extension of time in their said communication and had asked the Company to comply with their inspection report. All this correspondence was also available with the **Audit Firm**. Hence, to say that the **Audit Firm** did not find any reason to disbelieve the purported recording of the various notes of meetings with RBI is completely misleading.

The **Audit Firm,** after having identified the risk, neither obtained external confirmation from the RBI, (as required by Para 19 of SA 330) nor designed and implemented any responses to the risk identified (as required by SA 330).

f) The **Audit Firm** has stated that they did not use the work of internal auditor. However, at two different instances, in its response dated 10th September, 2019, the **Audit Firm** has referred to the work of the internal auditor. The instances are use of Internal Audit Report for risk assessment (Page 59), and for verification of existence of collaterals which was in the scope of work of the internal auditor (Page 67).

As per Para 153 of Guidance Note on Audit of Internal Financial Controls Over Financial Reporting, "*The auditor should form an opinion on the adequacy and operating effectiveness of internal financial controls over financial reporting by evaluating evidence obtained from all sources, including the auditor's testing of controls, misstatements detected during the audit of Financial Statements, and any identified control deficiencies. Note: As part of this evaluation, the auditor should review reports issued during the year by*

internal audit (or similar functions) that address controls related to internal financial controls over financial reporting and evaluate control deficiencies identified in those reports." As admitted by the **Audit Firm**, they did not use the Internal Audit Report while forming an opinion on the adequacy and operating effectiveness of internal financial controls.

WP 2.14.2.10 refers to a meeting held with the head of the Internal Audit function of the company documented in WP 2.5.2.20. However, the minutes of this meeting only covers discussion regarding issues raised by RBI, and valuation of TTSL loans. There is no discussion regarding identification of ROMM due to fraud or error, as required by Para A11 of SA 315.

NFRA, therefore, concludes that the **Audit Firm** has not complied with the requirements of SA 610, "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting", and Para A11 of SA 315. Further, the **Audit Firm** has tried to mislead NFRA by giving contradictory statements.

g) According to Para 6 of SA 315, the risk assessment procedure should include Analytical Procedures. Para A13 of SA 315 further states that "Analytical Procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the ROMM in order to provide a basis for designing and implementing responses to the assessed risk. Analytical Procedures performed as risk assessment procedures may include both financial and non-financial information". Screen 2.4.1, as referred by the **Audit Firm**, is just a comparison of opening and closing balances of certain accounts. The final column shows the percentage change in the balance. Certain Rows – Provision for Standard Restructured Assets -96%, Current Investments 281%, Long-term Investment 133%, Provision for Income Tax -674%, Other Advances 822%, Security Deposit received 15233%, etc. show huge fluctuation in the balances. However, no further Analytical Procedures have been carried out to identify aspects of the entity which may assist the **Audit Firm** in assessing the ROMM. Similarly, the other attachment, referred to by the **Audit Firm**, is nothing else but Board Meeting Minutes regarding the financial and operating performance of the company for the period ended 31st December, 2017. Even here, no further analysis, analytical procedure or Audit Procedure has been carried out by the **Audit Firm**. NFRA, therefore, concludes that the **Audit Firm** has performed no Analytical Procedures as risk assessment procedures and have failed to comply with Para A13 to Para A15 of SA 315.

h) In WP on RAPD Memo (2.14.1.20), the **Audit Firm** had identified, as significant Risk, that "the Company grants rollover to both short term and long term loans and there is no specific mention of how many times the rollover is allowed as mentioned in RBI policy". The **Audit Firm** had also identified cases of Rollover as follows:

Client Name	Facility	Rollover Amount	Tenor	Effective Date of Rollover	Rollover Maturity Date
IL&FS Wind Projects Development Ltd	ITML	215 Cr	24 Months	28th February, 2018	28th August, 2018
Bhopal E-Governance Limited	STL	4 Cr	36 Months	27th February, 2018	27th August, 2018

As per Para (iii) of Appendix 2 of RBI Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016: "In the cases of roll-over of short term loans, where proper pre-sanction assessment has been made, and the roll-over is allowed based on the actual requirement of the borrower and no concession has been provided due to credit weakness of the borrower, then these shall not be considered as restructured accounts. **However, if such accounts are rolled-over more than two times, then third roll-over onwards the account shall be treated as a restructured account**."

The **Audit Firm** after having identified the significant risk of Rollover of loans, failed to design and implement any response to the identified risk, as required by SA 330.

i) The **Audit Firm** in Client Evaluation Detail Report which forms part of WP No 2.14.1.20 (RAPD) has classified the engagement risk- Final Risk Grade- as "Low". The 14th September, 2016, Report of the RBI, which was available with the **Audit Firm,** brought out serious issues related to compliance with NOF/CRAR. It also flagged numerous other issues, such as rolling over of loans (and not making the required provisions), evergreening, deficiencies in the credit policy, non-disclosure of restructured loans and advances, non-provisioning for diminution in value of investments etc. Each of these issues individually,

and certainly collectively, was serious enough to warrant upgrading of risk, and the planning and carrying out of appropriate audit responses. Even, as far as group exposure was concerned, it was seen that the amount (in excess of 10% of NOF) ballooned from ₹1470.21 Crores as on 31st March, 2015 to ₹5582.42 Crores as on 31st March, 2016. Clearly, the Management was going ahead in lending to the group companies in reckless disregard of the RBI's directions. The NOF was recomputed by the RBI at (-) ₹4123.76 Crores as on 31st March, 2016, as compared to (-) ₹45.93 Crores as on 31st March, 2015. This was also clearly very specific evidence of very risky management practices. It may further be noted that the Client Company was identified and notified by the RBI as a Systemically Important (SI) NBFC. Nowhere in the Audit File is there any evidence that the auditors took note of the SI-NBFC character of the Client Company into its risk assessment. Quite apart from all other considerations enumerated above, the fact that the Client Company was identified as a SI-NBFC itself should have qualified it for being put into a very high risk category.

j) Surprisingly, the Client Evaluation Detail Report, forming part of WP 2.14.1.20 (RAPD), which gave the Final Risk Grade- as "Low" to the Auditee Company, was not even seen by the EQCR. The EQCR has also failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET. Thus, the **Audit Firm** has failed in complying with various provisions of SQC 1, SA 220 and SA 230.

2.6.4 Having examined the responses of the **Audit Firm**, NFRA concluded as follows in **DAQRR**:

a) There had been a woeful lack of clarity, and utter confusion had prevailed in the ROMM assessment.

b) Important aspects of the Auditee Company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the Company, the wide discrepancies in reporting of NPAs, etc., had not been given adequate importance in the ROMM assessment.

c) It was observed that the audit responses planned to reduce or mitigate the identified risks and the actions taken based on the audit responses to such identified risks were insufficient, improper and inadequately carried out.

d) In crucial matters, the **Audit Firm** had relied completely on the Management's Representations.

e) The **Audit Firm** has failed to comply with the requirements of Para 12, Para 26 and Para 47 of SA 240, Para 15 of SA 200 and Section 143 (1) (a) of the Companies Act, 2013.

f) The Audit Procedures performed by the **Audit Firm** are completely insufficient in relation to the requirements laid down in Paras 5.25 and 5.26 of Chapter 5 "*Areas of Audit Concern*" of the Technical Guide on Audit of NBFCs *i*ssued by ICAI.

g) The **Audit Firm**, after having identified the risk, neither obtained external confirmation from the RBI (as required by Para 19 of SA 330) nor designed and implemented any responses to the risk identified (as required by SA 330).

h) The **Audit Firm** has not complied with the requirements of SA 610, Guidance Note on Audit of Internal Financial Controls Over Financial Reporting and Para A11 of SA 315. Further, the **Audit Firm** has tried to mislead NFRA by giving contradictory statements.

i) The **Audit Firm** has performed no Analytical Procedures as risk assessment procedure and have failed to comply with Para A13 to Para A15 of SA 315.

j) The **Audit Firm** after having identified the significant risk of Rollover of loans, failed to design and implement any response to the identified risk, as required by SA 330.

k) The EQCR has also failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET.

l) The **Audit Firm**, its EP, and the EQCR were all guilty of professional misconduct arising out of gross violations of the law and the applicable Accounting Standards. The ET also failed to exercise due diligence, and failed to obtain sufficient information necessary for expression of an opinion.

2.6.5 After examining the responses of the **Audit Firm** to the DAQRR, NFRA concludes as follows:

a) The **Audit Firm** has, in their response to Para 2.6.3 (a) of **DAQRR**, stated that," *We apologise for any confusion regarding the documentation of the date of the meetings.*

However, we would request you to please consider that the time log is an internal administrative procedure and should not be misconstrued to be evidence of non-involvement in the engagement. The electronic sign offs and logs thereof are critical and determinative evidence of involvement in the engagement. As was clarified earlier, the risk assessment and planning discussions were held on various dates and with various stakeholders. The EQCR's discussions with ET members on risk assessment took place on 4 April 2018. The summary of all these discussions were documented on various dates and finally compiled on 15 April 2018. Accordingly, we submit that we have complied with the requirements of Para 4 of the SA 300. We acknowledge that the aspects referred to in the NFRA's observation could have been better documented. We submit that the RAPD document is valid, and the EP and key team members were part of the planning discussion and there is no gross negligence as alleged." The **Audit Firm** has however failed to address NFRA's observations made in its **DAQRR** Report that, "The firm has not complied with the requirement of Para 4 of SA 300 which requires the EP and Other Key Members to be part of the planning discussion". The **Audit Firm** has failed to show any Audit Evidence regarding participation of EP and other key members in the planning discussion. The **Audit Firm** itself has made a contradictory statement vis-à-vis what is stated in the WP. While the WP demonstrates the date of discussion to be 15th April, 2018, the **Audit Firm** has submitted that the discussion has actually been undertaken on 16th March, 2018 and 21st March, 2018. The **Audit Firm** has now tried to camouflage its failure by stating that *all these discussions were documented on various dates and finally compiled on 15 April 2018.* This brings out the gross negligence of the **Audit Firm** in documenting important matters relating to ROMM.

b) In response to Para 2.6.3 (b) of **DAQRR**, the **Audit Firm** has stated that, "*The ET has documented in WP 2.14.1.20 of eAudit file that there are limited incentives, rationalizations and/or opportunities to fraudulently adjust revenue recognition, and hence the fraud risk related to revenue recognition is not present. Para A30 of the SA 240 states that fraud risk assumption in revenue recognition may be rebutted. The rationale for rebutting fraud risk is also explained in detail in WP 2.14.2.10 of our eAudit file. We would also like to draw your attention to the documentation under the heading* ***'Interest Income on Loans & Advances'*** *and* ***'A. Profit and Loss on sale of Investments/Interest Income in Investments/Interest on Deposits'*** *in page 7 of WP 2.14.2.10 of our eAudit file, where it is clearly documented that these processes are 'system' based / 'highly automated with minimal manual involvement'...*" On perusal of WP 2.14.2.10, it is seen that **Audit Firm** has identified Interest income on loans, income from investments, lease income, interest and deposits, debt securitization & distribution fees and consultancy & advisory services

as the areas with risk of fraud and in the conclusions section, **Audit Firm** has stated that "*Based on the identified fraud risk factors, there are limited incentives, rationalizations and/or opportunities to fraudulently adjust revenue recognition, so the fraud risk related to revenue recognition is not present. Therefore, the presumed fraud risk related to revenue recognition was rebutted.*" There is no documentation of how the conclusions are reached just after identifying the areas of fraud risk factors, without conducting any audit procedures. The **Audit Firm** has also stated in their response that, "*We would also like to draw your attention to the documentation under the heading **'Interest Income on Loans & Advances'** and **'A. Profit and Loss on sale of Investments/Interest Income in Investments/Interest on Deposits'** in page 7 of WP 2.14.2.10 of our eAudIT file, where it is clearly documented that these processes are 'system' based / 'highly automated with minimal manual involvement".* After reviewing Page 7 of the WP 2.14.2.10 as referred to by the **Audit Firm**, it is observed that there is no documentation of the fact that interest income on loans & advances, profit and loss on sale of investments, interest income on investments or interest income on deposits are 'system' based or 'highly automated with manual involvement'. Hence, the **Audit Firm** has tried to mislead NFRA by quoting a sentence which is not supported by its Audit File.

Further, it is to be noted that in accordance with Para 12 of SA 240, the auditor shall maintain professional skepticism throughout the audit, recognizing the fact that 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. Given this requirement of Para 12 of SA 240, the **Audit Firm's** contention that, "… *We had discussion with the joint auditors who have been auditing the Company for the last 10 years. They did not highlight any integrity issues about the Management, and we had no reasons to disbelieve our joint auditors. We had also obtained a 'No Objection Certificate' (Refer WP 1.1.1.100 of our eAudit file) from our joint auditors which also indicated that there was no objection, professional or otherwise in being appointed as joint auditors. Hence, we emphasize that there is no contradiction on the conclusion to rebut fraud risk in revenue recognition and the documentation under the heading 'Emphasis on the risk of fraud'* is not in accordance with the requirements of SA 240. Hence, the observations made by NFRA in its **DAQRR**, i.e. the **Audit Firm** has failed to exercise due diligence, was grossly negligent, and failed to comply with the requirement of Para 47 of SA240 are still relevant.

c) **Audit Firm** has not addressed NFRA's observations in Para 2.6.3. (c) of **DAQRR** regarding documentation to comply with requirements of Para 26 of SA 240, absence of

analysis with respect to the Revenue Recognition Policy of the Company and maintaining professional skepticism throughout the audit. This clearly implies that **Audit Firm** has accepted this observation.

In response to NFRA's observations made on Section 143(1)(a) of the Companies Act, **Audit Firm** has stated that, "*Section 143(1)(a) of the Companies Act, 2013, requires the auditor to inquire 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. We refer to the 'Work done on security' in WP 3.230 of our eAudit file and* ***Appendix 8*** *relating to procedures with regard to security creation. With regard to inquiring into whether the terms on which loans have been made are prejudicial to the interests of the company, our procedures in addition to those described above for security, included observations on rate of interest on loans given during the year – refer WP attachment 4.160 of our eAudit file vis-à-vis borrowing cost – refer WP attachment 2. .0010 of our eAudIT file. Based on the above, we observed that generally the rates were well above the average borrowing rate of the Company. Accordingly, we submit that we have complied with the requirements of Section 143(1) (a) of the Companies Act, 2013.*" On Perusal of WP 3.230, NFRA notes that **Audit Firm** has taken 20 samples for evaluating the securities. However, the **Audit Firm** has merely evaluated the securities without actually checking them with the amount of loans sanctioned by the company. i.e. Security values are not evaluated with respect to the amount of loans sanctioned. Hence, from this it cannot be established whether the loans are adequately secured or not and whether the terms on which they are made are not prejudicial to the interest of the company. Hence, the **Audit Firm's** evaluation does not provide any conclusions as to whether the evaluations as required by Section 143(1)(a) of the Companies Act are adhered to.

The **Audit Firm** has not addressed NFRA's observations made in **DAQRR** that, "the **Audit Firm** in their response has tried to mislead NFRA by making an unacceptable statement that *"The possible suppression of the NPA's by ignoring defaults or by making NPA's 'regular' by ever-greening are risks associated with treatment of loans and directly linked to the risk of valuation of loans".* The possible suppression of NPAs or ever greening are income recognition issues primarily apart from being loan classification and valuation issues.

NFRA had examined WP 4.160 as referred by the **Audit Firm** in their response as their performance of procedures on loans with regard to the status as NPA. The said WP does

not contain any evidence of the performance of any Audit Procedures except the arithmetical verification of the interest computation. Hence, NFRA's observations still stands and are deemed to be accepted by the **Audit Firm**.

d) In response to Para 2.6.3 (d) of the **DAQRR**, the **Audit Firm** has stated that, "*As regards the actual revenue generation of Company's borrowers, it may also be noted that the loan exposures of the Company were primarily for companies that are in the business of Real Estate and Infrastructure development. In many instances, the projects were in progress and revenue generation would commence upon significant progress in the project or on completion of the project. Provisioning under Indian GAAP, for loans granted by NBFCs is governed by RBI prudential norms. The RBI norms in turn are based upon value of collateral. Thus, for financial reporting purposes under Indian GAAP, value of security plays a pivotal role. Our audit procedures were designed to examine this aspect.*" The **Audit Firm's** contention that in many instances, the projects were in progress and revenue generation would commence upon significant progress in the project or on completion of the project is not supported by any of the WPs neither has the **Audit Firm** referred to any of the WPs in the eAudit file submitted to NFRA. This statement of the **Audit Firm** is a mere written submission without any basis and hence would be construed as an attempt to mislead NFRA. The **Audit Firm** has further in its response stated that, "*The Technical Guide requires the auditor to cover the loan booking, approval and disbursement process, subsequent collections and collateral management and verifying the recorded provisions for loan losses. As discussed above, our audit procedures included verification of approvals for loan by the delegated authority. The company had a well-defined procedure in this regard and the documents provide support that the procedures was duly followed. The statement of loans approved and sanctioned by the proper delegates were placed before the Board which included independent directors (for their noting and review). We verified that the above procedures were followed. The procedures summarized above substantially cover the procedures required to be performed under Para 5.25 and Para 5.26 of the technical guide. Accordingly, we respectfully submit that we have obtained appropriate audit evidence through designing and implementing responses for the risk identified.*" Having noted the requirements of the Technical Guide the **Audit Firm** has only evaluated whether the loans were approved by delegated authority, ignoring the other requirements of the Technical Guide, for instance, subsequent collections, collateral management and verifying the provisions for loan losses. Hence, NFRA's observations made in its **DAQRR** report that the Audit Procedures performed by the **Audit Firm** are completely insufficient when compared with the stipulations in Paras 5.25 and 5.26 of the Technical Guide on Audit of NBFCs issued by *ICAI* and that the **Audit Firm** failed to obtain appropriate Audit

Evidence through designing and implementing responses for the risk identified (as required by SA 330), are reconfirmed.

Further, the **Audit Firm** has remained completely silent on NFRA's observation in **DAQRR** regarding the walkthrough of the lending process (WP 11.1.10). The **Audit Firm** did not raise issues identified "*in the only CAM*" examined by the **Audit Firm** as part of risk assessment with the Management and obtain an understanding about how the Management granted the loans notwithstanding such adverse reports. The **Audit Firm** has thus failed to obtain appropriate Audit Evidence through designing and implementing responses for the risk identified (as required by SA 330).

e) The **Audit Firm** in their response to Para 2.6.3 (e) of **DAQRR** has stated that, "*based on our review of the communication between the Company and the RBI we did not note the need to perform any further confirmatory procedures in this regard.*" However, this response of the **Audit Firm** does not address the observations made by NFRA in its **DAQRR**, i.e. "*The **Audit Firm,** after having identified the risk, neither obtained external confirmation from the RBI, (as required by Para 19 of SA 330) nor designed and implemented any responses to the risk identified (as required by SA 330).*" This is a clear acceptance by the **Audit Firm** of its failure to perform the audit procedures as required by Para 19 of SA 330 and hence, the observations made by NFRA in its **DAQRR** are still relevant. For our detailed comments on NOF/CRAR, please refer to section 2.4 of the AQR report.

f) The **Audit Firm** in their response to Para 2.6 3. (f) of **DAQRR** has stated that, "*The ET would like to highlight the differentiation between the reliance on the work of internal auditor and consideration of the internal audit report for risk assessment procedures. Para 3(b) of SA 610 (Revised) provides that if based on the auditor's preliminary understanding of the internal audit function obtained as a result of procedures performed under the SA 315, the external auditor does not expect to use the work of the function in obtaining audit evidence then the requirements in the SA 610 (Revised) relating to using the work of that function do not apply. We would like to submit that the ET had reviewed the internal audit reports – Refer WP 2.5.3.30 of eAudit file for the purposes of our risk assessment procedures as required under Para 153 of the Guidance Note on Audit of Internal Financial Controls over Financial Reporting (GN on IFC) and under the SA 315 and had decided not to rely on internal audit work in terms of SA 610 (Revised). Accordingly, we submit that there is no contradiction in our statements and there is was no intent to mislead the NFRA. On the basis of the above, we submit that we have complied with the requirements*

of SA 610, GN on IFC and Para A11 of SA 315." On perusal of the WP 2.5.3.30 of the eAudit File, NFRA has noted that the **Audit Firm** has documented the summary of the internal audit reports. The Internal Audit Reports are not part of the Audit File. Further, if the **Audit Firm** had decided not to rely upon the Internal Audit Report after reviewing the same, why the Audit Firm in its response did dated 10th September, 2019, refer to the work of the internal auditor in two instances? The instances are use of Internal Audit Report for risk assessment (Page 59), and for verification of existence of collaterals which was in the scope of work of the internal auditor (Page 67).

Further, NFRA has in its **DAQRR** report stated that, "There is no discussion regarding identification of ROMM due to fraud or error, as required by Para A11 of SA 315." The **Audit Firm's** response does not address this observation made by NFRA.

g) The **Audit Firm's** response to Para 2.6.3 (g) of **DAQRR** does not address the observations made by NFRA in its report and hence NFRA's observations still holds i.e. **Audit Firm** has performed no Analytical Procedures as risk assessment procedures and have failed to comply with Para A13 to Para A15 of SA 315.

h) The **Audit Firm** in their response to Para 2.6.3 (h) of **DAQRR** has stated that," *As regards the issue of rollover of loans, as stated in the memo, the matter was included in the RAPD Memo in view of the issue reported in the RBI inspection report. The Company had provided its response to the RBI vide its letter dated 30 November 2016 - refer Page No. S526 of 'File 4.RBI (Pg S470 to S623)' in folder '5. IFIN March 2018 File No. S – Others' in 'Other work papers' folder of our audit file, wherein the Company had explained on page 11 of the letter, the manner in which the rollovers were in compliance with RBI guidelines. Based on the submissions of the Company, we were informed that the RBI did not pursue the said observation. We read the inspection reports for the year ended 31 March 2016 to confirm this assertion of management. (Refer file "RBI Letter 1 Nov 2017" attached in the embedded zip file in WP attachment 2.5.1.10 of our eAudit file.) After having initially identified the issue of rollover of loans, the ET obtained a better understanding of the same based on a reading of the Company's response and the RBI's consideration of the same in its subsequent inspection reports. Based on audit procedures performed (refer WP attachment 2.260 of eAudit file), the rollovers of loans by the Company during the year were in line with the Company's policy as explained in Company's letter to the RBI dated 30 November 2016. Accordingly, we submit the issue was satisfactorily addressed in our audit response, as required by SA330.*" NFRA has examined Page No. S526 of 'File 4.RBI (Page S470 to S623)' in folder '5. IFIN March 2018 File No. S – Others' in 'Other work papers' folder, as

referred by the **Audit Firm** and found that, the company has responded to RBI observations made in the case of Gayatri Infra Ventures Limited and the company has stated that "roll over policy adopted by the company in this case is far more strict than prudential norms as roll over is allowed only once as against two times under prudential norms". However, there is no documentation of the Rollover policy of the company as should have been verified by the **Audit Firm**. Further, to say that ET obtained a better understanding of the same based on a reading of the Company's response and the RBI's consideration of the same in its subsequent inspection reports, clearly indicates that ET has relied on the response of the company without actually evaluating the Rollover Policy, if any, of the company. NFRA has examined WP 2.260 as referred by the **Audit Firm**, and observed that there is no work done against the Rollover cases, neither the cases identified by the **Audit Firm** in the RAPD Memo (WP 2.14.1.20) (also provided in NFRA **DAQRR** report) were selected for evaluating the rollover cases. Hence, NFRA reiterates its observation made in **DAQRR** that the **Audit Firm** after having identified the significant risk of Rollover of loans, failed to design and implement any response to the identified risk, as required by SA 330.

i) In response to Para 2.6.3 (i), the **Audit Firm** has stated that," *Whilst the client risk grade in the document 'CAF' was considered as 'Low', the engagement risk and the Final combined risk grade as per EAF has been categorized as 'High' as may be noted in the 'Risk summary' section of the 'Engagement Evaluation Detail Report'. Refer the document 'EAF' embedded in the 'Risk formalities' Section of RAPD. The Client Evaluation considers various aspects of the entity including its governance structure, reputation etc. and suitability for the Firm to be associated with the Client. In the case of IFIN, at the time of client acceptance, factors such as presence of independent board of directors, absence of adverse media reports, high credit rating etc. resulted in a 'Low' client risk evaluation. Upon completion of satisfactory Client Evaluation (including obtaining of necessary approvals), the Firm considers the risk associated with various services to be provided to the client. The engagement risk evaluation takes into account the risks at the client level as well as at the engagement level and is thus a composite and relevant evaluation of the risk at an overall level. In the case of IFIN, although the risk at Client Evaluation level was assessed as 'Low', the Engagement Risk for the audit was assessed as 'High' - refer WP attachment 1.1.1.50 of our eAudit file, primarily due to factors such as the Company being debt listed, being engaged in financial services sector etc.*" On a perusal of WP 1.1.1.50, NFRA observes that in page 2 of the WP, the Final risk grade is stated as 'LOW' and in the 'Risk Summary section' the Final risk grade is stated as 'HIGH'. Further in page 19, in Q. 11.0120 i.e. **Is the engagement considered, for other reasons, to be high risk by the EP/FRP/RMP? The option chosen was 'NO'**. Further there are no justifications provided

in the entire WP for evaluating the risks. The WP referred by the **Audit Firm** itself is contradicting their risk assessments at various places and hence the evaluation of risk for planning and performing the audit is a complete sham. Further, as stated by the **Audit Firm** in their response to NFRA's **DAQRR** report, "*Engagement Risk for the audit was assessed as 'High', primarily due to factors such as company being debt listed, being engaged in financial services sector etc.*" is nowhere mentioned in the WP 1.1.1.50, as referred by the **Audit Firm** and hence is baseless and unacceptable.

j) In response to Para 2.6.3 (j), the **Audit Firm,** in their response, has stated that, "*The client evaluation report and the engagement evaluation report were embedded in page number 8 of the document 2.14.1.20 RAPD Discussion agenda attached in our eAudit file. This work paper has been reviewed and signed off by the EQCR. We also submit that, whilst the client risk was identified to be 'low', the engagement risk was categorised as 'High' (refer to our response in para 2.6.3 (i) above). On the basis of our responses to Para 2.6.3 (a) to (i) above, we submit that the EQCR has not failed to provide an objective evaluation of the significant judgements regarding ROMM made by the ET. Accordingly, we submit that the **Audit Firm** has complied with the provisions of SQC 1, the SA 220 and the SA 230.*" For our comments on Risk Assessment Procedures please refer to Section 2.6.3 (f) and (i) above. Further, on a perusal of WP Client Evaluation Detail Report, embedded in the WP 2.14.1.20, RAPD Discussion, NFRA reiterates that the WP is not even seen by the EQCR (Mr. Akeel Master) and hence he has failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET. There is no sign-off by EQCR, neither was he part of list of Approvers of the WP. The response of the **Audit Firm,** which is not supported by their WPs, is an attempt to mislead NFRA.

2.6.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) There had been a woeful lack of clarity, and utter confusion had prevailed in the ROMM assessment.

b) Important aspects of the Auditee Company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the Company, the wide discrepancies in reporting of NPAs, etc., had not been given adequate importance in the ROMM assessment.

c) It was observed that the audit responses planned to reduce or mitigate the identified risks and the actions taken based on the audit responses to such identified risks were insufficient, improper and inadequately carried out.

d) In crucial matters, the **Audit Firm** had relied completely on the Management's Representations.

e) The **Audit Firm** has failed to comply with the requirements of Para 12, Para 26 and Para 47 of SA 240, Para 15 of SA 200 and Section 143 (1) (a) of the Companies Act, 2013.

f) The Audit Procedures performed by the **Audit Firm** are completely insufficient in relation to the requirements laid down in Paras 5.25 and 5.26 of Chapter 5 "*Areas of Audit Concern*" of the Technical Guide on Audit of NBFCs *i*ssued by ICAI.

g) The **Audit Firm**, after having identified the risk, neither obtained external confirmation from the RBI (as required by Para 19 of SA 330), nor designed and implemented any responses to the risk identified (as required by SA 330).

h) The **Audit Firm** has not complied with the requirements of SA 610 and Para A11 of SA 315. Further, the **Audit Firm** has tried to mislead NFRA by giving contradictory responses.

i) The **Audit Firm** has performed no Analytical Procedures as risk assessment procedure and have failed to comply with Para A13 to Para A15 of SA 315.

j) The **Audit Firm** after having identified the significant risk of Rollover of loans, failed to design and implement any response to the identified risk, as required by SA 330.

k) The EQCR has also failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET.

l) The **Audit Firm**, its EP, and the EQCR were all guilty of professional misconduct arising out of gross violations of the law and the applicable Accounting Standards. The ET also failed to exercise due diligence, and failed to obtain sufficient information necessary for expression of an opinion.

2.7 INTERNAL CONTROLS OVER FINANCIAL REPORTING (ICFR)

2.7.1 In its communication dated 7th August, 2019, NFRA had observed that the **Audit Firm** had identified ten specific items of What Can Go Wrong (WCGW). However, none of the specified items covered the possibility of manual override of controls by management or TCWG.

2.7.2 The **Audit Firm** in their response dated 30th August, 2019, had referred to Section 2.7 of the eAudit File in its entirety for entity level controls which addresses the risk of override of controls by management. The **Audit Firm** has also referred to WP on journal entries (Section 2.11 JE, Section 2.9.4, Section 3.1 JE and Section 4.6.1 in eAudit File), which the **Audit Firm** has claimed to have details of procedures performed in response to the risk of manual override of controls by management.

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

a) Para 90 of *Guidance Note on Audit of Internal Financial Controls over Financial Reporting* Entity-level controls include (a) Controls related to control environment and (b) Controls over management override. The Note following Para 90 states that controls over management override are important for effective internal financial controls over financial reporting for all companies. NFRA having examined the WP 2.7, 2.9.4, 2.11, 3.1 and 4.6.1, concludes that controls over management override do not form part of the evaluation of the internal financial controls over financial reporting. Hence, the **Audit Firm** has failed to exercise due diligence to comply with the requirements of Para 90 of the *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

b) One of the specific items of WCGW identified by the **Audit Firm** pertains to "Lending". NFRA has examined WP 11.1.10, "Walkthrough – Lending" and WP 2.260 (Credit Review cases) and concludes as follows:

i. NFRA has identified a list of twenty-three Credit Review cases (from WP 2.260) where RBI and/or the **Audit Firm** has raised serious concerns regarding the loans provided by the Auditee Company. The **Audit Firm** has observed several cases of ever greening of loans by the Auditee Company. The **Audit Firm** has also noted that in several cases the security documents have not been collected by the Auditee Company. The Management response is either NIL or inadequate. (The list of such

cases along with the RBI/**Audit Firm's** remarks and the Management responses thereto had been provided in **Appendix II to the DAQRR)**. The **Audit Firm** has failed to perform any further audit procedures on these issues and has instead, without any examination of evidence, concluded that loan balances are not materially misstated.

ii. The **Audit Firm** in WP 11.1.10, has stated that Credit Risk Monitoring Group maintains the repository of documents and provides other reports such as Perfection of Document Report, Covenant Report, CAM Review and Loan Classification Report. However, the **Audit Firm's** verification of Covenant Report and Loan Classification Report and the **Audit Firm's** observations thereon, after conducting the audit procedures, is not available/documented in the Audit File.

iii. As far as verification of "Perfection of Document Report" is concerned, the **Audit Firm** has examined a single CAM of New India Structures Private Limited, which was granted a short-term loan facility of ₹2700 Million by the Auditee Company. WP 11.1.10 clearly states that loans are processed in two ways i.e., Automatic Approval in system and Manual Approval. The fact that a manual override had to be undertaken is indicative of the need to relax the conditions of viability, creditworthiness of the borrower, collaterals required etc. in specific cases. This would have been clear from an analysis of the CAMs. The Audit File does not provide any evidence in support of procedures performed and CAMs scrutinized to understand the reasons for manual override.

iv. The **Audit Firm** has attached one pdf File of Perfection of Documents, which only contains a list of documents pending. However, as explained under credit assessment and distribution section of the Walkthrough, it does not contain what documents are pending from the borrower, what documents are already collected from them and an examination of satisfaction with regard to documents collected. The **Audit Firm** has not carried out any Audit Procedures with respect to perfection of the documents already received. The **Audit Firm** has simply kept a "list of documents pending" in the Audit File.

v. The **Audit Firm** has, thus, failed to satisfy itself that internal controls pertaining to "Lending" in place were adequate and operating effectively. The **Audit Firm** has not exercised due diligence in examination of Credit Review Cases.

c) Para 41 of *Guidance Note on Audit of Internal Financial Controls Over Financial Reporting* issued by the ICAI, requires the auditor to test the operating effectiveness of the internal financial controls over financial reporting during the FY under audit and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. On perusal of the eAudit File submitted to NFRA, it is observed that most of the controls tested by the **Audit Firm** have been performed on 26th April, 2018. Further, most of the controls have been tested as at the balance sheet date. Hence, the **Audit Firm** has failed to exercise due diligence to comply with the requirements of Para 41 of the *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

d) On perusal of WP 11.1.10, NFRA observes that examination of the role of internal auditors in the process of evaluating the internal controls over loans and the Internal Audit Reports neither forms part of the referred WP nor of the eAudit File submitted to NFRA. It is to be noted that Para 153 of the *Guidance Note on Audit of Internal Financial Controls Over Financial Reporting* requires the auditor to review reports issued during the year by the internal auditor (or similar functions) that address the controls relating to internal financial controls over financial reporting and evaluate control deficiencies identified in those reports. Hence, the **Audit Firm** was grossly negligent and has failed to exercise due diligence to comply with the requirements of Para 153 of the *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

e) Another specific item of WCGW identified by the **Audit Firm** pertains to PPE. Section 143 (3) (i) of the Companies Act, 2013, requires that the Audit Report should include "*whether the company has adequate internal financial controls with reference to Financial Statements in place and the operating effectiveness of such controls*". Para 34 of *Guidance Note on Audit of Internal Financial Controls Over Financial Reporting* states that *"a company's internal financial control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company…*". On perusal of the PPE section of eAudit File and WP 80.1.0010, NFRA has observed that the **Audit Firm** has performed a walkthrough of a single transaction starting from raising a requisition of the asset till the passage of accounting entry in the system (AXAPTA). The **Audit Firm** has concluded that "*the company has adequate internal financial controls system over financial reporting and such internal financial controls over financial reporting were operating effectively as at 31st March, 2018*" without actually

evaluating the same as required by the *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*. Hence, the **Audit Firm** has failed to comply with the provisions of the Companies Act, 2013, and *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*. The **Audit Firm** has also failed to obtain sufficient information which is necessary for expression of an opinion on internal financial control.

2.7.4 NFRA, therefore, concluded as follows in **DAQRR**:

a) The **Audit Firm** has failed to examine that internal controls pertaining to "Lending" and "Assets" in place were adequate and operating effectively. The **Audit Firm** has not exercised due diligence in examination of Credit Review Cases and was grossly negligent in the conduct of its professional duties.

b) The **Audit Firm** was grossly negligent in the conduct of its professional duties and has failed to exercise due diligence to comply with the provisions of the Companies Act, 2013, and Para 41, 90 and 153, *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

c) The **Audit Firm** has failed to obtain sufficient information which is necessary for expression of an opinion on internal financial control. This amounts to professional misconduct as defined by Section 22 of the Chartered Accountants Act (No. 38 of 1949) read with clause 8 of the Part I of the second schedule to the said Act.

2.7.5 The **Audit Firm's** replies in response to the observations of NFRA in the **DAQRR** have been examined and NFRA's conclusions thereon are as follows:

a) In response to Para 2.7.3 (a) of **DAQRR**, the **Audit Firm** has stated that, "As stated in our response dated 30 August 2019, control testing of journal entries which is controls over management override, was tested and documented in Sections 2.11.JE, 2.9.4 and 3.1.JE in addition to other procedures documented in eAudit Section 4.6.1. *Controls work over period-end Financial Reporting Process was covered in eAudit section 2.9.3. Further, controls over related party transactions were tested and documented in eAudit section 2.6.8 and work paper attachment 2.6.8.10 Related Party Assessment. Controls over provisioning were tested and documented in eAudit section 3.1 attachment reference 2.130 TOC Lending. As regards work done on controls over estimates, please refer to section 2.6.11 of our eAudit file as also our overall evaluation of estimates in section 4.5.1 of our*

eAudit file. Controls related procedures on entity level controls was covered in eAudit section 2.7. In view of our submissions as above, we reiterate that adequate controls related work has been performed in respect of various sections which among other areas extend to Estimates, Unusual and Related Party transactions, Journal Entries, Financial Reporting Process and Entity Level Controls. These controls, individually and collectively, primarily address the risk of management override of controls.

NFRA had examined the WP 2.7, 2.9.4, 2.11, 3.1 and 4.6.1 at **DAQRR** stage and observed that controls over management override do not form part of the evaluation of the internal financial controls over financial reporting. NFRA has examined Section 2.9.3 and WP 2.9.3.10, which merely contains the literature on how to check the final closing entries in the Balance Sheet and do not reflect any of the audit procedures carried out by the **Audit Firm** to ensure that controls exist and they are operating effectively. On perusal of eAudit Section and WP 2.6.8.10, it is observed that with regard to related party transactions, **Audit Firm** has obtained a list of related parties from the Management and verified the MBP-1 forms of the Directors and concluded that related party transactions are fairly presented. On perusal of the WP 4.5.2.0010, it is found that it is a mere repetition of WP 2.6.8.10, hence our observations noted above stands. NFRA having examined the WPs, reiterates its conclusion that controls over management override do not form part of the evaluation of the internal financial controls over financial reporting.

b) (i) There is no response to the point made in para 2.7.3. (b) (i) above that in respect of 23 Credit Review cases the **Audit Firm** had failed to perform any further audit procedures on these issues and had instead, without any examination of evidence, concluded that loan balances were not materially misstated. The **Audit Firm** has sought to evade the issue of non-performance of the necessary audit procedures by stating that "*As regards the Credit Review cases (From WP 2.260) listed in Annexure II of the **DAQRR**, while we acknowledge that the documentation could have been clearer, we have provided references in our audit file to the information that was obtained, and procedures performed by ET in reaching its conclusions in respect of these accounts. - Please refer **Appendix 3"**.* Very clearly, what is not documented is to be regarded as not having been done. *However, notwithstanding the above,* NFRA has examined just two entries out of Appendix 3, forming part of the **Audit Firm's** response (and not part of the Audit File) to just showcase that the reply of the **Audit Firm** is an afterthought and a sham. The observations of NFRA are as follows:

- ARM Telecom Services Ltd. was provided a loan of ₹ 31.40 cr. The **Audit Firm** has noted in their remarks column of WP "*Credit Review" embedded in WP 2.260* that

1. Valuation from preferred valuer (N.M. Raiji) is required, 2. Existence of pledged shares of Istiva Steels Pvt Ltd. to be verified (Physical shares) 3. Breakup value for Istiva Steel Pvt Ltd is negative 166.18. Looking at the company performance till FY 16-17, future projections of cash flows does not seem to be viable. Request you (management) to provide substantiated cash flows for FY 17-18 and 4. ICOMM Tele Ltd. shares breakup value is negative 31.23. The **Audit Firm** has in Annexure 3 referred to WP, "*18. ARM Telecom Services Limited Page no. V1-564 to V1-587 of Other Work Papers Folder*". On perusal of the WP, NFRA observes that IFIN had extended the loan against pledge of 1,08,05,924 shares of ICOMM Tele Ltd., mortgage of 1 acre land in Hyderabad owned by Istiva Steel Pvt Ltd along with PGs of Mr. Ramrao Paturu and Mr. Sumanth Paturu. Further, valuation report of M/s BRAND & Associates, Chartered Accountants was taken for fair valuation of equity shares of Istiva Steel Pvt. Ltd. Further, financials of Istiva Steel Pvt Ltd. show negative net worth of 63 Crores for the FY 16-17 and negative ₹61.20 Crores for the FY 15- 16. There is no documentation of the valuation of 1 Acre land in Hyderabad and the PGs, which were also forming part of the security towards the loan facility. **Audit Firm** has not documented as to how they have dealt with the information provided by the Management and as to their own observations made in WP "*Credit Review*".

- Varun LPG Carriers Pvt Ltd was provided a loan of ₹500 cr. The **Audit Firm** has noted in their remarks column of WP "Credit Review" embedded in WP 2.260 that 1. Charge on shares of Varun LPG carriers Pvt Ltd. is not created and the same is shown as unsecured loan 2. The amount paid by Varun Resources is out of disbursements made to Varun LPG and 3. Financials of Varun LPG carriers Pvt Ltd. is not available. The **Audit Firm** has in Annexure 3 referred to WP, "12. Varun Resources Page no. V1-224 to V1-228" On perusal of the WP NFRA observes that IFIN had extended the loan towards acquisition of new building vessels from China to be repaid from equity tie-up for the project. In the Current Status section of the WP it is stated that "*In view of NCLT Proceedings and RBI observations, IFIN has reviewed the classification of exposure and recomputed the provision based on original schedule and has made provision to the extent of 40% of the outstanding exposure*" Two Valuation reports of Bell Shipping Ltd are provided in the WP. There is no documentation of Financial Statements of Varun LPG Carriers Pvt Ltd. Further, **Audit Firm's** observations made in WP "Credit Review" also remained unaddressed. The **Audit Firm's** conclusions on such issues were also not documented.

The **Audit Firm** has also made additional observation related to collaterals. As far as performing audit procedures on collateral is concerned, the contention of the **Audit Firm** that "*Only when the client is expected not to be able to repay the loan or when execution of the collateral is relevant for the repayment, the audit procedures over collateral become relevant*' is completely absurd. **Unless the Audit Firm has devised a mechanism to predict which client will not be able to repay the loan or when the collateral will become relevant for repayment, the Audit Procedures for collaterals will be relevant in all circumstances.** *And this contention is also despite the fact that the* ***Audit Firm*** *itself has stated that,* performing audit procedures on collateral is important *"... to cover specific legal requirements such as Section 143(1)(a) of the Companies Act, 2013.*

b) (ii) **In response to Para** *2.7.3 (b)(ii) of* ***DAQRR****, the* **Audit Firm** has stated that, "*As regards the Loan Classification Report referred to in WP 11.1.10, reference may be made to WP 2.330 which was prepared from and verified with the Loan Classification Report. In the course of the verification of creation of security, the ET had verified the same with reference to this report. The Covenant Report was referred to during the course of the audit but a copy of the same has not been retained in our file.*" NFRA after reviewing WP 2.330 reiterates that evaluation of classification of loans does not form part of the Audit File and as admitted by the **Audit Firm** in its response. The Covenant Report also does not form part of the Audit File.

b (iii) **In response to Para** *2.7.3 (b)(iii) of* ***DAQRR****, the* **Audit Firm** has stated **t**hat, "*2.7.3 (b)(iii): With regard to the documentation of Manual Approval in WP 11.1.10, the following is documented in the said work paper ' Loans are processed in two ways i.e. Automatic Approval in system and Manual Approval. Due to demands of loans in a short period of time or system inconsistencies the loans are at times approved Manually and then regularised in the system.' As can be seen from the above, the reasons for Manual Approval as per the information and explanations provided to the ET was due to legitimate commercial consideration such as 'processing in a short period of time or system inconsistencies'. Accordingly, these were not considered to be manual override of controls and no specific procedures were performed in this regard".* This is a clear admission of the **Audit Firm** about the correctness of NFRA's observations made in its **DAQRR** that, "*The fact that a manual override had to be undertaken is indicative of the need to relax the conditions of viability, creditworthiness of the borrower, collaterals required etc. in*

specific cases. This would have been clear from an analysis of the CAMs. The Audit File does not provide any evidence in support of procedures performed and CAMs scrutinized to understand the reasons for manual override". In fact, apart from documenting the fact that some loans were processed manually and others were processed electronically, there is no documentation of the number and the value of loans manually processed and the number and value of loans processed electronically. This would have been the logical starting point for any examination of the extent and pervasiveness of manual override of controls. Without getting a handle on the total magnitude involved, the **Audit Firm** could not have had any basis for the design of its audit procedures. The **Audit Firm** has thus failed to address NFRA's observations made in **DAQRR** and hence it is concluded that the **Audit Firm** has failed to exercise due diligence to comply with the requirements of Para 90 of the *Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

b) (iv) The **Audit Firm** in their response to 2.7.3(b)(iv) has stated that "*Page 3 of WP 11.1.10 documents the following 'Perfection of Documentation Report is maintained in excel and contains a list of documents pending to be received and the document is prepared monthly under Maker Checker Control'. This report was frequently referred to during the course of the audit and verification of security in respect where documents have been received - refer WP eAudit Section 3.1 attachment reference 2.130 TOC Lending. This was cross verified with pending documents list.*" In WP 2.130 TOC Lending the **Audit Firm** has documented that, "*We have verified for 2 sample months that the Perfection of document report has been prepared and shared with the respective departments. We have verified for the month of June that the Perfection of Report document has been prepared. The Officer (CRMG) has run the Legal OK Checklist for each client and has compiled the items listed as "Not received" for preparation of Perfection of Document Report. The report has been checked by Milie Tamboli (Manager, CRMG) and post review the same has been shared with all the concerned Account Officers. The Perfection of Document Report has been sent to Jinesh Sanghavi, Dwaipayam Ghosh, Shrikant, Crispin D' Souza, Lokeh Chebium and Amit Shah.*" However, the **Audit Firm** has failed to address NFRA's observations made in **DAQRR**, i.e. "the **Audit Firm** has not carried out any Audit Procedures with respect to perfection of the documents already received. The **Audit Firm** has simply kept a "list of documents pending" in the Audit File. The **Audit Firm** has, thus, failed to satisfy itself that internal controls pertaining to "Lending" in place were adequate and operating effectively." NFRA's reiterates its observations made in the **DAQRR**.

c) The **Audit Firm**, in their response, has stated that, "*With regard to the comment that most of the controls have been tested as at the balance sheet date, we state that, it is not*

mandatory for the auditor to have performed the testing procedures before the end of the year. Accordingly, performing the procedures in April 2018 over samples selected throughout the year ended 31 March 2018 and not only at year end, is in compliance with the Guidance Note." Guidance Note clearly requires the **Audit Firm** to test the operating effectiveness of the internal financial controls during the FY under audit and not just as at the balance sheet date. Hence the contention of the **Audit Firm** that it is not mandatory for the auditor to have performed the testing procedures before the end of the year is not in accordance with the requirements of Para 41 of the Guidance Note.

d) Para 153 of the Guidance Note on ICFR requires the auditor to review reports issued during the year by the internal auditor (or similar functions) that address the controls relating to internal financial controls over financial reporting and evaluate control deficiencies identified in those reports. **Audit Firm**, in their response, has stated that, "*We refer to WP 11.1.10 of our eAudit file which contain documentation describing the ET's walkthrough of the lending process. A review of the Internal Auditors work, and their reports was separately reviewed and captured in WP attachment 2.5.3.30 of our eAudit file. As can be seen from the referred work paper, all internal audit reports issued during the year were reviewed by the ET which includes observations relating to lending business and assessed for impact on financials as well as on audit procedures. Based on a review of the same, there were no indications that we could not rely on the internal control environment.*" On perusal of the WP 2.5.3.30 of the eAudit File, NFRA has noted that the **Audit Firm** has documented the summary of the internal audit reports. The Internal Audit Reports themselves do not form part of the Audit File. Further, the **Audit Firm's** evaluation of the control deficiencies as identified by the internal auditors and their conclusions are not documented. It may also be noted that the **Audit Firm** in its reply dated 10th September, 2019, had stated that "*ET did not use the work of Internal Auditor- refer documentation in eAudit Screen 2.7.4 of our eAudit File".*

e) It is to be noted that Para 34 (1) of the Guidance Note on ICFR, requires the **Audit Firm** to evaluate the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of the assets of the company. The **Audit Firm,** in their response, has stated that, "*The testing of operating effectiveness of the controls over additions and deletions to PPE are documented in WP C1.0010 FA Additions TOC and WP C4.0010 FA Deletions TOC. As can be seen from the aforesaid work paper, 25 samples each for transactions of additions and deletions of PPE that took place through the year were tested for operating effectiveness of the control."* Further **Audit Firm** in *WP C1.0010 FA Additions TOC* and *WP C4.0010 FA Deletions* has stated that they have obtained the

fixed assets register and identified the additions and deletions made during the year. However, on perusal of the Audit File, there is no record of the Fixed Assets traceable. Further, in the case of Biometric System (1 No) acquired on 31st of December, 2017, it was found to be capitalized in the books of accounts as on 8th November, 2017 and in the case of Servers (4 Nos) acquired on 31st May, 2017, they were found to be capitalized in the books as on 01st April, 2017 much before the assets were actually acquired. This brings out the casual attitude in which the Audit was carried out. Thus, the **Audit Firm** has actually failed to evaluate *the internal financial controls system over financial reporting as required by the Guidance Note on Audit of Internal Financial Controls over Financial Reporting*.

2.7.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm** has failed to examine that internal controls pertaining to "Lending" and "Assets" in place were adequate and operating effectively. The **Audit Firm** has not exercised due diligence in examination of Credit Review Cases and was grossly negligent in the conduct of its professional duties.

b) The **Audit Firm** was grossly negligent in the conduct of its professional duties and has failed to exercise due diligence to comply with the provisions of the Companies Act, 2013, and the Guidance *Note on Audit of Internal Financial Controls over Financial Reporting especially Paras 41, 90 and 153 thereof.*

c) The **Audit Firm** has failed to obtain sufficient information which is necessary for expression of an opinion on internal financial control. This amounts to professional misconduct as defined by Section 22 of the Chartered Accountants Act (No. 38 of 1949) read with clause 8 of the Part I of the second schedule to the said Act

2.8 ANALYTICAL PROCEDURES

2.8.1 In its communication dated 7th August, 2019, **NFRA** had conveyed its prime facie conclusions as follows:

a) Based upon the audit working papers available, **NFRA** had observed that the **Audit Firm** had not performed the Analytical Procedures in the manner required by of SA 520. The **Audit Firm** was found to be ignorant of the essence of the requirement as stated in Para 3(b) and Para 6 of the SA 520 which provides that the **Audit Firm** should 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.

b) The **NFRA** found that instead of analyzing the trend for a period of minimum 5-10 years, the **Audit Firm** had restricted its working on Analytical Procedures to the comparison of the opening and the closing balances of the Financial Statements for the year under audit.

c) It was found in certain working papers referred by the **Audit Firm** that they had covered only the arithmetical verification of the information provided by the Management instead of Analytical Procedures.

d) **NFRA** had further noted that it was not clear if the **Audit Firm** had covered significant matters, as highlighted by the whistle blower's letters and RBI inspections reports, in the Analytical Procedures.

e) **NFRA** had observed, after going through the working papers referred by the **Audit Firm,** that the conclusions arrived at on the basis of the variances had not been documented. Also, multiple cases of inconsistent variances were found, which had not been countered, neither in reference to the Audit Committee presentation, nor otherwise as per the requirement of Para 7 of SA 520.

2.8.2 The **Audit Firm,** in its response dated 10th September, 2019, had stated as follows:

a) Paras A4 and A6 of SA 520 say that it is the auditor's judgement whether to use or not use substantive analytical procedures. Substantive analytical procedures are generally more

applicable to large volumes of transactions that tend to be predictable over time.

b) Considering the unique nature of the financial operations of the company the **trend analysis of multiple years may not yield meaningful audit evidence.**

c) The matters highlighted in the whistle blower's letters and RBI Inspection Reports including loans and advances utilization, collateral on loans and borrowings etc. cannot be covered through analytical procedures. These were covered through WPs on test of details etc.

d) Referring to Para A17 of SA 520, the **Audit Firm** has submitted that there were no instances of material variances that were inconsistent with the understanding obtained in the analytical review performed.

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

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. The **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 the 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 objective mentioned in 3(a) read with Para 5 and Para A4 and A5 of SA 520. 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 comparison of the opening and closing balance of the elements of Financial Statements for the same year.

b) 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 the comparison of the opening and closing balances for the Financial Statements for the year under audit (W P no 4.3.1.50). Thus, the **Audit Firm** has not carried out the processes, as required under SA 520.

c) The **Audit Firm** has referred to WP 4.3.1.50, WP 4.160 (Interest Income Recomputation), WP 2.0010 and WP 3.170 (Cost of Borrowing) as the proof of carrying out the Analytical Procedures. **NFRA** has gone through all the four working papers. They cover only arithmetical verification. The **Audit Firm** has kept silent on this observation of **NFRA** and has thus, accepted that the only Analytical Procedure carried out was in the form of arithmetical verification. 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.

d) The **Audit Firm** in their response have admitted that with respect to matters which were highlighted by the Whistle blower letters or RBI Inspection Reports including loans and advances utilization, 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 NOF, provisions and diminution of 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 the Para

on ROMM. Moreover, the Credit Rating Agency ICRA in its report published on 28th March, 2018, had reported that the gross NPA had increased to 4.48% in September 2017. This had been only 0.60 % in March 2012. Similarly, the **Net NPA to Net Worth Ratio had increased to 21%** as of September, 2017. This had been only 2.18 % as of March, 2012. This report was publicly available. The report highlighted several vulnerabilities of IFIN's business model. 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 assisted/enabled the **Audit Firm** to identify misstatements while forming an overall conclusion on the Financial Statements of the Company.

e) **NFRA** had observed that the bases of variance have not been documented properly and multiple cases of inconsistent variances were found. The **Audit Firm**, however, has contended that there were no instances of material variances that were inconsistent with the understanding obtained in the Analytical Review performed. **NFRA** has gone through the working paper number 4.3.1.50- Final Analytical review. There is no explanation to the variances found in more than 50% of the items at assertion level in this working paper. Moreover, there are many material variances found in the working paper like

i. Note 5 – Variance of 39% i.e. from ₹450 Crores to ₹175 Crores in General Contingencies,

ii. Note 13 – Variance of 8942% i.e. from ₹42.93 Lakhs to ₹38.82 Crores in Outstanding Trade Receivables for a period exceeding six months from the due date,

iii. Note 15– Variance of more than 100% in Derivative Assets from ₹0 to ₹184 Crores and Variance of more than 100% in income accrued on investments from ₹3.55 Crores to ₹25.7 Crores, d). Note 19 – Variance of 90% in Lease Income from ₹5.65 Crores to ₹54 Lakhs, etc.

As required by Para 7 of SA 520, if Analytical Procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent, the auditor shall investigate such differences. The **Audit Firm** has not carried out any investigation in all such cases. Thus, the auditor has failed to comply with Para 7 of SA 520.

f) There are also many instances in WP no. 4.3.1.50, where wrong formulae are used resulting

into misleading figures of variances. Note 3, 4, 5 and 6 do not mention FY or mentions wrong FY and PY. This shows the casual and unprofessional manner in which the audit has been carried out.

2.8.4 NFRA, therefore, concluded in **DAQRR**, that the **Audit Firm** has failed to:

a) design and perform Analytical Procedures near the end of the audit as required by Para 3(b) read with Para 5, Para A4 and Para A5 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.

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

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

e) 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.

f) carry out investigation in cases of Material Variances and has thus failed to comply with Para 7 of SA 520.

2.8.5 After examining the responses of the **Audit Firm to the DAQRR**, NFRA concludes as follows:

a) 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 which have been neglected by the **Audit Firm** except the comparison of the opening and closing balance of the elements of Financial Statements (WP 4.3.1.50) for the same year.

b) As per Para 6 of SA 520, the auditor shall 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. Para 6 also gives reference of Para A17- A19 of SA 520. Para A18 states that the results of such analytical procedures may identify a previously unrecognised risk of material misstatement. Thus, the statement of the **Audit Firm** that procedures should be responsive to assessed ROMM is wrong and misleading.

c) Since, hardly any analytical procedures were actually carried out, the question of whether "the ET did not come across anything inconsistent with its understanding of the entity" does not arise at all.

d) Clause 3 (b) read with Para 6 and Paras A17-A19 of the 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. As already stated during **DAQRR**, this cannot be confused with objective mentioned in 3(a) read with Para 5 and Para A4 and A5 of SA 520.

e) The **Audit Firm** has again referred to WP 4.160 (Interest Income Recomputation), WP 2.0010 and WP 3.170 (Cost of Borrowing) as the proof of carrying out the Analytical Procedures. As clearly brought out during **DAQRR,** they **cover only arithmetical verification**. The **Audit Firm** has kept silent on this observation of **NFRA** and has thus, accepted that the only Analytical Procedure carried out was in the form of arithmetical verification.

f) Even though the Appendix to SA 520 may be illustrative in nature, it gives a long list of Analytical Procedures to be carried out including trend analysis, ratio analysis and confirmation of sources of information. As admitted by the **Audit Firm**, they have restricted their working on Analytical Procedures to the comparison of the opening and closing balances for the Financial Statements for the year under audit (W P no 4.3.1.50).

g) There is no evidence in the Audit File that the ET had considered various methods of Analytical Procedures and decided that the same were inappropriate. Hence, the statement, "*the ET decided that such a trend analysis may not be appropriate for this engagement"* is completely misleading and an afterthought. Further, the **Audit Firm** has also failed to show that they had asked for any information for carrying out Analytical Procedures but which were not maintained by the Company.

h) The WP 2. .0010, which the **Audit Firm** claims as the proof of test of reasonableness for interest expenses against interest bearing obligation records that "Interest recalculation done, verified change in rate of Interest". The main principle of test of reasonableness is using one event or transaction to predict or assess the reasonableness of others that have a connection with it. This has not been carried out by the **Audit Firm**.

i) The issue regarding RBI report and the whistle blower complaint has been covered in other parts of the report.

j) In reply to Para 2.8.3 (a), the **Audit Firm** has stated that they have performed the relevant substantive Analytical Procedures. However, in response to Para 2.8.3 (d), the **Audit Firm** has stated that they had opted for test of details instead of substantive Analytical Procedures. This clearly brings out the confusion regarding use of Analytical Procedures and an attempt to mislead NFRA.

k) The **Audit Firm**, as part of due diligence, should have obtained Credit Rating Report from the Management and should have thoroughly analyzed it. Surprisingly, the **Audit Firm** says that they are not aware about such a publicly available document. A copy of the report is placed at **Annexure II**. The ICRA report, in fact, covered period up to 30th September, i.e. period of the Audit

l) The **Audit Firm** has stated that they were aware about the increase in NPAs and referred to their responses on GCP. In such scenario, the **Audit Firm** should have investigated the differences and inconsistent relationships. This would have assisted/enabled the **Audit Firm** to identify misstatements while forming an overall conclusion on the Financial Statements of the Company. However, they completely failed to obtain sufficient information which is necessary for expression of an opinion while critically evaluating reversal of General Contingency Provision by Management.

m) **NFRA** had observed that the bases of variance have not been documented properly and multiple cases of inconsistent variances were found. The **Audit Firm** has acknowledged that their analysis could have been better documented and they will take steps to strengthen documentation of such analysis.

n) NFRA had pointed many material variances found in the working paper number 4.3.1.50-

Final Analytical review. There is no explanation to the variances found in more than 50% of the items at assertion level in this working paper. The **Audit Firm** has now stated that they were aware of the reasons for the said variances. It appears that the **Audit Firm** has carried out the investigation of such differences after the issuance of **DAQRR** and not at the time of Audit. Because no such reasoning has been recorded in the Audit File and especially in the working paper number 4.3.1.50- Final Analytical review. As required by Para 7 of SA 520, if Analytical Procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent, the auditor shall investigate such differences. Thus, the auditor has failed to comply with Para 7 of SA 520.

o) The **Audit Firm** has acknowledged NFRA's observation regarding arithmetical errors, typo errors, use of wrong formulae resulting into misleading figures of variances, wrong FY and PY, etc. This reinforces NFRA's view that "This shows the casual and unprofessional manner in which the audit has been carried out".

2.8.6 In view of above, NFRA is reinforced in its earlier conclusion that the **Audit Firm** has failed to:

a) design and perform Analytical Procedures near the end of the audit (except comparison of the opening and closing balances for the Financial Statements for the year under audit) as required by Para 3(b) read with Para 5, Para A4 and Para A5 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.

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

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

e) 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.

f) carry out investigation in cases of Material Variances and has thus failed to comply with Para 7 of SA 520.

2.9 EVALUATION OF GOING CONCERN

2.9.1 In its communication dated 7th August, 2019, **NFRA** had conveyed its prime facie conclusions as follows:

a) **NFRA** had observed that the **Audit Firm** had failed to perform any audit procedures in compliance with the requirements of Para 10 of SA 570 (Revised) which requires consideration of any events or conditions existing that may cast significant doubt on the entity's ability to continue as a going concern. In so doing the **Audit Firm** had to make an evaluation of the Management's assessment of the entity's ability to continue as a going concern.

b) Such evaluation of the going concern assumption by the **Audit Firm** as was done was found to be completely insufficient as a guide to future liquidity. The decrease in the Net worth of the Company as on 31st March, 2018, and the major reduction in the Profit earned during the year, were not given due importance. The **Audit Firm** failed to test the source of the cash generated and the company's ability to meet the immediately arising future liabilities.

c) The **Audit Firm** had not complied with the provisions of Para 11 of SA 570 (Revised) and had failed to capture the significance of the RBI's inspection and report regarding non-compliance of minimum NOF/CRAR requirements to continue in the NBFC business. The company had repeatedly delayed in submitting as per the RBI directions the compliance roadmap.

d) It was observed that the **Audit Firm** has failed significantly to fulfill the requirements under Para 16, 18, 22, 23,24 and 25 of the SA 570 (Revised) including obtaining the Management assessment of the going concern assumption and communicating with TCWG.

e) **NFRA** concluded that not only the **Audit Firm** had failed to obtain sufficient evidence, the **Audit Firm** had also been negligent about the available evidence. Also, there had been no instance of the **Audit Firm** communicating with TCWG, or considering the implications of the going concern assumption for the auditor's report.

f) **NFRA** noted that the **Audit Firm** had not obtained any independent/corroborative evidence. It had not shown the required professional skepticism. **NFRA** had also shown that the claim of the **Audit Firm** that they had discussed with the Management and understood the plans they had drawn up to comply with the RBI requirements was FALSE. No such plan was found in the Audit File.

2.9.2 The **Audit Firm**, in its response dated 30th August, 2019, has stated as follows:

a) The **Audit Firm** has quoted the decision in Tri-Sure India Limited v. A.F. Ferguson & Co. to contend that the evaluation of the going concern assumption should be made based upon the situation that prevailed at the time of the original audit, excluding all the facts that have come to light subsequently.

b) The **Audit Firm** has referred to WP 4.6.2.10 where the overall assessment of the Going Concern assumption has been documented, based on the information and explanations provided to them and the facts, events and conditions existing on the date of the audit opinion.

c) Regarding the Management assessment in this regard, the **Audit Firm** has referred only to Para 8 in page 4 of "Management Representation Letter- Standalone" in attachment 4.7.2.10 of the eAudit File. The said Para states that "The Standalone Financial Statements are prepared on the accrual basis. The going concern assumption is appropriate in the circumstances of the company".

d) The **Audit Firm** has quoted Para 7 of SA 570 (Revised) which provides that:

"7. However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to entity's ability to continue as a going concern."

e) The **Audit Firm** has argued that they considered various aspects of the company including NPAs, operating cash flows, the maturity profile disclosure, credit ratings, repayment record, legal proceedings, indication of liquidation of the entity or ceasing the operation of the company etc. and concluded that even if some of the indicators pointed towards a deteriorating situation they were not severe enough, individually or collectively with other events or conditions, to cast significant doubt on the entity's ability to continue as a going concern.

f) The **Audit Firm** has clarified that the decrease in net worth of the Company is on account of the declaration of final dividend for the FY 2017 during the year 2017-18. They also have said that the reduction in profits for the year was not severe enough to be taken as an adverse condition or event.

g) Regarding the observation of the RBI inspection, the **Audit Firm** has contended that the issue of NOF/CRAR identified and reported by RBI was one of regulatory capital computation and not one of solvency and hence not related to the going concern assumption of the company. Further the Management had drawn up a plan to achieve the reduction in group exposure to the required level by 31st March, 2019. This plan was approved by the BOD on 28th May, 2018, (refer Point V in Page 4 of the Management Representation (RBI) embedded in cell E10 of the attachment 4.7.2.10 to the eAudit File) and the **Audit Firm** did not find any reason to believe that these group exposures highlighted in the RBI inspection could not be reduced in compliance with the RBI directions.

h) Multiple rating agencies including ICRA, CARE and India Rating had provided high credit rating against various instruments.

i) The **Audit Firm** has mentioned that the RBI SCN regarding potential cancellation of registration had not been received by the company till the date of issuance of the Audit Report on its standalone Financial Statements. The fact of receipt of the notice before the issuance of the auditor's report on consolidated Financial Statements was not intimated to the auditors by the company. Based upon the information available with them, they were not aware of the notice by the RBI.

j) In the light of the above, the **Audit Firm** felt justified that neither written communication with TCWG nor EoM in the Audit Report was required.

2.9.3 The **NFRA** has examined the above contentions of the **Audit Firm** and had concluded as follows in the **DAQRR**:

a) **NFRA** is reinforced in its prime facie conclusion that there was no management assessment of the entity's ability to continue as a going concern required by SA 570 (Revised). **NFRA** finds the **Audit Firm** grossly negligent in compliance with SA 570 (Revised) in considering the below mentioned statement (Para 8 in page 4 in the Management Representation WP 4.7.2.10) as the Management Assessment of the entity's ability to continue as a going concern:

"The Standalone Financial Statements are prepared on the accrual basis. The going concern assumption is appropriate in the circumstances of the company"

The above referred statement neither contains any assessment nor any analysis from the Management. It is a mere bold assertion bereft of any justification or supporting evidence. The stand of the **Audit Firm** is not only violative of the spirit but also the very letter of SA 570 (Revised). As clearly provided by Para 10(b) of SA 570 (Revised), the auditor was duty bound to discuss with the Management the basis for the intended use of the going concern assumption in a situation where the Management had itself not performed such an assessment, as was the admitted situation in this case. Para 16(a) of SA 570 (Revised) also provides that when management has not yet performed an assessment of the entity's ability to continue as a going concern, the **Audit Firm** shall request the Management to make the assessment. No such request has been included in the Audit File.

b) Para 10(b) of SA 570 (Revised) is under the requirement portion of the SA. As is the convention relating to the Requirements portion, all such requirements are made **Unconditional and Mandatory** by the use of the word "shall". Given the situation described in the paragraph, the **Audit Firm** did not have any discretion in the matter. The discussion with the Management and enquiry with them required by the SA had to be complied with and the same had to be documented as per the requirements of the SA relating to documentation. Their reference to the working paper in this regard leads to a confirmed admission that the **Audit Firm** has not conducted any such discussions and enquiry; neither is any other proof of such discussion and enquiry available in the Audit File.

c) The **Audit Firm** has not provided any evidence to show that they scrutinized or otherwise

performed any procedures at all to review the cash flow forecasts for at least a 12-month period from the Balance Sheet date. No working papers or references in the Audit File have been provided in this connection.

d) Tri-Sure India Limited v. A.F. Ferguson & Co. is not of any use in the circumstances of the present case since the **Audit Firm** had not fulfilled the requirements of the SA 570 (Revised) with regard to the evaluation of the going concern assumption even based on available facts at the time of the audit as concluded in our prime facie observation as well as our conclusion in this report. At any rate, the decision in Tri-sure antedates the coming into force of SA 570 (Revised), and has no value as against the specific mandatory requirements of this SA.

e) The **Audit Firm** has failed significantly to exercise due professional skepticism while performing the risk assessment procedures related to events and conditions or conditions that could cast significant doubt on the entity's ability to continue as a going concern. Para A7 of SA 570 (Revised) documented in WP 4.6.2.10 as well as the Para 11 of SA 570 (Revised) that requires the auditor to remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The **Audit Firm's** contention that the NOF/CRAR issue as identified and reported by RBI was one of the regulatory capital computation and not one of solvency and hence not related to the going concern of the company is not acceptable at all, the checklist provided under Para A3 of SA 570 (Revised) itself provides that *"Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions"* as an indicator of the events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. The **Audit Firm** has completely ignored the fact that the RBI, at multiple times had rejected the requests and submissions made by the company.

f) The **Audit Firm's** assertions about the approval of the compliance plan by the Board are found to be unsupported by Audit File evidence. Para V at Page 4 of Management Representation (RBI) clearly refers only to the disclosures (termed as "Representation") proposed in the Financial Statements and the Directors Report. The Management Representation itself does not speak of a well thought out and finalized action plan, but is only a tentative indication of the likely shape that it could take. The Management appeared to be still in the hope of persuading the RBI to extend the deadline and was preparing to

work out a plan only "in the unlikely event RBI does not permit extension of timeline". In the light of the earlier RBI refusals to extend the deadline, this appeared to be an unjustified position. Besides, when there was no action plan for ensuring compliance, the **Audit Firm's** assertion that they were convinced that there were no doubts about the feasibility of such "action plan" is bereft of any meaning. Further as tabulated below, the chronology of the communication with RBI nowhere indicates that the RBI had accepted the company's plea to permit the submission of the compliance roadmap by the 30th June, 2019, and the company had been found to continuously deferring the compliance fulfillment since the initial due date of submission of the roadmap i.e., 14th November, 2016.

S. No.	Date	Sender	Particulars
1	14th September, 2016	RBI	To submit the roadmap for compliance within two months and comply by 31st March, 2019 i.e.14th November, 2016
2	30th November, 2016	IFIN	Request to provide an opportunity of being heard
3	27th March, 2017	RBI	Rejection of submission made on 30th November, 2016
4	3rdApril, 2017	IFIN	Request to give time to discuss the steps taken and future plans for reduction of exposure by Company
5	16th May, 2017	IFIN	General Submission by IFIN to RBI
6	1st November, 2017	RBI	To submit the roadmap for compliance and comply by 31st March, 2019
7	22nd November, 2017	IFIN	Request to allow time till 31st January, 2018 to submit the roadmap
8	4th December, 2017	RBI	RBI raised the concern of ignorance of serious regulatory violations by the Company
9	8th December, 2017	IFIN	Sought time to meet the CGM DNBS on 14th December, 2017

S. No.	Date	Sender	Particulars
10	26th December, 2017	IFIN	Acknowledgement by BOD of due date of 31st March, 2019 for making the compliance and to request RBI to extend the date till 31st March, 2021
11	7th February, 2018	IFIN	Request to RBI to extend the due date for compliance till 31st March, 2021
12	13th March, 2018	RBI	Regarding non-submission of Planned Roadmap and Rejection of request for extension of date till 31st March, 2021
13	16th March, 2018	IFIN	Submission of Profit related details in response to letter dated 13th March, 2019
14	23rd March, 2018	RBI	To submit the planned roadmap
15	17th April, 2018	IFIN	Informed RBI that they expect to submit the roadmap by 30th June, 2018
16	16th May, 2018	IFIN	Reiterated that they will submit the roadmap by 30th June, 2018
17	5th June, 2018	RBI	SCN for Cancellation of Certificate of Registration

g) **NFRA** reiterates that the maturity pattern of certain assets and liabilities as disclosed in the notes to accounts of the Financial Statements has been prepared by the Management only. **NFRA** could not find any document at all in the Audit File to substantiate any kind of audit procedures performed by the auditor to evaluate the authenticity of any such information.

h) Para 7.6 of RBI circular Ref/ No. DNBS (PD). CC.No.15/02/01/2000-200 1 Dated 27th June 2001, clearly provides that the mismatches (negative gap) in the 1-30/31 days' bucket course may not exceed 15% of the cash outflows in the normal course in this time bucket. Notwithstanding a clear breach of this condition, the **Audit Firm** has not pointed this out. NFRA analysed the WP referred by the **Audit Firm** in its response regarding loans and advances but it was observed that the checking/testing of classification by the **Audit Firm**

is limited to the calculation of dates and no other factor has been considered by the **Audit Firm**.

i) With reference to the SCN Letter bearing reference no. DNBS, MRO, CMD No.2120/13.09.050/2017-18 dated 5th June, 2018, by which the RBI has issued notice to the company to show cause why their certificate of registration as NBFC should not be cancelled, the **Audit Firm** has failed to consider the same in accordance with the provisions of Para 16 of SA 570 (Revised) "Going Concern" in their Audit Report on Consolidated Financial Statements of the Company issued on 28th June, 2018. The SA, inter alia, says that the **Audit Firm** has the responsibility that if the events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor has to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors.

Para 1.1(e.) of the EL dated 1st February, 2018, says as follows:

(e) informing us of the subsequent events that require adjustments to or disclosure in the Financial Statements in accordance with the SA 560 (Revised), "Subsequent Events" issued by ICAI, and as prescribed by the Central Government in accordance with Section 143 (10) of the Companies Act, 2013. This would include:

- *Events occurring between the date of the Financial Statements and the date of the auditor's report;*

- *Facts which become known to the Management after the date of the Auditor's report but before the date of Financial Statements are issued; and*

- *Facts which become known to the Management after the Financial Statements have been issued*

  Which if they had been known at the time of approval of Financial Statements or the Audit Report date, may have caused the Financial Statements to be amended.

If the Management had, on its own, not provided an updated Management Representation prior to the signing of the Audit Report on the Consolidated Financial Statements on 28th June, 2018, the **Audit Firm** was duty bound to ask the Management for the same and obtain it. The **Audit Firm** has seriously failed in not doing so.

The minutes of the Audit Committee meeting dated 29th August, 2018, clearly indicate that the details of the SCN must have been brought to the notice of the **Audit Firm** on or before the date of the meeting through the meeting agenda. Given this, the **Audit Firm** is held to be grossly negligent in complying with SA 560 "Subsequent Events" dealing with procedures to be performed on the facts which become known to the Auditor after the Date of the Auditor's report but before/after the date on which the Financial Statements have been issued. The auditor has failed to emphasize the importance of any such communication from the regulator, RBI, and its possible effects on the Financial Statements and "Going Concern Assumption" of the Company. No record of any procedures performed or action taken or communication been made with the Management or TCWG is found in the Audit File.

2.9.4 On a consideration of all the above, NFRA concluded that the **Audit Firm** had completely failed to obtain sufficient, appropriate audit evidence to assess the Management's use of the going concern assumption.

2.9.5 NFRA has examined the responses of the **Audit Firm** to the DAQRR and has concluded as follows:

a) Written representation from the Management regarding its assessment of the entity's ability to continue as a going concern in the WP is a mere assertion lacking any justification or supporting reasoning. As clearly provided by Para 10(b) of SA 570 (Revised), the auditor was duty bound to discuss with the Management the basis for the intended use of the going concern assumption in a situation where the Management had itself not performed such an assessment, as was the admitted situation in this case.

b) The claim made by the **Audit Firm** that the final overall conclusion of the Management was considered appropriate as documented in Page 7 of WP 4.6.2.10 under the heading 'Conclusion' which says

"Based on our understanding and work done, we believe that material uncertainty does not exists and we need not report on going concern issue in the audit report or the financial statements."

is only an assertion by the **Audit Firm** which lacks any justified evidentiary audit procedures conducted by the firm.

e-Audit screen 2.14.1 is a Risk assessment and planning discussion which answers the question "Has management performed an assessment of the entity's ability to continue as a going concern?" in affirmative. An answer in the affirmative to this question was clearly not in order, in view of the absence of any such assessment performed by the Management. It then refers to WP 4.6.2.0010 for the evaluation of management's assessment of the entity's ability to continue as going concern. e-Audit screen 4.2.2 is a risk assessment update in a Yes/No question format. It just says that based on the audit procedures performed and the audit evidence obtained throughout the audit, going concern events and conditions including management's assessment thereof are still appropriate. As required by Para 17 of SA 570 (Revised), the auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. No such audit evidence has been found in the Audit File.

c) WP 4.6.2.10 does not provide any explanation/ justification regarding the grounds of management's use of going concern basis of accounting. It does not provide any mention about the **Audit Firm's** discussion with management and TCWG except on the matter of loss of key management personnel(?) without replacement, which is not a sufficient matter to evaluate the going concern assumption. It basically states the auditor's and management responsibility which is otherwise stated in SA 570 (Revised), rather than the work done by management on the assessment of use of going concern basis of accounting. The claims of the **Audit Firm** regarding assessment of factors and conditions affecting going concern assumption also does not hold true as there were no audit procedures done by **Audit Firm** to assess the various factors. Brief statements of factual information regarding some events can not suffice and substitute for the assessment required to be made.

*Considering points (a) to (c) above, the **Audit Firm** has clearly failed to comply with Para 10 of SA 570* (Revised)

d) NFRA reiterates its views that no evidence was produced to show that cash flow forecasts for at least 12 months' periods from Balance sheet date was performed. Maturity profile analysis, as referred in WP, was prepared by management only. **Audit Firm's** analysis was

limited to recalculation of maturity dates based on the data given by management only. No other audit procedure was conducted by the **Audit Firm**. The claim by **Audit Firm** regarding work done on projected cash flows and liquidity is misleading, as no such work was found in the WPs mentioned by the **Audit Firm**.

For Loans and Advances classification, the work done by the **Audit Firm** was unable to impart any meaning, as the only work done, that is Formulas used, are incomplete/false. The "Asset Liability Management Maturity pattern of certain items of Assets and Liabilities", which has been disclosed in the Financial Statements by the Management is not a substitute for future cash flow analysis.

e) The reference of Expert Advisory Committee of ICAI issued in December 2009 is not applicable in this case, as that expert opinion relates only to Public Financial Institutions. Loan disbursement of about 9 times of previous year when the operating cash flows were low as compared to previous FY, cannot be justified, as it has led to negative operating cash flow. As AS3 says, "The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise". Negative operating cash flow could hamper the operating capability of the enterprise and ultimately the very existence of the company.

f) As far as the Tri-Sure India Limited v. A.F. Ferguson & Co case is concerned, the **Audit Firm** is now of the view that this case was mentioned only for the evaluation of going concern assumption. Based on all the facts detailed above, NFRA is reinforced in its conclusion that the **Audit Firm** had not fulfilled the requirements of the SA 570 (Revised) with regard to the evaluation of the going concern assumption even based on available facts at the time of the audit.

g) The **Audit Firm's** opinion on impact of NOF/CRAR on assessment of going concern, has already been examined by NFRA in its **DAQRR**. The impact of non-compliance with minimum NOF/CRAR requirements squarely falls within the scope of matters discussed in Para A3 of SA 570 (Revised) and cast a significant doubt on the entity's ability to continue as a going concern. The **Audit Firm's** contention that the NOF/CRAR issue as identified and reported by RBI was merely one of regulatory capital computation, and not one of

solvency, and hence not related to the going concern of the company is not acceptable at all. The checklist provided under Para A3 of SA 570 (Revised) itself includes *"Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions"* as an indicator of the events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. Moreover, RBI was continuously asking for a detailed roadmap to meet the minimum NOF and CRAR requirements which the company was unable to submit even when the deadlines for doing so were repeatedly breached. This led to issuance of notice to show cause about cancellation of certificate of registration. This was a matter that certainly had a definite impact on the going concern assessment for the Company.

h) NFRA has already examined, in **DAQRR**, the issue related to the Management Plan. The Management Plan was not an approved plan, but only a tentative plan to be submitted in case RBI disapproved its time-extension request. Thus, the **Audit Firm** has failed significantly to fulfill the requirements under Paras 16 and 23 of the SA 570 (Revised) including obtaining the Management assessment of the going concern assumption and communicating with TCWG.

i) With regard to the matter of SCN being known to the company only after the date of audit report, there was no communication found in the Audit Files regarding the discussion with the Management (CFO) immediately after knowing the above fact, as asserted by the **Audit Firm**. *Exclusion of documentation with regard to SCN from the Audit File cannot be justified in any case.* If the Management had, on its own, not provided an updated Management Representation prior to the signing of the Audit Report on the Consolidated Financial Statements on 28th June, 2018, the **Audit Firm** was duty bound to ask the Management for the same and obtain it. The **Audit Firm** has seriously failed in not doing so. The auditor has failed to emphasize the importance of any such communication from the regulator, RBI, and its possible effects on the Financial Statements and "Going Concern Assumption" of the Company. No record of any procedures performed or action taken or communication made with the Management or TCWG is found in the Audit File. NFRA reiterates its conclusion that the **Audit Firm** was grossly negligent in complying with SA 560 "Subsequent Events" and has failed to emphasize the importance of any such communication from the regulator, RBI, and its possible effects on the Financial Statements and "Going Concern Assumption" of the Company.

j) As the **Audit Firm** has given no explanation regarding the breach of ALM guidelines by the company, NFRA reiterates its conclusion that mismatches (negative gap) in the 1-30/31 days' bucket exceeds 15% of the cash outflows in this time bucket. The company has failed to comply with the ALM guidelines and the **Audit Firm** has failed to point this out.

2.9.6 Having examined the responses of the **Audit Firm** to its prime facie observations/comments/conclusions, **NFRA** is reinforced in its conclusion that:

a) The **Audit Firm** had not obtained the Management's assessment of the applicability of the going concern assumption; consequently, no evaluation of such assessment has been made.

b) The evidence discussed above indicated that there were serious doubts about the justification for the use of the Going Concern assumption in the present case. The **Audit Firm** has completely failed in displaying the required professional skepticism and obtaining sufficient appropriate evidence on this matter.

c) The **Audit Firm**, therefore, has clearly not complied with SA 570 (Revised).

d) The **Audit Firms** assertions and response are thus found not sufficient, not appropriate and not conclusive in support of discharge of their obligations to test and evaluate and report on the Going Concern assumption as regards the Company.

e) It is therefore concluded that the **Audit Firm** has:

i. Failed to disclose a material fact known to them which is not disclosed in the Financial Statements, but disclosure of which is necessary in making such Financial Statements where they are concerned with that Financial Statements in a professional capacity;

ii. Failed to report a material misstatement known to them to appear in a Financial Statements with which they are concerned in a professional capacity.

iii. Not exercised due diligence and has been grossly negligent in the conduct of their professional duties;

iv. Failed to obtain sufficient information which is necessary for expression of an opinion or its expression are sufficiently material to negate the expression of an opinion.

2.10 MATERIALITY

2.10.1 In its communication dated 7th August, 2019, **NFRA** had conveyed its prime facie conclusions as follows:

a) **NFRA** had referred to the attachment 2.2.1.10 and noted that the WP is not in compliance with the SAs prescribed by Section 143 (9) read with Section 2 (7) and Section 143 (10) of the Companies Act, 2013.

b) Further, **NFRA** had observed that the rationale for ascertaining Materiality at the rate of 4.5% is not explained or supported by any calculation or reasoning anywhere.

2.10.2 The **Audit Firm**, in its response dated 30th August, 2019, has stated as follows:

a) In the course of the audit, the ET has considered compliance with the Standards of Auditing and documented the same as evidenced by a duly filled up checklist - refer WP 3.4.2.20. Thus, compliance with all SAs in India has been evaluated;

b) ICAI Standards have been harmonized with International Standards;

c) It is our policy to comply with the more stringent auditing standards, be they Indian or International. In this process, the SAs in India get definitely complied with as per the provisions of Section 143 (9) and 143 (10);

d) As regards differences between ISA and SAs so far as it relates to SA 320, the same is relating to specific aspects relevant for public sector entities dealt with in Paras A3 and A10 of ISA 320 which reference has been deleted in SA 320 in the corresponding Paras A8 and A9. Given that the engagement under review is not that of a public-sector entity, this difference is not relevant;

e) Generally, for listed entities, 3%-5% of the PBT is considered as a reasonable benchmark. Further, while determining the percentage we have considered factors such as Concentration of ownership and/or management, Debt arrangements, status of entity as a regulated entity, etc. (Refer attachment 2.2.1.10 Pg. 3-5 which explains the same). Based on these ET has concluded to use 4.5% as a rate to determine the materiality;

f) Determination of materiality is a matter of judgment and this judgment for the engagement under review is reasonable and consistent with prevalent benchmark.

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

a) 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 judgements 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. The assessment of the **Audit Firm** (as mentioned in attachment to WP 2.2.1.10) for the Auditee Company is that the company is debt listed and the entire equity capital is held by the holding company or its nominees. Thus, the main users of the Financial Statements would be debtors rather than investors or potential investors. This is for the reason that investors are also those in charge of management and have privileged access to information about the company that render it unnecessary for them to rely exclusively on the Financial Statements. As per KAM 38.1030 of the **Audit Firm**, the metrics applicable to the circumstances of the entity should consider the nature of the interest of the users as a group in the entity's Financial Statements. As an example, KAM 38.1030 gives the ability to repay debt as also a relevant metric. Further 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. However, 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 Metric of PBTCO would be the most appropriate without any application of mind or due diligence as required. KAM 38.1070 provides that the rationale for the determined benchmark shall be documented. However, no such rationale appears anywhere in the Audit File.

b) The **Audit Firm** has used nine qualitative factors for determination of the materiality as a percentage of benchmark (PBTCO) in WP 2.2.1.10. Based on analysis of these nine qualitative factors, the **Audit Firm** has used 4.5% of PBTCO as the benchmark rate for materiality out of the prescribed range of 3 to 5%. The various quality factors considered by the **Audit Firm** are as follows:

i. The company is debt listed.

ii. The company does not have publicly traded debt arrangements.

iii. The company has few stakeholders.

iv. There are only few external users of Financial Statements.

v. The company is debt listed but does not have a high public profile.

vi. The entity is an NBFC which operates under fairly stable business environment and the operations are relatively less complex.

As can be seen from the statements above, many of the assertions made by the **Audit Firm** are either unsubstantiated or contradict each other. For instance, when it is asserted that the "company has few stakeholders", or that "there are only few external users of Financial Statements", no data has been given in support of these conclusions. To assert that the "company does not have publicly traded debt arrangements" is factually incorrect and contradicts the statement that "the company is debt listed". Quite apart from the approach taken by the **Audit Firm** with reference to the benchmark materiality metric, the dismissive attitude and approach that underlies the assertion that the company has only "few" stakeholders and that there are "only few" external users of Financial Statements, besides being conclusive proof of negligence on the part of the **Audit Firm**, is damaging proof of lack of due diligence, casualness in discharging the obligations of the audit assignment, and the lack of the proper tone at the top as far as QC is concerned. Based on these statements, the **Audit Firm** has fixed the materiality at a high level of 4.5% in the spectrum of 3-5%. This clearly shows that the **Audit Firm** has fixed the materiality at 4.5% without any application of mind or due diligence. In fact, in one of the annexures to the Working Paper, the materiality has been shown as 4% of PBTCO. This highlights the lax attitude by which the whole materiality exercise has been carried out by the **Audit Firm**.

c) 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 various working papers quoted by the **Audit Firm** do not show any attempt made by the audit for identifying if there were any such particular classes of transactions, account balances or disclosures where the lower materiality level would be

applicable.

d) The **Audit Firm** has also failed to show how the performance materiality as determined in WP 2.2.1.10 was used for determining the nature, timing and extent of further audit procedures as required by Para 11 and Para A12 of SA 320.

e) In their response dated 6th June, 2019 (to **NFRA's** letter dated 10th May, 2019), the **Audit Firm** had mentioned that no revision to the materiality had been considered.

During the perusal of eAudit File of BSR, **NFRA** found a WP "4.1.1.10- Reassessment of Materiality" in which materiality had been reassessed as per full year financials. Materiality as determined by the **Audit Firm** during risk assessment at the planning stage for Audit of FY 2017-18 was ₹12.7 Crores (as per WP 2.2.1.10- Materiality WP-18) and materiality reassessed as per final financials was ₹9.1 Crores. As such, the **Audit Firm's** reply that there was no revision to materiality is false.

However, **Audit Firm** has made references in their reply dated 6th June, 2019, to WP 2.2.1.10 and not to the reassessed materiality WP. It has also been noticed that **Audit Firm** had used reassessed materiality at some places while performing their audit procedures. For instance, in WP "2.3.1.10- Significant Account- Scoping", while identifying which class of transaction, account balance had to be scoped in/ out, **Audit Firm** used reassessed materiality as the basis of forming conclusions. This implies that the final materiality used by **Audit Firm** in WP 2.3.1.10 for performing their audit procedures was ₹9.1 Crores and not ₹12.7 Crores (₹13 Crores as rounded off) though in their reply to **NFRA** query No. 15.1, **Audit Firm** mentioned materiality as ₹13 Crores. Thus, **Audit Firm** has misguided **NFRA** through misrepresentation of facts.

f) **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 Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of **NFRA**.

g) The names of ET members who prepared/ reviewed the Audit WPs differ w.r.t what is

mentioned inside the WP and what is mentioned as per the sign off history in eAudit File. This clearly denotes the casual approach of the **Audit Firm** in Audit Documentation. This is exemplified as follows:

S.No.	WP No.	WP Name	Signoff on the WP	Date of Signoff	Work Done by and when as mentioned inside the WP
1.	2.2.1.10	Materiality WP-18	Prepared- Ruchi Telang Reviewed- Ritesh Sheth Reviewed- G N Sampath Reviewed- Akeel Master	23rd January, 2018 23rd January, 2018 24th January, 28th March, 2018	Prepared- Tarika Sampat Prepared- Vanita Agarwal Reviewed- Ritesh Sheth Reviewed- G N Sampath
2.	2.2.001.001	IFIN Materiality benchmark comparison (This WP is attached inside the WP 2.2.1.10)	Prepared- Ruchi Telang Reviewed- Ritesh Sheth Reviewed- G N Sampath	23rd January, 2018 23rd January, 2018 24th January, 2018	Prepared- Vanita Agarwal Reviewed- Diwaker Bansal

S. No.	WP No.	WP Name	Signoff on the WP	Date of Signoff	Work Done by and when as mentioned inside the WP
			Reviewed- Akeel Master	28th March, 2018	
3.	2.3.1.10	Significant Account-Scoping	Prepared- Ruchi Telang Reviewed- Ritesh Sheth Reviewed- G N Sampath Reviewed- Akeel Master	23rd January, 2018 23rd January, 2018 24th January, 2018 3rd May, 2018	Prepared- Tarika Sampat Reviewed- Ritesh Sheth
4.	4.1.1.10	Reassessment of materiality	Prepared- Tarika Sampat Reviewed- Anuj Rawat Reviewed- G N Sampath Reviewed- Akeel Master	24th May, 2018 25th May, 2018 25th May, 2018 28th May, 2018	Prepared- Tarika Sampat Reviewed- Anuj Rawat

It also appears from the above table that the EP has failed to document his review of the reassessment of materiality WP in the conduct of audit of FY 2017-18. Para 17 of SA 220 requires the EP, through a review of the audit documentation and discussion with the ET, to be satisfied that sufficient appropriate audit evidence has been obtained to support the

conclusions reached. Therefore, EP violated the requirements of Para 17 of SA 220.

h) The table mentioned in Para above shows who had performed/ reviewed the audit work and the date on which such work was done. The WP "4.1.1.10- Reassessment of Materiality" was prepared on 24th May, 2018, by ET and reviewed on 25th May, 2018, by EP in which revised materiality was calculated at ₹9.1 Crores. However, the WP "2.3.1.10- Significant Account- Scoping" was prepared on 23rd January, 2018, by ET and reviewed on 24th January, 2018, by EP.

The audit procedures performed in WP "2.3.1.10" uses the materiality of ₹9.1 Crores (calculated in WP "4.1.1.10") as basis of their working. This clearly shows that the WPs have been prepared as an afterthought and to misguide **NFRA**.

2.10.4 Having examined the responses of the **Audit Firm** to its prime facie observations, **NFRA** concluded as follows in **DAQRR**:

a) The **Audit Firm** has failed to document the rationale for the determined benchmark which was the requirement of their own SQC policy. The Auditee Company was a debt listed company. **Audit Firm** did not examine any indicator for ability to repay debt but simply presumed the benchmark of PBTCO without any application of mind or due diligence as required.

b) The nine qualitative factors used by the **Audit Firm** for determination of the materiality as a percentage of benchmark (PBTCO) are either unsubstantiated or contradict each other. This, besides being proof of negligence on the part of the **Audit Firm**, is proof of lack of due diligence and casualness in discharging the obligations of the audit assignment. This is also material departure from the generally accepted procedure of audit applicable to the circumstances.

c) 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. The **Audit Firm** has also failed to show how the performance materiality as determined in WP 2.2.1.10 was used for determining the nature, timing and extent of further audit procedures as required by Para 11 and Para A12 of SA 320. Therefore, **Audit Firm** has failed to exercise due diligence and also failed to

report material departure from the generally accepted procedure of audit applicable to the circumstances.

d) **Audit Firm's** assertion that there was no revision to the materiality was incorrect. **NFRA** found a WP where **Audit Firm** had reassessed the materiality as per full year financials which is different from what was assessed at planning stage. Thus, **Audit Firm** had misinformed **NFRA** through misrepresentation of facts. Further, EP violated the requirements of Para 17 of SA 220.

e) The dates on which the WPs were prepared by the **Audit Firm** clearly shows that WPs had been prepared as an afterthought as the WPs use information from a WP which was not even prepared till that date. This shows failure to not only comply with functional requirement of Standards of Auditing but also the ethical requirements under SQC 1.

2.10.5 The replies of the **Audit Firm** in response to the observations of NFRA in the **DAQRR** have been examined and NFRA's conclusions thereon are as follows:

a) Regarding Para 2.10.3 (a), the **Audit Firm** has said that, in their professional judgement, they concluded that the economic decisions of the users of the financial statements of IFIN, being a profit-oriented entity, are most likely to be influenced by the entity's performance, for which PBTCO is a primary indicator. However, it is clear that the **Audit Firm** has simply presumed that the Benchmark Metric of PBTCO would be the most appropriate without any application of mind or due diligence as required. The reasoning given now, is an afterthought and is not available in Audit File though their own internal guidelines, (KAM 38.1070) requires this to be documented. The **Audit Firm's** assertion that "we submit that the ET has adequately documented the rationale for the determined benchmark and has arrived at its conclusion of the determined benchmark after evaluating alternate benchmarks with due application of mind and necessary due diligence" is completely without any evidence in the Audit File to back it.

b) In response to Para 2.10.3 (b) of **DAQRR**, **Audit Firm's** contention that Company does not have any publicly traded debt arrangement because the debentures are not actively traded on any stock exchange is unacceptable, since irrespective of whether the debentures are traded actively or not on the stock exchange, the fact remains that debenture holders remain the most important external users of Financial Statements.

As shown in the **DAQRR**, the dismissive attitude and approach that underlies the assertion that the company has only "few" stakeholders and that there are "only few" external users of Financial Statements, besides being conclusive proof of negligence on the part of the **Audit Firm**, is damaging proof of lack of due diligence, casualness in discharging the obligations of the audit assignment, and the lack of the proper tone at the top as far as QC is concerned. Based on these statements, the **Audit Firm** has fixed the materiality at a high level of 4.5% in the spectrum of 3-5%. This clearly shows that the **Audit Firm** has fixed the materiality at 4.5% without any application of mind or due diligence.

The assertion regarding materiality, if net asset/ gross asset was instead used as the benchmark, is meaningless as it is completely hypothetical and not at all reflected in the Audit File.

c) In response to Para 2.10.3 (c) of **DAQRR**, the **Audit Firm** has stated there are no significant accounts or disclosures that were required to be audited using a lower materiality. The **Audit Firm has even failed** to show any attempt made for identifying if there were any such particular classes of transactions, account balances or disclosures where the lower materiality level would be applicable. This is a failure to comply with Para 10 of SA 320.

d) In response to para 2.10.3(d) of **DAQRR**, the **Audit Firm** has stated that *"The Auditing Standard does not require us to demonstrate how the performance materiality was used for determining the nature, timing and extent of further audit procedures. It requires us to consider performance materiality in determining the nature, timing and extent of further audit procedures".* The **Audit Firm** has referred to work paper *"2.3.1.10 Significant Account- Scoping"* of eAudit file, and *WP attachment 1.370. 20* of eAudit file for selection of sample in the audit of expenses using Monetary unit sampling as examples of how performance materiality has been used in assessing the risks of material misstatement and in determining the nature, timing and extent of further audit procedures. NFRA has gone through the Work papers and accepts the response of the **Audit Firm**.

e) In response to Para 2.10.3 (e) of **DAQRR**, the **Audit Firm** has stated that due to misunderstanding of the question on their part, they responded that "no revision to materiality was considered" and that the same was not to misguide NFRA. Such a response of **Audit Firm** is completely unacceptable. The question asked by NFRA was crystal clear

and the **Audit Firm's** response to it was also clear. Now, when NFRA has identified the WP which carried out the reassessment of materiality, the **Audit Firm** has tried to cover it up by calling it a misunderstanding. It is clear that there was an attempt by the **Audit Firm** to misguide NFRA.

Secondly, the **Audit Firm's** statement that "the recomputed materiality had no material impact on the audit procedures or conclusions. Therefore, the reply given was that 'no revision to materiality considered.'" is again unacceptable. Whether the revision to materiality had an impact or not on the audit procedures, **Audit Firm** cannot misrepresent facts to NFRA.

Also, the **Audit Firm** mentions that they responded **"No revision to materiality considered"** due to misunderstanding, and, yet, in the latter part of their reply they themselves mention that they responded thus because there was no material impact on the audit procedures or conclusions. Both these responses are contradictory to each other. It clearly indicates that the **Audit Firm** deliberately tried to mislead NFRA.

Further, the **Audit Firm** has referred to WP 2.2.1.10 and not to the reassessed materiality WP. On the other hand, the **Audit Firm** had used the reassessed materiality at some places while performing their audit procedures. Thus, there is inconsistency in the approach of the **Audit Firm**.

f) In response to Para 2.10.3 (f) of **DAQRR**, the **Audit Firm** has referred to International Federation of Accountants (IFAC) stating that Standards of Auditing have been harmonized and are in conformity with the corresponding International Standards issued by IFAC. It is to be noted that 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 Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA.

g) In response to Para 2.10.3 (g) and (h) of **DAQRR**, the **Audit Firm** mentions that even though the name of team members who originally worked on it are included in the work paper attachment, the team member who eventuallytakes responsibility for the work signs off in eAudit. Such a response indicates that there is no reliability that attaches to the names of individuals mentioned in the work paper. Also, if as stated by **Audit Firm**, responsibility for the work is taken by the persons who signoff in eAudit, then it gives rise to the question

as to why names of ET members are mentioned in the work paper. This practice of the **Audit Firm** in documentation of the name of person who prepares/reviews the WP would lead to dilution of responsibility and resultant lack of accountability.

Further, the reply of the **Audit Firm** states that after computing the revised materiality, the ET assessed whether the same had any impact on scoping of accounts, and accordingly assessed the same in the attachment embedded in page 2 of WP2.3.1.10 of eAudit file. Also, WP 2.3.1.10 earlier contained the scoping based on materiality originally computed which was overwritten with scoping based on recomputed materiality, and this is claimed to be the reason why the said work paper was signed off in January 2018. On the perusal of the eAudit File, it is seen that sign off indicates by WHOM and WHEN amongst the ET members the particular WP was prepared/ reviewed. Now, when the revised materiality was overwritten as stated by the **Audit Firm** itself, the same had to be signed off accordingly on the date such changes were made in the WP. The **Audit Firm** has clearly failed to provide any valid explanation/ reasons for the facts pointed out in **DAQRR** in this regard and this creates a doubt on the reliability on the whole sign off exercise performed by the **Audit Firm**.

2.10.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm** has failed to document the rationale for the determined benchmark which was the requirement of their own SQC policy. The Auditee Company was a debt listed company. The **Audit Firm** did not examine any indicator for ability to repay debt but simply presumed the benchmark of PBTCO without any application of mind or due diligence as required.

b) The nine qualitative factors used by the **Audit Firm** for determination of the materiality as a percentage of benchmark (PBTCO) are either unsubstantiated or contradict each other. This, besides being proof of negligence on the part of the **Audit Firm**, is proof of lack of due diligence and casualness in discharging the obligations of the audit assignment. This is also material departure from the generally accepted procedure of audit applicable to the circumstances.

c) 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.

d) The **Audit Firm's** assertion that there was no revision to the materiality was incorrect. NFRA found a WP where the **Audit Firm** had reassessed the materiality as per full year financials which is different from what was assessed at planning stage. Thus, the **Audit Firm** had misinformed NFRA through misrepresentation of facts. Further, EP violated the requirements of Para 17 of SA 220.

e) The dates on which the WPs were prepared by the **Audit Firm** clearly shows that WPs had been prepared as an afterthought as the WPs use information from a WP which was not even prepared till that date. This shows failure to not only comply with functional requirement of Standards of Auditing but also the ethical requirements under SQC 1.

2.11 Investments

2.11.1 NFRA sought the following clarifications from the **Audit Firm** vide letter dated 23rd 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?

2.11.2 The **Audit Firm** in its response dated 20th November, 2019, stated as follows: -

a) The Purchase of equity shares referred to in 'a' above was approved by delegated authority of the Company through Investment Approval Memos which were verified by the ET.

b) The purchase consideration was in line with the price approved by the delegated authority and the valuation obtained from an independent valuer by the Auditee which was reviewed in – "Sr. No. 11 Gujarat Road and Infrastructure Company Limited I (page no I-98 to I-131)" and "Sr. No. 18 Pipavav Railway Corporation Limited I (page no I-539 to I-567)" in folder "2. 1 IFIN March 2018 File No. –I - Investment". The competence and objectivity of the Valuer was evaluated and documented in eAudit screen 2.9.9.3 and 2.0.6. The

purchase consideration was considered to be at arm's length on the basis of the aforesaid independent valuation.

c) The transfer of ownership of the investments to the Auditee as on 31st March, 2018, was verified from the demat statement in WP "11403006_h" in zip file "Final D Mat holding Reco" embedded in cell C in tab "Invest. Holding Sheet" and cell no. H106 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit File.

d) Other investments of the Company with related parties as at 31st March, 2018, are as per attached list in Annexure 1 given as below:

Annexure 1

Investments of the Company with Related Parties as at 31 March 2018

Name of Investee (a)	Instrument (b)	Carrying Value as at 31 March 2018 (Net of provision) (Rs. in crores) (c)	Valuation References (d)	Demat statement/ Physical Certificate/ Unit Statements References (Refer attachment 4.140) (e)
IL&FS Capital Advisors Ltd	Equity shares	0.69	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H81 in tab "Invest. Holding Sheet" of attachment 4.140 of our audit file.
IL&FS Infrastructure Equity Fund-I (P Units)	Investment in funds	182.90	Valuation particulars in file "Sr. No. 5 IL&FS Infrastructure Equity Fund-I (I2.226-I2.236)" in folder "2. 2 IFIN March 2018 File no. I2 - Investment"	Unit statement. Refer cell no. H127 in tab "Invest. Holding Sheet" of attachment 4.140 of our audit file.
IL&FS IIDC Fund	Investment in funds	65.65	Valuation particulars in file: "Sr. No. 4 IL&FS IIDC Fund (I2.215-I2.225)" in folder "2. 2 IFIN March 2018 File no. I2 - Investment".	Unit statement. Refer cell no. H128 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Transportation Network Ltd (ITNL)	Preference Shares	160.00	-	Demat statement. Refer page no. 2 of the demat statement "11369138_h" in zip file "Final D mat Holding Reco" embedded in cell C25 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Transportation Networks Ltd	Equity Shares	57.79	Assessment as per AS-13 in file "Sr. No. 2 IL&FS Transportation Network Ltd (ITNL)_I (page no I-36 to I-71)" in folder "2. 1 IFIN March 2018 File no. I - Investment".	Demat statement. Refer demat statement "11431795_h" in zip file "Final D mat Holding Reco" embedded in cell C25 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Global Financial Services Pte Ltd	Equity Shares	12.21	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H77 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Global Financial Services (UK) Ltd	Equity Shares	3.02	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H78 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Global Financial Services (ME) Ltd	Equity Shares	3.59	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H79 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Global Financial Services (HK) Ltd	Equity Shares	12.86	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H80 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Broking Services Private Ltd	Equity Shares	-	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	1) Demat statement. Refer page no. 2 of the demat statement with name "08DPC9U_1601480000069456_060420181109 35.pdf " in the zip file "Final D mat Holding Reco" embedded in cell C25 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file and physical certificate. Refer cell no. G83 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
Syniverse Technologies (India) Pvt Ltd	Equity Shares	0.01	Last Audited Financial Statements in file "Sr. No. 3 Syniverse Technologies (India) Pvt Ltd_I (page no I-72 to I-90)" in folder "2. 1 IFIN March 2018 File no. I - Investment".	Physical certificate. Refer cell no. H88 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
Syniverse Technologies (India) Pvt Ltd (Series B)	Preference Shares	0.00		Physical certificate. Refer cell no. H91 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
Syniverse Technologies (India) Pvt Ltd (Series D)	Preference Shares	9.99		Physical certificate. Refer cell no. H92 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Investment Trust - IV (PTC - II)	PTC	-	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H107 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IL&FS Investment Trust - IV (PTC -Series I)	PTC	-	Net worth particulars in tab "Net worth" of attachment 03.0010 of our eAudit file.	Physical certificate. Refer cell no. H108 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.
IFIN Realty Trust (Class A)	Investment in funds	34.11	Valuation particulars in file "Sr. no. 3 IFIN Realty Trust (I2.183-I2.214)" in folder "2. 2 IFIN March 2018 File no. I2 - Investment".	Unit statement. Refer cell no. H125 in tab "Invest. Holding Sheet" of attachment 4.140 of our eAudit file.

All these were classified as non-current investments by the Auditee and the existence of these investments were verified with the demat statements/ physical certificates- for details refer to column (e) of the Annexure 1 and other reference to WPs. Valuation of the aforesaid investments reference is given in column (d) of Annexure1.

e) The procedures performed with regard to the above are as follows:

i. Obtain a certified list of related parties from the Management - the list is attached at Page No. 14 of WP attachment 1.540;

ii. Also read the minutes of the Board Meeting and resolution to check for any additional relationships- refer page 17 of WP attachment 1.540;

iii. Verify if all parties covered under the list of related parties under AS 18 (as provided by Management and as verified above), that require disclosure, form part of financial disclosure - refer page 20 of WP attachment 1.540;

iv. Verify the related party transactions and balances with signed Financial Statements obtained from the subsidiaries and associates/records maintained by the Company - refer page 20 of WP attachment 1.540;

v. Verify the list of related parties as provided by the Company with the list of related parties of its holding and parent company as contained in the communication received from the auditors of the holding and parent company.

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

A. **<u>Purchase of Investment from Related Parties</u>**

a) The Auditee Company had purchased 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 consideration of ₹147.18 Crores and ₹54 Crores respectively from a Related Party. The **Audit Firm** has stated that purchase consideration was in line with valuation obtained from an independent valuer N. M. Raiji & Co (the Valuer or NMRC or Management Expert). The purchase consideration was considered to be at arm's length on the basis of the aforesaid independent valuation. The competence and objectivity of the Valuer was evaluated and documented by the **Audit Firm** in eAudit screen 2.9.9.3 and 2.0.6.

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

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)

b) 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:

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.*

The Auditor in eAudit screen 2.9.9.3 and 2.0.6. has evaluated the competence and objectivity of the Valuer, which is reproduced below for quick reference:

2.9.9.3 N M Raiji, Knight and Frank, Cushman and Wakefield, Colliers International Property Limited

Name of Expert

Name	Type
N M Raiji, Knight and Frank, Cushman and Wakefield, Colliers International Property Limited	Valuers

Document the evaluation of the expert's competence,capabilities and objectivity including inquiry regarding interests and relationships that may create a threat to the expert's objectivity (inquiry required only for experts engaged by KPMG)

1. N. M. RAIJI & Co.:- It is a Chartered Accountants firm in Mumbai is engaged in providing comprehensive professional services in the areas of Auditing, Taxation, Company Laws, Management Consultancy, Project financing. Mergers and Acquisitions, Corporate refinancing and other allied services. N. M. RAIJI & CO., is a partnership firm who qualified as a Chartered Accountant in year 1942. With more than 75 years of professional experience specialized in banking and financial services apart from the traditional services of accountancy, direct and indirect taxes, audits, company law, constantly endeavor to provide quality services to clients.

2.0.6 Experts and/or KPMG specialists

This activity does not need to be marked as prepared. It is only required to be marked as reviewed.

Expert(s)

Name	Type	Does the expert have the necessary competence, capability and objectivity for our purposes?	Our evaluation of the expert's competence, capability and objectivity
G N Agarwal	Actuary	Yes	Refer attached wp at 2.9.9.2.10
			1. N. M. RAIJI & Co.:- It is a Chartered Accountants firm in Mumbai is engaged in providing comprehensive professional services in the areas of Auditing, Taxation, Company Laws, Management Consultancy, Project financing. Mergers and Acquisitions, Corporate refinancing and other allied services. N. M. RAIJI & CO., is a partnership firm who qualified as a Chartered Accountant in year 1942. With more than 75 years of professional experience specialized in banking and financial services apart from the traditional services of accountancy, direct and indirect taxes, audits, company law, constantly endeavor to provide quality services to clients.

The description of NMRC given by the Auditor in eAudit screen provides very basic information. In fact, the **Audit Firm** has copied the same from the NMRC website which is clearly visible from the screenshot of NMRC website shown below:

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 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.** A simple copy-paste from the website of Management Expert has been done. This shows the casual nature in which the work has been carried out by the **Audit Firm.**

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).

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.

c) 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:

***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.

d) On examination of the referred WP, i.e. the Valuation Report of PRCL and GRICL issued by N. M. Raiji & Co, the following points/facts come to notice:

i. In valuation of PRCL share price, the Valuer has used equal weightage to the Comparable Company Method and Price to Book Value Method.

ii. In valuation of GRICL share price, the Valuer or NMRC has applied the Discounted Free Cash Flow (DCF) Approach.

iii. While applying these methods for the valuation, there was no information mentioned in both the reports regarding the basis of assumptions, sources of the data used, and other relevant facts of the report.

iv. 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 are 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;

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 Valuer Reports while giving the opinion which directly or indirectly impact the Financial Statements of the Auditee Company.

e) On examination of WP "11403006_h" in zip file "Final D Mat holding Reco" embedded in cell C in tab "Invest. Holding Sheet" and cell no. H106 intab "Invest. Holding Sheet" of attachment 4.140 in eAudit File, it is observed that only 91,88,846 share of GRICL were transferred from ITNL to IFIN instead of 93,27,125.

The **Audit Firm** has not shared any evidence for transfer of PRCL shares except working in Sheet No. 4.140 of eAudit File in which it is 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 Crores 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%20Report/Annual%20Report%202018-2019.pdf.

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.

f) Further analyzing/reviewing the eAudit File, NFRA found WP.1.310 in which the auditor has evaluated the valuation of PRCL and GRICL. The final assessment of the **Audit Firm** for GRICL was "*Considering the above assessment there is requirement of provision*". **This assessment was based on calculation of intrinsic value of share which was calculated at ₹30.74 per share against the purchase price of ₹157.80 per share. The total amount of diminution calculated by the Audit Firm for GRICL was ₹145 Crores. Similarly, an amount of ₹28.14 Crores was calculated as diminution for PRCL.** The only explanation given by the Management of the Company in both the cases and recorded in the WP is '*no apparent reasons compelling the Company to exit the investments in the near future*'. The final conclusion of the **Audit Firm** in case of PRCL is that the Investments are significantly misstated. However, the **Audit Firm** has completely failed to question the Management and has accepted the Management's Assertion. The **Audit Firm** has gone against its own assessment and has accepted higher valuation of the Investments at ₹173.14 Crores. The **Audit Firm** has, thus, colluded with the Management, and has overstated the profit by ₹173.14 Crores (sum of ₹145 Crores and ₹28.14 Crores) in these two cases.

g) The **Audit Firm** in its response attached the Annexure I and referred WP 1.540 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. In WP 1.540, nowhere in the document IECCL was 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-disclosure of significant related party in Management Representation itself creates a doubt on the credibility of Management and competence of Auditor. (The detailed discussion regarding IECCL investment is in the next point.)

B. **Valuation of Other Investments**

h) 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 WPs 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 three 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
Last Mile Online Limited	Unquoted Compulsory Convertible Debentures	680.00	0.00

NFRA has examined WP "1.310 Investment Schedule Mar-2018" prepared by the ET to summarize their approach to verify the analysis of valuation of non-current investments as at 31st March, 2018, along with the separate WPs submitted by the **Audit Firm** in their folder "2. 1 IFIN March 2018 File no. I – Investment" and "2. 2 IFIN March 2018 File no. I2 – Investment" in folder "Other WPs" in their "IFIN 2017-18 Audit Files". The observations of NFRA are in following Paragraphs.

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

i. The **Audit Firm** in their worksheet "IECCL" of WP "1.310 Investment Schedule Mar-2018" has clearly indicated that against average cost price per share of the investments in equity of the IECCL of ₹81.62, the intrinsic value of the share as on 31st March, 2017, and 31st March, 2016, is computed at ₹6.57 Per share and ₹2.35 per share. Further, 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.

ii. The **Audit Firm** has also noted in the same worksheet that even after considering the average market price per share during the last one year, there was a diminution of 46% in the value of investment.

iii. While the diminution in the value of investment is being computed for the year ended on 31st March, 2018, instead of recognizing developments pertaining to the investee's business during the current FY, data including the order book for the FY 2015-16 and FY 2016-17 was considered by the **Audit Firm**. Even if these figures for the past years were 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.

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 a part of obtaining Audit Evidences. Although the **Audit Firm** analyzed the indicators like market value and investee's net assets and results, even after noting the negative observations, the **Audit Firm** failed to provide any justification for not recognizing the diminution in the value of investments.

v. The **Audit Firm** based upon its assessment had clearly noted that there is requirement to provide for impairment (of ₹27.06 Crores), though, in conclusion, it agreed with the Management intention not to create any provision for impairment. WP indicates that no query was raised to the Management by the **Audit Firm** to obtain reasonable justification to support this accounting treatment.

vi. WP "Sr. No. 1 IL&FS Engineering & Construction Co. Ltd I (page no I-2 to I- 35)"

in folder "2. 1 IFIN March 2018 File no. I – Investment" of "Other work paper" submitted as a part of the "IFIN 2017-18 Audit File" contains the detailed impairment testing done by the Company's Management of the IECCL investment. The document nowhere indicates any query being raised on the said submission by 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.

vii. The **Audit Firm** has gone against its own assessment and has accepted higher valuation of the Investments by ₹27.06 Crores. The **Audit Firm** has, thus, colluded with the Management, and has overstated the profit by ₹27.06 Crores.

j) **Investment in Properties at Mumbai**

i. The Company has an investment in properties amounting to ₹5,393.77Million as at 31st March, 2018, and ₹4,129.96 Million as at 31st March, 2017, as a part of their non-current investments.

ii. NFRA has examined the worksheet "Property Details" in "WP "1.310 Investment Schedule Mar-2018" embedded in the eAudit File and Valuation Report issued by Knight Frank India Private Limited forming part of WP "Sr. No. 12 Kohinoor Square Project (I2.389-I2.408)" in folder "2. 2 IFIN March 2018 File no. I2 – Investment" in folder "Other Work papers" of "IFIN2017- 18 Audit File".

iii. Based upon the examination, it is understood that the investment in properties pertains to the allotment of specified area of 2,29,235.00 Sq. Feet area at Kohinoor Square Project, Mumbai.

iv. The **Audit Firm** has noted that "*It must be noted that majority of the lenders to this project has assigned their loans to Edelweiss ARC (EARC), i.e. approx. 80% of the loan and is in process of restructuring of debt towards completion of project. EARC is of the view that area allocated to IL&FS group is without clear NOC from senior lenders and hence, IL&FS should be treated as unsecured and not be comfortable in considering IL&FS allocated area out of balance unsold area*".

v. The **Audit Firm** based upon their assessment in the said WP had noted that

"Considering the above assessment, there is requirement of provisions for impairments". Even after noting the requirement to create provision for impairment on the said investment the **Audit Firm** concluded that there is no diminution in the value of the investment.

vi. The **Audit Firm** had simply relied upon the Valuation Report issued by "Knight Frank India Private Limited" without undertaking any independent analysis of the same to verify the assumptions and estimates considered by the Valuer.

vii. It is important to note here that the Valuer 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."

viii. 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 if 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.

k) **Last Miles Online Limited**

i. NFRA has examined the worksheet of "Last Miles" in WP "1.310 Investment Schedule March-2018" embedded in the eAudit File and Valuation Report issued by Biyani Mittal & Co. forming part of WP "Sr. No. 16 Last Mile Online Ltd. (I2.413-I2.483)" in folder "2. 2 IFIN March 2018 File no. I2 – Investment" in folder "Other Work papers" of "IFIN2017-18 Audit File".

ii. The **Audit Firm** has clearly noted in their Assessment as follows:
"Considering the above assessment there is requirement of provisions for impairments. What is the basis of giving CCD at 0.01 pc when instrument is unsecured. Latest update on the project."

iii. Also, the **Audit Firm** has concluded that:
"On considering above analysis of Financial Statements and other negative aspects in the company, the Company has not made any diminution in the value of investments other than temporary and ***that investments are significantly misstated****. Further, as per management there exists no apparent reasons compelling the Company to exit the investments in the near future."*

iv. Even after duly analyzing the negative aspects 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 solely relied on the Valuation Report of the Management Expert without performing any additional independent audit procedures that justify the valuation of the Company.

v. 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.

vi. It is, thus, evident from the discussion above that the **Audit Firm** 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.

2.11.4 Having examined the responses of the **Audit Firm** to its prime facie observations, NFRA, therefore, concluded as follows in DAQRR:

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

b) The **Audit Firm** indulged into a deliberate effort 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.

2.11.5 The **Audit Firm's** responses to the observations of NFRA in the DAQRR have been examined and NFRA's conclusions thereon are as follows:

a) Regarding Para 2.11.3.(A)(a) and (b), the **Audit firm** has stated *that purchase of equity shares of GRICL and PRCL was a related party transaction and the transaction and pricing were approved by the AC and the Board of directors (Board) of IFIN in their respective meetings held on 28 May 2018. Accordingly, both PRCL and GRICL were investments purchased during the year 2017-18.*

NFRA notes that the approval obtained from AC and BOD was after the date of closure of Financial Statements for FY 17-18. Whereas as per Section 177 of the Companies Act, 2013:

(4) Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include, —

(iv) *approval or any subsequent modification of transactions of the company with related parties*;

Admittedly, no approval from the Audit Committee was taken before the date of the transaction. This was a clear violation of law that the Audit Firm has chosen to remain

silent about.

Regarding evaluation of the competence, capabilities and objectivity of management's expert, the **Audit Firm** mentioned that *the ET was led by an EP who has many years of experience in audit and was well aware of the competence and capabilities of the valuer firm in question. Moreover, the valuer was based in Mumbai and both management and valuer confirmed their independence in the form of Management Representation Letter and Valuation report respectively. Regarding the relevance of the management's expert's competence, auditor mentioned that valuer was familiar with the accounting framework being adopted by the Company and used internationally accepted valuation methodologies. Furthermore, non- identification of any payments/ expenses to the valuer other than for valuation fees and the fact that the valuer was not an employee of the Company eliminate all threats to a management's expert's objectivity.*

NFRA notes that the awareness of EP regarding the competence and capabilities of the valuer firm in question has been nowhere documented down in the Audit Files, making this awareness useless/irrelevant in the eyes of the law. Furthermore, as per Para A37 of SA-500, there are many factors that can influence capability such as geographical location and the availability of time and resources. Consideration of the only fact that the valuer is located in Mumbai does not per se amount to examination of capability to satisfy the requirements of SA. The **Audit Firm** has also failed to show its examination of the relevance of the management expert's competence to the matter. It is also noted that no appropriate audit procedures were conducted by the firm to evaluate the threats to a management's expert's objectivity, and the only fact noted was the non-identification of any payments/ expenses to the valuer other than for valuation fees which again were not mentioned in the Audit Files. It is also a fact that the same valuer was awarded numerous valuation assignments from other companies in the ILFS group and, taken together, all this amounted to a significant self interest threat. The Audit Firm has chosen to remain silent on the fact that its assessment of the valuer's competence was just a copy- paste of the Valuer's website. Thus, the **Audit Firm** has failed to comply with Paras 8, A38, A40, and A41 of SA 500.

b) The **Audit Firm** has made points like Licensing requirement for Valuers, knowledge and experience of EP and details given by Valuer in response to Para 2.11.3.A.(c) of DAQRR. However, the **Audit Firm** has not given reference of a single WP to support the claim. The **Audit Firm** has failed to show that they have obtained understanding of the work of the

Management Expert, understanding of the relevant field of expertise of the Management Expert, auditor's determination of whether the auditor has the expertise to evaluate the work of the management expert, etc. The **Audit Firm** has thus failed to comply with Paras 8 (b) and A45 of SA 500.

c) In response to Para 2.11.3.A.(d), the **Audit Firm** has stated that *source of information has been identified in the valuation reports. Regarding basis of key assumptions, the Methods used for valuation were amongst the acceptable methods used by Valuers. For GRICL, assumptions for future revenue and costs are derived from the projected Income Statement and Balance Sheet, historical revenue growth was 13%, while forecast revenue CAGR was approximately 11% and discount rate appeared to be in line with the discount rate used by analysts. For PRCL, the Valuer presented the historical income statement and the historical balance sheet; multiples considered by the valuer in the analysis have been presented in the report along with weightage assigned to such multiples while arriving at the value.*

NFRA has again examined the Valuation Reports. As far as GRICL is concerned, the valuer has noted that the decrease in the revenue in FY 18-19 from the revenue of FY 17-18, whereas **Audit Firm** has claimed that CAGR was approximately 11%. Regarding PRCL, there is no basis for the multiple (P/BV), or basis on which equal weightage was considered, found in the valuation report. Further, in both the cases, the **Audit Firm** has not shown any Audit Evidence to prove that they have performed any test or working to check the fairness of the Valuation Reports while evaluating the share value. The **Audit Firm** has claimed that they reviewed and analyzed number of documents. But neither any reference of the documents is available in file nor any WP showing the independent analysis that has been referred 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.

d) In response to Para 2.11.3.A.(e), the **Audit Firm** has stated that ITNL has approached IFIN to sell 93,27,125 equity shares, but the actual number of shares of GRICL purchased by IFIN is 91,88,846. *Regarding the physical verification of share certificates, the **Audit Firm** submitted that the information provided to the NFRA on physical verification of shares of PRCL was based on the information contained in our working papers a copy of which is also submitted to the NFRA. Since we have not obtained copies of the share certificates, we are unable to provide any further information on this. The **Audit Firm** has further clarified*

that the date of recording of purchase investments is not necessarily the date on which it is legally registered in the name of the purchaser. It is the date on which the risks and rewards transfer to the purchaser.

The **Audit Firm** has clearly admitted the veracity of the statement that "they have falsely stated that the ET has physically verified the evidence in the form of certificates". Further, there is no clarification provided by the **Audit Firm** regarding the date on which, according to the **Audit Firm**, risks and rewards were transferred to the purchaser. In absence of any legally documented date, the **Audit Firm** cannot assume the transfer in itself. Thus, 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.

e) In response to Para 2.11.3.A.(f), the **Audit Firm** has stated that *though the WP does note the difference in value between the cost of purchase and the Net Asset Value and refers to the difference as 'Diminution' in the case of GRICL and as 'Diminution requiring provision' in the case of PRCL, the same is done prior to consideration of the valuation as per the independent valuation report. Accordingly, the same should be considered as a very preliminary/ limited assessment based only on the NAV and before consideration of the independent valuation reports and not as a final conclusion reached. Further, the worksheet of PRCL does consider the independent valuation of shares and notes that 'Value per share as per valuation report is more than cost of the share'. On the basis of the above we submit that there is an error in recording the conclusion on this sheet which should have been recorded as 'investments are not significantly misstated'. Mindful of your observations, we will take the necessary steps for strengthening our documentation of audit evidence.*

NFRA observes that there is no evidence to support the **Audit Firm's** assertion that the conclusion stated in the WP is a preliminary assessment. There is no evidence regarding the dates of preparation of WP, when was the preliminary assessment and final assessment done, etc. In fact, the so called preliminary assessment of the **Audit Firm** in case of PRCL clearly refers to the valuation report. The **Audit Firm** is trying to mislead NFRA by portraying collusion with management as an error in the work papers.

Thus, the **Audit Firm** has gone against its own assessment and has accepted a higher valuation of the Investments at ₹173.14 Crores. The **Audit Firm** has, thus, colluded with the Management, and has overstated the profit by ₹173.14 Crores (sum of ₹145 Crores and

₹28.14 Crores) in these two cases.

f) In response to Para 2.11.3.A.(g), the **Audit Firm** states that *IECCL qualifies as an associate company, (hence related party), under the Companies Act 2013, but disqualifies under Accounting Standards specified under section 133 of the Companies Act, 2013, as the Group does not have* significant *influence over IECCL.' So, it was not included in WP as related party under AS 18.*

NFRA has again examined WP 1.540. The WP in fact mentions the RPT list as **List of Related Party as per Section 2(76) of the Companies Act, 2013 and Rules thereunder (March 31, 2018)**. It nowhere clarifies that separate RPT list is being maintained under AS18. The WP also gives a complete analysis of various provisions of Companies Act, 2013. Also, the provisions of the Act would always prevail over those of the Standards. Hence, this non-disclosure of significant related party in Management Representation itself creates a doubt on the credibility of Management and competence of Auditor.

g) In response to Para 2.11.3.B.(i), the **Audit Firm** stated that *the diminution of Rs. 27.06 Crores is the amount of decline computed with reference to a simple average of the High and Low price of the shares during the year, but work paper does not capture whether that decline is 'temporary' or 'other than temporary'. Management had considered the various questions/ concerns raised by the ET as well as the joint auditors and addressed the same in their assessment in the work paper which contains the detailed impairment testing done by the Company's Management of the IECCL investment. Factors such as order book position, business development initiatives, extent of recoverability from Claims, revenue and profit projections taking the above into account, reconciliation of average market price of IECCL equity shares to the carrying value based on aforesaid factors to assess extent of diminution, if any that could be considered other than temporary, were considered by management, which when reviewed, satisfied the ET that, the amount assessed in the detailed impairment testing work paper to be a decline, other than temporary, there were no further amount to be recognized in the financial statements.*

NFRA has examined the above contentions. A continuous decline of 67.75% over a period of three years, cannot be termed as temporary in nature. The **Audit Firm** has not given any satisfactory response to the observation of NFRA that *"While the diminution in the value of investment is being computed for the year ended on 31st March, 2018, instead of recognizing developments pertaining to the investee's business during the current FY, data*

including the order book for the FY 2015-16 and FY 2016-17 was considered by the ***Audit Firm".*** The claim of the **Audit Firm** that the Management had considered the various questions/ concerns raised by the ET as well as the joint auditors and addressed the same in their assessment in the work paper is not tenable, as no such questions are available either in the Working Paper or in the impairment testing done by the Company's Management of the IECCL investment. As stated in the DAQRR, the **Audit Firm** has also failed to verify the compliance with the requirements of Para 17 of AS 13. NFRA reiterates the fact that the **Audit Firm** had simply relied on the information provided by the Management instead of performing sufficient appropriate audit procedures.

h) In response to Para 2.11.3. (B)(j), the **Audit Firm** has stated that *the value of the Kohinoor property as per valuation report of Knight Frank was valued at Rs.550 Crores as against its carrying value of Rs. 499 Crores in the books of IFIN as at 31 March 2018.* But, as observed in DAQRR, the **Audit Firm** has failed to undertake any independent analysis of the valuation to verify the assumptions and estimates considered by the Valuer.

The **Audit Firm** has further stated that the statement "*It must be noted that majority of the lenders …….. balance unsold area*" was made *when IFIN was holding allotment letters of the property and prior to registration of the property in the name of IFIN in May 2017 and payment of stamp duty upon purchase of the property and registration of the same, IFIN was no longer a creditor/ lender and the aforesaid remarks, in our view, do not affect IFIN's title to the property purchased*. However, this claim is not supported by any Audit Evidence. The Audit Firm has not provided any evidence regarding the dates of the above-mentioned statement to show whether it was before or after the registration of property.

The **Audit Firm** has further added that the comments captured in the Work Paper that *"Considering the above assessment, there is requirement of provisions for impairments" was a preliminary/initial comment which itself was based upon noting of EARC prior to purchase of the property by IFIN.* Here again, the **Audit Firm** has no documentation to show the final comments of the **Audit Firm** or the way in which this initial comment was addressed by Management/Audit Firm.

According to the **Audit Firm***, "The ET had also inspected the registered agreements for the property and on which stamp duty and registration fees were paid".* However, copies of these are not available in the Audit File and there is no Audit Evidence to support the claim.

The **Audit Firm** has further stated that, "*considerations such as 'any charges, mortgages*

or amounts owing on the property or for any expenses or taxation, which may be incurred in effecting a sale' are not very relevant particularly since the valuation indicates a fair amount of headroom over the carrying value of the property". However, the claim of the Audit Firm regarding this is irrelevant and cannot be accepted as no Audit Procedures were done by the audit firm to substantiate such claim.

Overall, it appears that the line of argument given by the **Audit Firm** is not supported by Audit Evidence and hence, is an afterthought. The **Audit Firm** has not carried out any verification of the acquisition, the legal ownership and entitlement of the said property. Thus, the **Audit Firm** has 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.

i) In response to the Para 2.11.3.(B)(k), the **Audit Firm** has stated that the comment in the work paper "Considering the above assessment.....update on the project" should be read more as a question by the ET before proceeding with further analysis rather than as a conclusion and the comment "On considering above analysis of Financial Statements …….are significantly misstated "should be read as a preliminary / initial observation based on figures in financial statements of a Company that has not commenced business rather than as a final conclusion.

However, it may be noted that the above-mentioned conclusions were the only assessment and the conclusions found in the Work Paper. The **Audit Firm's** claim that "*comments regarding investment being misstated is a preliminary observation*" is completely misleading as there is no other conclusion found in the work paper except some factual details. In fact, the **Audit Firm** itself has concluded that:

"On considering above analysis of Financial Statements and other negative aspects in the company, the Company has not made any diminution in the value of investments other than temporary and ***that investments are significantly misstated****. Further, as per management there exists no apparent reasons compelling the Company to exit the investments in the near future."*

It may be noted that this is the only 'Conclusion' Para in the WP. Thus, the **Audit Firm** has completely neglected the possible negative impacts on the financial position of the

Company and it solely relied on the Valuation Report of the Management Expert without performing any additional independent audit procedures that justify the valuation of the Company. The action of Audit Firm seems to be a deliberate effort to hide the diminution in value of this investment.

2.11.6 NFRA, therefore, concludes that:

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

b) The **Audit Firm** indulged into a deliberate effort 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.

2.12 CREATION OF CHARGES

2.12.1 **NFRA** had sought clarification from the **Audit Firm** vide letter dated 23rd 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 2.330 and embedded worksheet "Secured and Unsecured Loan sheet" tab "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.

2.12.2 The **Audit Firm,** in its response dated 20th November, 2019, has stated as follows: -

a) Out of loans amounting to ₹2079.46 Crores (of response of the **Audit Firm** dated 20th November, 2019), loans aggregating ₹1,438 Crores were verified on test basis. The selection of such loans was made on a random basis.

b) Confirmations were obtained/received from the parties for their outstanding balances as on 28th February, 2018, and no differences were noticed based on such confirmations. Such parties had unsecured loans aggregating ₹1,436 Crores as on 31st March, 2018, and none of the loans were NPAs as on 31st March, 2018, as per the RBI guidelines.

c) In most cases, the security creation was pending for period of one year or less from the date of disbursement. Further, based on **Audit Firm's** experience, it is not uncommon to have delays in creation of security in the lending business.

Hence the non-creation of security as on 31st March, 2018, in these cases was not considered to be a threat from a recoverability perspective as at the date of opinion.

d) The Company's processes and controls over 'Perfection of Documentation' covered the aspect of Registration of Charges and same was tested in eAudit File in Working Paper 2.130 "C2 Disbursement without Docs".

e) Due to all of the above reasons, the **Audit Firm** did not consider any modification while giving an unqualified opinion in Audit Report.

f) The WP references provided in WP 2.330 was an inadvertent error. The particulars of the work done i.e. testing of secured and unsecured portion of loans as well as Current and Non-Current classification of loans, have been captured in the various tabs of WP attachment 2.330 itself as well as in WP attachment 2.260.

2.12.3 NFRA had examined the above contentions of the **Audit Firm** and observed as follows in **DAQRR**:

a) **NFRA** examined the WPs mentioned by the **Audit Firm** and found that WP 2.330 pertains only to classification of the loan. This does not check validity of the loan. WP 1.300, which pertains to validity, checks validity of loan for 7 out of 25 Parties having an aggregate value of ₹423 Crores as per details below:

S.No.	Name of Parties	Amount of loan disbursed during the FY 2017-18 (₹ In Crores)
1	Earth Environment Management Services Pvt. Ltd.	7.83
2	GHV Hotel (India) Pvt. Ltd.	130.00
3	Hill County SEZ Pvt. Ltd.	149.00
4	Neelkamal Realtors Tower Pvt. Ltd.	53.39
5	Oscar I**NFRA** Pvt. Ltd.	14.00
6	Serveall Construction Pvt. Ltd.	21.48
7	Varun LPG Carriers Pvt. Ltd	47.40
Total		**423.10**

Therefore, validity check was, in effect, performed only on 1/5th of the total loans (₹423.10 Crores out of the total of ₹2,079 Crores) in question and not on ₹1,438 Crores as wrongly stated by the **Audit Firm**. Thus, the **Audit Firm** was grossly negligent in the conduct of its professional duties and has also tried to mislead the Authority.

b) 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, the **Audit Firm** used a random sampling basis and checked validity details for only 7 parties out of 25 parties, and only on 1/5th of the value of the total loans. The **Audit Firm** even excluded important related party like IL&FS Engineering & Construction Co. Ltd. Thus, the **Audit Firm** did not comply with SA 500 and failed to exercise due diligence.

c) Clarification was required about the audit evidence and audit procedures performed for testing the validity of the security available, and the recoverability of the loan on which

charge was not created. The confirmation of balances from parties and their non NPA status do not provide this clarification.

d) 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.

e) **NFRA** has examined and analysed the working Papers referred to by the **Audit Firm** and found that in one-third of the cases, security creation was pending for more than one year, which is contrary to the statement of **Audit Firm.** The security creation/registration was pending as on 31st March, 2018, 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.	29th March, 2017	121
		29th March, 2017	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.	20th March, 2017	48

S. No.	Name of Borrower	Date of Disbursement	Total Amt. Unsecured (₹ in Crores)
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 referred to Working Paper 2.130 in tab "C2 Disbursement without Docs" – 'Company's processes and controls over Perfection of Documentation' in support of its argument. While examining this working paper, it was found that this document contains a listing of the steps to be followed by the Auditee for updating the status of loan documentation. The **Audit Firm** took a sample for two months i.e. August 2017 and January 2018 which was verified by mails exchanged between the managerial staff. No other procedure or technique was applied for the purpose of verification of these steps.

Further, the document does not perform any test pertaining to creation/registration of charge against borrower companies.

g) The WPs referred by the **Audit Firm**, WP 2.330 and WP 2.260, for testing of Secured and Unsecured portion of loans as well as Current and Non-Current classification of loans, had only one work sheet about Charge Creation. Even this work sheet does not cover the information of all the 25 parties. 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 do not exist. And the WPs 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**.

2.12.4 **NFRA**, therefore, concluded as follows in **DAQRR**:

a) The **Audit Firm** was grossly negligent in the discharge of its professional duties by performing validity check only on 1/5th of the total loans (₹2,079 Crores) in question.

b) The value of the loans said to have been examined by the **Audit Firm**, viz. ₹1438 Crores is not supported by the evidence and is, therefore, clearly false.

c) The **Audit Firm** did not comply with Para A53 of SA 500 by adopting sampling where the population constituted a small number of large value items and there is significant risk.

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.

e) 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.

2.12.5 After examining the responses of the **Audit Firm** to the findings of the DAQRR, concludes as follows:

a) There is no worksheet tilted 'March Disbursements' in the attachment 2.330. It is sad to note that the **Audit Firm** is referring to documents which either do not exist or do not check

validity of the loan. Thus, validity check, as shown in **DAQRR**, was, in effect, performed only on 1/5th of the total loans (₹423.10 Crores out of the total of ₹2,079 Crores) in question and not on ₹1,438 Crores as wrongly stated by the **Audit Firm**.

b) NFRA reiterates its views that it would have been more appropriate to examine 100% of the population, where the population constituted a small number of large value items especially when absence of charge creation should have raised red flag. However, the **Audit Firm** used a random sampling basis and checked validity details for only 7 parties out of 25 parties, and only on 1/5th of the value of the total loans. Thus, the **Audit Firm** did not comply with SA 500 and failed to exercise due diligence.

c) The original argument made by the **Audit Firm** was that, "*In most cases, the security creation was pending for period of one year or less from the date of disbursement*". When it was shown that Creation/Registration of charge was pending for 32.56% of loans for more than a year, it is now being argued that "*security on loans of ₹ 1958 Crores comprising 94 % of the above loans was outstanding for* ***less than an year except for a few that were marginally beyond a year***". This brings out the erroneous data, and duplicity in the arguments made by the **Audit Firm**.

The **Audit Firm** was asked to clarify about the audit evidence and audit procedures performed for testing the validity of the security available, and the recoverability of the loan on which charge was not created. The **Audit Firm**, instead, mentioned few of the cases as part of the presentation made to the Audit Committee, that too on the date the Audit Report was approved and signed. In fact, the **Audit Firm** has even failed to record what was discussed in the ACM. Creation of insufficient security to cover the whole loan should, in fact, be seen as a red flag and not as a comforting factor.

d) In its reply dated 10th September, 2019, the **Audit Firm** had stated that "*ET did not use the work of Internal Auditor- refer documentation in eAudit Screen 2.7.4 of our eAudit File".* Now, the **Audit Firm** wants to rely on the Internal Audit reports to showcase absence of any adverse observations (in Internal Audit reports) with regard to the Company's process of registration of charges. This shows that the reply of the **Audit Firm** is a sham and an afterthought. Further, it has already been shown at the **DAQRR** stage that the test of controls and other documents either do not exist or hardly have any information regarding Creation/Registration of Charges. The **Audit Firm** has, thus, 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).

e) The fact is that Creation/Registration of charge was pending for 32.56% of loans for more than a year. 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 and value of loans for more than a year.

f) The Branch visit report checks documents related to charge creation in only two instances, i.e., Geowork Infra Projects Private Limited and Unitech Ltd. In both the cases, the document examined is Notarised undertaking for security creation and Certified true copy of resolution passed by BOD to create charge. There is no Audit evidence regarding creation/registration of charge against borrower companies.

g) Worksheet '*Security Creation post 31 Mar' embedded in Tab 'Secured and Unsecured Loan*' in WP 2.330 just gives a list of charges, as given by the Management, created after 31st March. It does not give any audit procedures performed to ensure the validity and recoverability of loans which were contractually secured but pending for Security Creation/Registration. The **Audit Firm** has again referred to Working Paper 2.130 in tab "C2 Disbursement without Docs" – 'Company's processes and controls over Perfection of Documentation' in support of its argument. This document contains a listing of the steps to be followed by the Auditee for updating the status of loan documentation. The **Audit Firm** took a sample for two months i.e. August 2017 and January 2018 which was verified by mails exchanged between the managerial staff. No other procedure or technique was applied for the purpose of verification of these steps. Further, the document does not perform any test pertaining to creation/registration of charge against borrower companies.

2.12.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm** was grossly negligent in the discharge of its professional duties by performing validity check only on 1/5th of the total loans (₹2,079 Crores) in question.

b) The value of the loans said to have been examined by the **Audit Firm**, viz. ₹1438 Crores is not supported by the evidence and is, therefore, clearly false.

c) The **Audit Firm** did not comply with Para A53 of SA 500 by adopting only sampling, and not 100% verification, in a situation where the population constituted a small number of large value items and there is significant risk.

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.

e) 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.

2.13 SUBSEQUENT EVENTS

2.13.1 In its communication dated 23rd October, 2019, NFRA had conveyed its prime facie conclusions as follows:

a) With reference to SA 560, NFRA had observed that the **Audit Firm** had not taken into consideration the market price of the shares of ITNL which declined over 2017-18. Further, the Statutory Auditors of ITNL, in the Limited Review Report dated 13th August, 2018, raised the issue of existence of material uncertainty on the Company's ability to continue as a going concern.

b) RBI issued SCN for cancellation of Certificate of Registration to IFIN on 5th June, 2018. The matter was, inter alia, discussed in the Audit Committee Meeting of 29th August, 2018 i.e. before the AGM.

2.13.2 The **Audit Firm** in its response dated 20th November, 2019, has stated as follows:

a) In the case of IFIN, relevant dates as per the **Audit Firm** for the purpose of understanding the implications under SA 560 are as follows:

Particulars	**Date**
Date of Financial Statements- Standalone and Consolidated	31st March, 2018
Date of Auditor's Report and issue of Standalone Financial Statements	28th May, 2018
Date of Auditor's Report and issue of Consolidated Financial Statements	28th June, 2018

The **Audit Firm** has not audited or reviewed Financial Statements or results of the Company for any period after 31st March, 2018.

b) Investment in ITNL was shown in the Financial Statements of IFIN as per the AS 13 at cost less diminution other than temporary. The said investment constituted approximately 1% of the Company's asset base. The Limited Review Report of ITNL dated 13th August, 2018, (by SRBC and CO LLP), for the quarter ended 30th June, 2018, was issued after the date of the Financial Statements of IFIN.

c) The **Audit Firm** has quoted Para 14 of SA 560 and stated that the event (Limited Review Report of ITNL) does not qualify as a 'Subsequent Event', as Para 14 presupposes the existence of a fact prior to or on the date of issuance of Financial Statements. Accordingly, the essential elements of Para 14 of SA 560 are not triggered, and therefore, an auditor is not required to update the Audit Report to take into consideration events that occur subsequent to the issuance of Financial Statements. Further, after the aforesaid limited review report of ITNL was issued, the standard does not require or expect the **Audit Firm** to make enquiries about developments in the entities with whom the Company has dealt.

d) With respect to the matter relating to the SCN dated 5th June, 2018, relating to IFIN's Certificate of Registration, the **Audit Firm** has stated that they were informed about this at the end of July, 2018. This was after the date of the Auditors Report on the Standalone as well as on the Consolidated Financial Statements for the year ended 31st March, 2018. Thus, their Audit Opinions were issued without any knowledge that RBI had issued a SCN relating to certificate of registration of the Company. According to the **Audit Firm**, their responsibility is governed by the requirements of Para14 of SA 560 (facts which become known to the Auditor after the Financial Statements were issued). As per the requirement of Para 14 of SA 560, after being aware of the SCN, the **Audit Firm** had discussed the matter with the Management. The **Audit Firm** was informed that the Company had submitted broad plan for reduction of group exposure on 8th June, 2018, and revised plan on 27th July, 2018. RBI in its letter dated 14th August, 2018, was critical of the group exposure reduction plan submitted by the Company and advised the Company to immediately reduce the group exposure. Further, progress in this regard, till 30th September, 2018, was to be reviewed by RBI.

e) The **Audit Firm** has further stated that no adjustment to the Financial Statements for the year ended 31st March, 2018 was necessitated by the SCN and that to the best of their knowledge, no action was taken by RBI with regard to the SCN. Further, the RBI had given time to the Company to meet the required NOF/CRAR by 31st March, 2019. In view of the above, the **Audit Firm** has submitted that the requirements of SA 560 with respect to the RBI's SCN dated 5th June, 2018 were complied with.

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

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 an audit of Financial

Statements of IFIN:

Particulars	Date
Date of Financial Statements - Standalone and 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 (Date of notice of AGM)	**29th August, 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. Thus, the **Audit Firm's** claim of date of Auditor's Report as date of issue is not correct as per Section 136 of the Companies Act, 2013, and SA 560 and the **Audit Firm** has failed to exercise due diligence in this regard.

b) The Limited Review Report of ITNL dated 13th August, 2018, wherein 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 Para 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'* raised by in the Limited Review Report of the ITNL dated 13th August, 2018, is a diminution in the value of investment 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 **Audit Firm** has stated that RBI SCN dated 5th June, 2018, regarding cancellation of registration certificate of IFIN and reply of the IFIN to RBI dated 8th June, 2018, were not informed by the Company and the same come to the notice of the **Audit Firm** much after the date of Audit Report of Standalone Financial Statements and Consolidated Financial Statements. Further, Company's letter dated 27th July, 2018, and RBI letter dated 14th August, 2018, were in any case later than the date of the Audit Report. However, the date of notice of AGM of the Company and hence, the date of issue of the Standalone Financial Statements and Consolidated Financial Statements was 29th August, 2018. The **Audit Firm** has also stated that SCN was informed by the Company towards the end of the July, 2018. The same matter was also discussed in the Audit Committee Meeting held on 29th August, 2018. Thus, the contention of the **Audit Firm** that they did not have any knowledge that RBI had issued a SCN relating to certificate of registration of the Company is completely false and misleading.

The **Audit Firm** has also stated that, as per the requirement of Para 14 of SA 560, after being aware of the SCN, the **Audit Firm** had discussed the matter with the Management. It is surprising that when the Company had concealed the notice received from RBI, the **Audit Firm** had not raised any question on this matter with Management. Further, the RBI SCN was for cancellation of Certificate of Registration of IFIN which had serious implication on the assumption of going concern. 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.

2.13.4 NFRA, therefore, concluded as follows in **DAQRR**:

a) The **Audit Firm's** claim of date of Auditor's Report as date of issue is not correct as per

SA 560 and the **Audit Firm** has failed to exercise due diligence in this regard.

b) The question on the '*going concern*' raised in the Limited Review Report of the ITNL dated 13th August, 2018 is tantamount to diminution in the value of investment 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.

c) 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 material misstatement known to them.

2.13.5 NFRA has examined the above contentions of the **Audit Firm** and has concluded as follows:

a) As per Para 5(d) SA 560: Date *the financial statements are issued – The date that the auditor's report and audited financial statements are made available to third parties.*

Thus, 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. Thus, the **Audit Firm's** argument that signing the Audit Report on the standalone financial statements and consolidated financial statements of IFIN for the year ended 31 March 2018 should be considered as 'date the financial statements are issued' for the purpose of SA 560 is not correct. The sharing of financial information with Credit Rating Agency cannot be considered as Auditor's Report being made available to the public (at large). Thus, the **Audit Firm's** claim of date of Auditor's Report as the date of issue of the financial statements is not correct as per Section 136 of the Companies Act, 2013, and SA 560 and the **Audit Firm** has failed to exercise due diligence in this regard.

b) In view of above, 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 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:

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 shal****l: (Ref: Para. A11)* **(emphasis added)**

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment and, if so,

(c) Inquire how management intends to address the matter in the financial statements.

The **Audit Firm** has, therefore, failed to report a material misstatement known to them to appear in the Financial Statements.

b) The **Audit Firm** was 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 concealed the notice received from RBI, the **Audit Firm** had not raised any question on this matter with Management. Further, the RBI SCN was for cancellation of Certificate of Registration of IFIN which had serious implications on the going concern assumption. Therefore, 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.

2.13.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) The **Audit Firm's** claim of date of Auditor's Report as date of issue of the financial statements is not correct as per SA 560 and that the **Audit Firm** has failed to exercise due diligence regarding facts that came to its notice before such date.

b) 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 the 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.

c) 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 obtain sufficient information which is necessary for expression of an opinion and failed to report material misstatement known to them.

2.14 REVERSAL OF GENERAL CONTINGENCY PROVISION

2.14.1 In its communication dated 23rd 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 General Contingency Provision.

2.14.2 The **Audit Firm** in its response dated 20th November, 2019, had stated as follows:

a) With regard to certain loan accounts that were identified to be NPA, and certain investments where provisions were suggested by RBI, the Company had provided its response to RBI on why it believed provisions were not necessary to be made. Pending receipt of the final report, the Company made an additional standard asset provisioning aggregating ₹121 Crores for three firms namely KVK, ERA and SIVA.

b) These accounts were covered in the communication of the **Audit Firm** to the Audit Committee – refer WP attachment 4.7.2.30.

c) As per the Company's Accounting Policy, General Contingency Provision is made to cover adverse events. In view of the additional standard asset provisions made during the year towards those specific accounts, the company reversed ₹175 Crores of General Contingency Provision.

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

a) **NFRA** has gone through slides 23, 29 and 30 in WP attachment 4.7.2.30 of the eAudit File as referred to by the **Audit Firm**. 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:

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.550 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.

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 are 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 that 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.

b) Further, the presentation showcases the additional standard provision created for three specific loans and the attempted justification for the same. **At no point in the presentation has the reversal of contingency provision been considered. The Audit Firm has not quoted any other working paper where they have raised the question of reversal of General Contingency Provision with** the Management**.** Thus, the explanation given by the **Audit Firm** in its reply dated 20th November, 2019, which in itself is a complete sham, is an afterthought and is not supported by any audit evidence. **NFRA** also observes that notes to account to the Financial Statements do not cover reasons for reversal of GCPs.

c) In working paper 2.14.1.20 *"Risk Assessment and Planning Discussion Memo"* the **Audit Firm** has noted the Provision for General Contingency. The Memo states that "the company intends to achieve contingency provisions at approximately 5% of the total assets of the company on or before 31st March, 2018". The Memo also notes that the company has provided ₹50 Crores out of P&L account for GCP in the half year ending 30th September, 2017.

Rs. in Mn

Particulars (B/S)	Half year Sept 2017	Year ended March 2017	Half year Sept 2016
Profit After Tax	919	2,088	955
GCP (P&L)	500	900	550
Asset base considered (Loans and Long term investments))	165,314	150,758	158,308
GCP (B/S)	5,000	4,500	4,150
%	3.02%	2.98%	2.62%

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, thetotal 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.

d) The Company's policy related to GCP is available in "Framework for Contingency Provision" which is available in the Audit File. The framework 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 intend to achieve contingency provision at ~ 5% of the total assets of the Company on or before 31st March, 2018.****"*

As per the policy of the Company and as shown in the RAPD Memo, the Company should have provided another ₹333.3 Crores 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.

e) Para 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 mentions creation of General Contingency Provision to cover adverse events that may affect the quality of the company's assets. However, the Financial Statements, instead of providing further for the contingency, reverses ₹225 Crores from the Profit and Loss Account. 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.

2.14.4 NFRA, therefore, concluded as follows in **DAQRR**:

a) 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.

b) The explanation given by **Audit Firm** for reversal of GCP, in its reply dated 20th November, 2019, is in itself a complete sham, an afterthought and not supported by any audit evidence. 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 General Contingency Provision by Management.

c) 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. The **Audit Firm** has failed

to report a material misstatement known to them to appear in the Financial Statements.

d) The reversal of GCP (of ₹225 Crores) is completely unjustified and 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.

e) 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.

2.14.5 The **Audit Firm's** responses to the observations of NFRA in the **DAQRR** have been examined and NFRA's conclusions thereon are as follows:

a) In response to Para 2.14.3(a) of **DAQRR**, the Audit Firm has stated as follows:

i. While the RBI Directions treat accounts where evergreening has taken place to be NPAs, evergreening itself is not defined, and hence involves a subjective determination. In the final inspection report for the year 2016- 17 dated 6 July 2018, based on the submissions made by the Company two out of the three accounts, Era and KVK, were not classified as NPAs.

ii. The Company had contended that the Siva Green transaction was undertaken based on a wind power project and the exposure was also protected by a Corporate Guarantee of CPIL and further security created i.e. Hypothecation of receivables from the Affordable Housing project.

iii. Further, in the Company's view, the transactions identified as ever greening (KVK & Era & Siva Group) by the RBI had an economic rationale and hence Company had represented that those transactions were not to be treated as ever greening and hence not as NPAs.

iv. Outside of the allegation of 'ever greening' (which was under discussion with the RBI) as explained above, these accounts were not NPAs as defined under the RBI Directions.

The RBI in its report has clearly brought out the way disbursements of the fresh loan were

used to repay the previous loan. The RBI has also shown that the company had capitalized interest receivable and no cash was received. The RBI had clearly brought out the reasons including ever greening of loans and classified these loan account as NPAs. **As on the date of signing of the balance sheet, the final RBI inspection report was not issued.** Despite this, the assets were not treated as NPAs and no provisions was made as directed by RBI. The disclosure made in the balance sheet was also inappropriate and completely misleading. Further, in case of Siva Green transaction, even after considering the various assets which were shown as security by the company, the auditors themselves, in their presentation had identified a shortfall of Rs.400 million. The **Audit Firm** had also stated that financial statements and valuation were not available and binding agreements were yet to be signed. In fact, the **Audit Firm** itself has stated that this account was identified by RBI as an NPA in the final report also. When the regulator of the sector, that is RBI, had itself identified the loan accounts as NPA, in its draft inspection report, the argument that "these accounts were otherwise not NPAs as defined under the RBI directions" is illogical and unacceptable.

*b) In response to Para 2.14.3(b of **DAQRR**), the **Audit Firm** has stated that:*

i. Maintenance of a General Contingency Provision ('GCP') is voluntary and not mandatory (i.e. discretionary), and management decided to reverse ₹175 Crores of the GCP during the year.

ii. The proposed reversal of the GCP was included in our communication with TCWG.

iii. The AC and the Board of Directors had, in their meetings held on 28 May 2018, approved the reversal of ₹175 Crores of the General Contingency Provision;

iv. Such reversal was transparently disclosed in the financial statements and,

v. This was also explicitly disclosed in the letter of representations – refer page 18 Para 83 of Management Representation.

Even though the maintenance of General Contingency Provision (GCP) is not mandated by law, it was the stated policy of the company to maintain GCP and to bring it to 5%. This was also disclosed in the Annual Report. **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, which the **Audit Firm** claims as its communication to TCWG, 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. **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.** Para 83 Page 18 of the Management Representation dated 28 May 2018 that has been quoted by the **Audit Firm** in support of their acceptance of this reversal of the GCP shows merely "utilised" provision of Rs 175 crores with zero explanation for the number. 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 scepticism. Thus, the explanation provided by the **Audit Firm** is a complete sham, an afterthought and not supported by any audit evidence.

c) In response to Paras 2.14.3(c) and (d) of **DAQRR**, the **Audit Firm** has now argued that since the Gross NPA and the incremental provisions for the year had significantly increased, it was decided to utilize the amount from contingency provision. On the other hand, the **Audit Firm** itself has stated that as per the company's policy on GCP, "the specific provision takes care of deterioration in assets quality in respect of specific assets and does not cover future risk which could hit the overall asset quality in difficult market scenario". The increase in the provisioning was to cover the deterioration in specific assets which have turned NPA (as identified by RBI) and which should have been reflected in the profits of the company. The non-mandatory nature of the provision, and management's "discretion" in dealing with this matter does not in any way absolve the **Audit Firm** of its responsibility to exercise the required professional scepticism. In the very evident complete absence of such professional scepticism, the only conclusion is that by reversing the GCP, the company inflated its profit and the **Audit Firm** colluded with the Management in thus overstating the profit. 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. Further, as per the policy of the Company and as shown in the RAPD Memo, the Company should have provided another ₹333.3 Crores 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.

d) In response to Para 2.14.3(e) of **DAQRR**, the **Audit Firm** has stated that "*The purpose of the GCP is 'to cover adverse events that may affect the quality of the company's assets' as brought out in the extract quoted by the NFRA.* T*he increase in NPAs and provisions towards the same as at and for the year ended 31 March 2018 was significantly higher as compared to the figures as at and for the year ended 31 March 2017 and was a situation that could be categorised as adverse that justified utilising the GCP against significant provisions created in the year 2017- 18. As stated above, maintenance of GCP was at the discretion of management and approved by the AC and the Board as well as appropriately and transparently disclosed in the financial statements.* However, it is observed that there is no Audit Evidence to support the above arguments. There is no evidence to support that the **Audit Firm** has even considered the inference that "*a situation that could be categorised as adverse that justified utilising the GCP against significant provisions created in the year 2017-18'* at the Audit stage. In fact, there is no evidence to suggest that such an argument was even made by the Management. This contention of the **Audit Firm** is an afterthought and a complete sham. Thus, it is amply clear that the **Audit Firm** has colluded with the company in fraudulent and wrongful disclosure of the Accounting Policies forming part of the Financial Statements.

2.14.6 In view of above, NFRA is reinforced in its earlier conclusion that:

a) 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.

b) The explanation given by **Audit Firm** for reversal of GCP, in its reply, is in itself a complete sham, an afterthought and not supported by any audit evidence. 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 General Contingency Provision by Management.

c) 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. The **Audit Firm** has failed to report a material misstatement known to them to appear in the Financial Statements.

d) The reversal of GCP (of ₹225 Crores) is completely unjustified and 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.

e) 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.

2.15 INTEGRITY OF AUDIT FILE AND AUDIT FIRM'S IT CONTROLS REVIEW

2.15.1 Major compliance requirements, relating to 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:

(a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and

(b) 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:

1. 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.

2. Enabling the ET to be accountable for its work.

3. Retaining a record of matters of continuing significance to future audits.

4. Enabling the conduct of quality control reviews and inspections in accordance with SQC.

5. **Enabling the conduct of external inspections** in accordance with applicable legal, regulatory or other requirements.

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:

(b) Who performed the audit work and the date such work was completed; and

(c) 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 paragraph 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:

(a) The specific reasons for making them; and

(b) 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 engagement quality control review.

ii. Para 25 (b)- The engagement quality control reviewer shall document, for the audit engagement reviewed, that the engagement quality control review 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.

2.15.2 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 reinforce 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 other than administrative changes, such as the following, after the Audit Report date:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the ET before the date of the Auditor's Report.

2.15.3 Thus, in an electronic environment, ensuring of these requirements of the SAs and SQC1 includes 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.

2.15.4 NFRA has observed mismatches between the signoff dates mentioned in the eAudit File and WP document properties and analysis of hour log submitted by the **Audit Firm** (based on timesheets of audit personnel maintained by the Firm). Five such cases have been laid out in **Annexure III**. Some of these have also formed part of the Prima-facie observations/comments/ conclusions. To assess the extent of compliance with SQC 1 and SA 230 for the requirements discussed above, NFRA wrote to the **Audit Firm** on 14th October, 2019, seeking clarifications and proof of authenticity of date of preparation of WPs. The **Audit Firm** was asked to provide NFRA the following:

a) The **Audit Firm's** administrative procedures/instructions relating to building up/organizing/closing the Audit File and the safeguards incorporated therein to ensure the integrity of the said Audit File, and to prevent any tampering thereof; and

b) Details of the IT systems and processes that are designed by the **Audit Firm** to ensure tracking of all additions/deletions/modifications of the electronic portion of the Audit File so as to obtain verifiable and tamper proof time logs of all such actions.

2.15.5 The **Audit Firm** responded to NFRA's letter dated 14th October, 2019, vide their letter dated 1st November, 2019. Following are the key responses:

a) "*We record who performed the Audit Work and the date such work was completed. To denote who performed the Audit Work and the date such work was completed, the preparer marks the Audit Documentation as "prepared" in eAudit. … Name of preparer and date is captured in eAudit as and when any eAudit screen or attachment is marked as "prepared" in the eAudit File.*

b) In documenting the nature, timing and extent of Audit Procedures performed, we record who reviewed the Audit Work performed and the date and extent of such review. To denote who reviewed the Audit Work and the date such work was reviewed, the reviewer marks the Audit Documentation as "reviewed" in eAudit. Name of reviewer and date is captured in eAudit as and when any eAudit screen or attachment is marked as "reviewed" in the eAudit File.

c) The completion of the assembly of the final Audit File after the date of the auditors' report(s) is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process that are administrative in nature, for example:

i. placing the final Financial Statements or final regulatory filing in the Audit File;

ii. performing routine file-assembling procedures such as deleting or discarding superseded documentation and sorting, collating and cross- referencing final audit documentation;

iii. preparing and completing checklists relating to the file assembly process;

iv. completing the documentation and assembly of audit evidence that we have obtained, discussed and agreed with the relevant members of the ET before the auditors' report(s) is signed and dated, for example: including documentation relating to a meeting with TCWG shortly before or on the date of the auditors' report(s);

v. adding information received after the date of the auditors' report(s), for example, an original confirmation that was previously faxed.

d) There is an Audit Manual which includes all these policies. This manual is referred at various places in eAudit File also and is available on intranet for all employees. The same is also reiterated in the trainings provided to staff. Further, communications are released as and when required to reiterate these policies.

e) We use eAudit application to document the procedures performed in an audit through audit work papers. At the conclusion of the engagement, the eAudit File is closed out and it produces a PDF retention file, which is the official file of record and is stored for the retention period."

2.15.6 However, NFRA observed the following and, therefore, communicated to the **Audit Firm** vide letter dated 24th January, 2020, that NFRA would be engaging NFRA's IT consultants to examine the **Audit Firm's** IT systems and processes in order to verify the integrity of the electronic portion of Audit File.

a) The **Audit Firm** maintains separate 'Engagement Codes' for each audit engagement and every audit team member has to submit time-sheet for number of hours worked on respective engagement. However, the same does not happen in practice and no control or monitoring is found in the system of the firm. Therefore, by inspecting the Audit File logs of signoff dates with document properties and the time-sheets of the ET personnel, NFRA could not conclude that the Audit Procedures are performed, documented and reviewed on the dates indicated therein and before the date of Audit Report.

b) Any audit team member can edit a document in electronic Audit File at any time before or after review signoff by the EP. There is neither any log of when the changes are made nor to what extent changes are made. Therefore, NFRA could not conclude that the **Audit Firm**

can ensure who has performed the Audit Work and the date such work was completed, and who has reviewed the Audit Work performed and the date and extent of such review.

c) There is no monitoring or control over the policy of modifications that can be made to an Audit Documentation. There is no track of what has been modified in the Audit File documentation post the Audit Report signoff. **Practically, an entirely new documentation of audit can be created with no logging or monitoring or control over the same.** Therefore, NFRA could not conclude that the **Audit Firm** can ensure that the Audit Documentation is completed in a frame contemporaneous with the actual audit procedures performed, and without performing any further Audit Procedures or changes other than administrative changes, after the Audit Report date.

d) No review takes place for the files modified after a review by the designated reviewer of the audit team. Therefore, there is sufficient reason to believe that the **Audit Firm's** SQC policy is not practiced and adhered to.

2.15.7 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. The **Audit Firm's** team was asked the queries as listed in **Annexure IV**, for which the team requested time to come back stating the following reasons:

a) The **Audit Firm** uses the proprietary audit application and audit methodology licensed to it by KPMG (Global).

b) The **Audit Firm** requires time to consult with the global IT team, in order to respond to NFRA's queries. Subsequently the **Audit Firm** had provided replies to the queries vide their email dated 4th March, 2020.

2.15.8 During the in-person review, and after examining the replies furnished, the NFRA's IT consultants observed following vulnerabilities in the electronic platform (eAudit Application) with respect to the attributes mentioned in Para 2.15.3

a) The details of changes made within a document/ form in the eAudit 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. 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 before Archival of the Audit File, and therefore the logs and reports are not available for future inspection. [Indicating absence of attributes mentioned in Para 2.15.3(a), version history and security and 2.15.3 (b) system logs and its monitoring]. Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

As per SA 230 "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 documents." As per SA 220, "Quality Control for an Audit of Financial Statements" 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.

Further it was explained that the IT platform has status indicators that changes whenever there are changes in sign-offs of preparer and reviewer of the documents. There are diagnostics reports based on these indicators. These reports are reviewed mandatorily by the engagement team at any time before closing of the efile. These functionalities enable the determination of when and by whom engagement documentation was created, changed or reviewed. Accordingly, the requirements of SA 230 and SA 220 are addressed as regards the work done up to the audit report date. In the context of the above explanations, the **Audit Firm** stated that there is no requirement under the SAs or elsewhere to maintain prior drafts of a single finalized document during the course of engagement starting from commencement of audit till signing of audit report as long as the final working papers are preserved, supporting the opinion.

During the file assembly period changes that are administrative in nature may be made to the audit documentation and the reviewer(s) /EP exercise their judgement on what to re-review in the engagement file before archival, using the diagnostic reports. If, in any exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document in the "Document Modification Work paper". Further, eAudit [the IT platform of the Auditor] documentation is an evolving process and various enhancements are done year- on-year

basis. As a part of this continuing enhancement, eAudit 2019 introduced an additional diagnostic report, 'Track changes subsequent to Auditor's Report(s) Date', which indicates activities and attachments changed subsequent to the date of the auditor's report, as entered by the audit ET. This report further facilitates the reviewer(s) / EP to exercise their judgement on what to re-review in the engagement file before archival. In any case, the EP takes the final responsibility for the changes made in the file before archival of file.

At the conclusion of the engagement, the eAudit file is closed out and it produces a PDF retention file (referred to as an RET file), which is the official file of record and is stored for the retention period. Once the eAudit file is closed out, it becomes a secure file. The same is stored on central servers and EPs have 'read only access' to those servers. There are adequate controls in place once the file is closed out to prevent any unauthorised access/changes.

The above features of the proprietary audit tool ensure integrity of audit documentation, indicates when and by whom the documentation was created, changed or reviewed and prevents unauthorized access to the engagement file. Basis this the **Audit Firm** is of the view that the IT Platform contains only the final audit documentation that supports the audit opinion; has process and system level controls depending on the stage of the audit and, accordingly, meets the requirements of SA 230 and SA 220.

NFRA examined the above reply:

NFRA agrees with the auditor 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 keeping of such documents. The comment refers to the 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.

It is abundantly clear from the reply furnished by the Auditor that any documents, including documents completed in all respects by the engagement team 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 IT platform to ensure that such changes to a completed document is

either not made, or if made, then it is either logged permanently in the IT system 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. Final review by the EP at the time of closing of Audit File is not the best solution for this weakness. It is well known that IT platforms can be programmed to address such vulnerabilities. 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 IT platform.** It is stated by the **Audit Firm** in their reply that diagnostic reports are available till the file assembly period. However, these reports are not seen preserved in the archived Audit File. All such reports and logs, including the "Review Notes" added to the Audit File, from the start of the Audit are wiped off by the application before archival of the Audit File. NFRA did not see any report of the status indicators or diagnostic reports preserved in the archived file made available for inspection.

Para 79 of SQC-1 requires 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.

The status indicators mentioned by the Auditor only raise a flag that something is changed and hence it becomes the responsibility of the EP to ensure that the new document available in the system is the sufficient appropriate audit evidence. 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 eAudit file after a specific procedure based on the document is completed by the engagement team and after it is duly reviewed, the IT system permits such deletions and leaves no traces of the deleted records, other than a flag that the document is deleted. Technically, the IT platform design is such that any or all of the documents in an e-audit file could be deleted or modified after the signing of the Audit Report and the Reviewer/EP at the time of closure of the file could re-review such changes, without providing any recourse to a subsequent reviewer, such as NFRA , to examine the earlier documents.

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, is tantamount to tampering with the original timing and documentation of performing the audit procedure.

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 on 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 that the EP takes the ultimate responsibility, it may be noted that the entire engagement team is accountable for the due performance of the engagement. By enabling modification 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].

Attention is drawn to para 17 of SA 220, which requires that on or before the date of the auditor's report, the EP 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 EP, the original review undertaken by the EP may lose its relevance. It is as good as not meeting the requirement of SA 220.

b) No logging and monitoring of eAudit server and database (DB) events. The list of people who have access to all application and DB servers are similar, such as IN-SG SQLDB Admin, in-svc-Deepak Bansal, in-svc-GaurvaC, insvcedcsql. The **Audit Firm** has not clearly answered how access was limited to ensure segregation and access only as per need basis, what is the process of maintaining generic IDs, can the server/DB administrators access eAudit Files etc. The Security testing reports, specific to eAudit and archival applications and servers, have not been shared. Further, the supporting process documentation has also not been shared so that it is not possible to understand the scope and frequency of security assessments. [Indicating absence of attribute mentioned in Para

2.15.3(a), version history and security, and 2.15.3 (b) system logs and its monitoring]

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

There is an adequate access control process, which is also need based, security testing is done, and the reports are available. Server/DB Administrator cannot access any eAudit files. The firm's IT processes are ISO 27001 certified and have implemented controls that are aligned with these standards.

NFRA examined the above reply:

The reply is silent regarding logging and monitoring of eAudit server and database (DB) events. The Security testing reports, specific to eAudit and archival applications and servers, have not been shared. In the absence of DB event logs and security testing reports, NFRA is not able to assure itself that unauthorized access to Audit Files by people having access to DB is prevented or monitored at system level. This aspect is critical in ensuring confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation, which is a fundamental requirement of SQC -1.

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:

i. Enable the determination of when and by whom engagement documentation was created, changed or reviewed.

ii. 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.

iii. Prevent unauthorized changes to the engagement documentation;

In the absence of proper explanations and DB logs, compliance with the above SQC requirement may be compromised by the **Audit Firm**. ISO 27001 requires that the audit logs recording user activities, exceptions, and information security events shall be produced

and kept for an agreed period to assist in future investigations and access control monitoring. Logging facilities and log information shall be protected against tampering and unauthorized access. However, no audit logs were produced to NFRA during the inspection of archived Audit Files.

c) Considerable delay has been noticed in installing and running patches, which clearly demonstrates lack of proper patch management, thereby leading to security vulnerabilities. Also, copy of release notes for the eAudit application version in use is not made available by the auditor. The release notes document the change/upgrade in the eAudit application functionality. Not building security controls into the design of the application as part of Software Development Life Cycle, while designing upgrades, could lead to an application vulnerable to intentional/unintentional modifications. [Indicating absence of attribute mentioned in Para 2.15.3(a), version history and security]

Reply by the **Audit Firm:**

In their response to the **DAQRR,** the **Audit Firm** submitted that:

In the context of an audit process, the firm has adequate processes on patch management, updating changes and upgrades, and the same is done on a timely basis. Further, the firm has adequate controls to discover vulnerabilities if any, in relation to these systems. Being an ISO 27001 certified firm, they perform a very extensive testing of application and infrastructure on defined parameters as per the mandated controls and firms' policies. The comment may be dropped in the AQR in view of the ISO certification and related process controls, which adequately cover the issues addressed.

d) An archived and locked Audit File can be accessed, opened, and documents within the same can be modified without disturbing original Signoffs, using "Re-Open Workbook" option in the e-Audit Tool. Further, the Audit File can be re-archived, wiping out all the logs and diagnostics reports in the process. Thus, there is no log available of the number of times an archived Audit File is retrieved from archival system, modified and re-archived. [Indicating absence of attribute mentioned in Para 2.15.3(a), version history and security and 3 (b) system logs and its monitoring]

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

Once an eAudIT file is closed out, it is locked for further edits and becomes a read only file. Accordingly, after such close-out, there is no question of logs of modifications, etc., unless there is a need to modify work papers in accordance with appropriate standards. In such a case, there is an established process, which creates a separate modified file at a current date. This ensures a complete tracking of modification. In respect of the NFRA's observation that archived files can be modified without disturbing original sign offs and that no logs are available of the number of times that an archived file is retrieved and re-archived, we submit that the original engagement file duly closed out after file assembly is non-editable and the same is available in its original form i.e., without reflecting any of the modifications done post close out. Further, in the exceptional scenario of an engagement file needing to be re-opened after archival (close out) in accordance with the requirements of para 16 of SA 230 and the firm guidance, the same is a separate and distinct engagement file from the original engagement file and the same would also be closed out separately and would be available on the firm server as a separate closed out engagement file.

NFRA examined the above reply:

NFRA agrees with the reply in so far as the process followed is concerned. However, the fact remains that, there are no logs available after the re-archival regarding the number of times an archived Audit File is retrieved from archival system and whether it is modified or not, who all accessed it and when accessed. The sign offs could be kept unchanged, though there is a modification in the document. Though there are diagnostic reports, the final reviewer may choose not to re-review such changed documents as re-review is not mandatory in the IT system. This may lead to a situation where there are documents in the Audit File having sign-off data not necessarily done by the actual owners of sign offs. This may pose a serious threat to integrity and accountability. In the absence of logs, the information required as per SQC -1 about when and by whom engagement documentation was changed is not available in the IT platform or in the files retained in it, since the modified Audit File is saved on a different date ("current date"-as mentioned by the **Audit Firm** in their reply).

e) An uploaded document, which has been marked as "Prepared" and "Reviewed" by someone, can be replaced with another document not necessarily prepared and reviewed by the same person, without affecting the Sign-offs in the original document or Re-Archival of the Audit File. Further, as the details of changes made to a document are not captured, this activity does not get flagged in the application for mandatory review. Also, once a team member

has uploaded/ created a document and marked it as "Prepared", the same can be marked to a selected person/ manager for review. Post completion of the review the document is to be Signed-off as "Reviewed". **However, technically it is feasible for the document preparer to mark the document as "Reviewed", bypassing the maker-checker authorizations all together. A reviewed document can be edited at any time but such a change does not mandate a "Re-Review" of the document and capturing of the changes made within the same.** Though such events are captured during the diagnostic check done by the application at the time of archival, addressing the issues under the above-mentioned categories is not made mandatory, and archival can be completed without performing the above reviews. [Indicating absence of attribute mentioned in Para 2.15.3(c) authentication and access control protocols]

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

During an audit, work papers are edited, replaced on the basis of the review comments given by the reviewers and the final documents are retained in the Audit File. The same is in line with the requirements of SA 230, “Audit Documentation”, 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 documents.” When an attachment is replaced in eAudit, it replaces a previously existing attachment in eAudit. In this situation, the "replacement" attachment would appear in eAudit as the only, original version, rather than as an edited version of the previously existing attachment. The internal document properties of the replacement attachment will reflect the Attachment Created Date and Attachment Last Modified Date. The status indicator for Sign off screens will change when any edit is made (including when a document is replaced) to an activity screen or attachment in eAudit.

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. A diagnostic report is available to indicate when an activity or attachment has been prepared and reviewed by the same person. Based on the diagnostic reports being reviewed by the reviewer(s)/EP, the preparer and reviewer may decide whether to re-review and re-mark

the edited activity screen or attachment as prepared or reviewed, based on the nature of the underlying changes made and their assessment of the same.

There is a diagnostic report "Activities Missing a Specific Reviewer Sign off" for any screens missing minimum review requirements, which is also reviewed by the ET including the EP, EQCR and the manager, and appropriate action as required is taken by them. Also, there is an alert in eAudit for the ET to ensure that before forming an opinion and reviewing Auditors report, they have reviewed all diagnostic reports and all the audit documentation supporting the audit report is contained in the file.

The observation that an uploaded document, which has been marked as "Prepared" and "Reviewed" by someone, can be replaced with another document not necessarily prepared and reviewed by the same person, without affecting the Sign-offs in the original document or Re-Archival of the Audit File is addressed through an indication of an asterix reflecting any change made to documents/screens post preparation/review. The feature of diagnostic reports being available to a reviewer which clearly highlight screens/documents that have been edited post preparation/review or those that are prepared and reviewed by the same person is a very strong control which allows the preparer/reviewer to decide whether to re-review and re-mark as prepared/reviewed depending on the nature of the change and their assessment of the same.

NFRA examined the above reply:

After examining the reply, it is evident that though there are certain controls to identify changes to critical information forming part of the Audit File, none of these controls address the following issues.

i. The said diagnostics reports are not forming part of the archived Audit File, which is the only record available for future verifications or inspections once the Audit File is closed within the stipulated number of days as per the quality policy of the firm.

ii. **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 for any changes, though there are controls at the time of closing of Audit File.** There are several documents that serves 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 IT platform at the beginning, remain in an open position, and hence vulnerable to unwarranted alterations.

iii. A document or data captured during the Audit can be deleted/removed/edited (for example the contents of a Word/Excel file) completely, thus providing an opportunity to tamper with the audit evidence. After the engagement is over, the final reviewer may not be able to fully revisit the procedures done during the audit.

iv. Because of the above issues, the requirements of para 79 of SQC-1 (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) is not fully met. Also, 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.

v. The factors in sl. no 1 to 3 makes both internal as well as external inspections ineffective since the evidence of compliance by the engagement team is 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".

vi. 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.

f) **Audit Files within eAudit Application, and their contents, can be modified post release of Audit Report till the Audit File is Archived. Further, the Audit File can be restored from the Archives, modified, and Archived again. There is no monitoring on the time period till which an Audit File can be accessible or editable. ETs can reopen the files**

and modify the file for additional documentation without any logging or traceability. This overlooks compliance with requirements of SA 230 as detailed in Para 2. [Indicating absence of attribute mentioned in Para 2.15.3(a), version history and security]

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

The **Audit Firm** stated that it has adequate processes available in relation to, Modifications post release of Audit Report till the Audit File is Archived; monitoring on the time period till which an Audit File can be accessible or editable; and reopening of files and their modifications. In accordance with requirements of SA 230 and SA 220 as stated above and the firm's guidance, the reviewer(s) / EP exercise their judgement on what to re-review in the engagement file before archival, using the diagnostic reports explained in (a) above which are available throughout the audit period including the file assembly period.

NFRA examined the above reply:

Notwithstanding the existence of process controls, the fact remains that the IT system is capable of making any modifications to the documents without disturbing the original sign offs. Though there are diagnostic reports, the final reviewer may choose not to re-review such changed documents as re-review is not mandatory in the IT system. This may lead to a situation where there are documents in the Audit File with unrelated sign-off data, thus posing a serious threat to integrity and accountability.

g) 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 2.15.3(c) authentication and access control protocols]

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

Web applications server generates a log for all end users with date and time stamp for eAudit application. Concurrent login access is required as the audit users access the system working from client/remote locations. As per the policy, user can only login from a firm issued device, using their own domain user ID and password. It is not relevant even if different systems are utilised for this purpose, since control lies with login id and password. Accordingly, the firm's processes around login access and password controls are stringent and adequate to avoid unauthorized access.

NFRA examined the above reply:

The reply is silent about data base administrator activities, which may occur outside web application server. It is pointless to argue that concurrent login access is required as the audit users access the system working from client/remote locations. **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.

h) Roles and responsibility matrix for all roles of ET members, including access and the level of access, is not defined completely, such as right to operations add/delete/modify/sign-off/ archive/ retrieve from archive etc. audit documents, for individual roles. [Indicating absence of attribute mentioned in Para 2.15.3(c) authentication and access control protocols].

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

At the start of the audit, it is the EP's responsibility to identify the ET to support him/her in conducting the audit. The roles are defined and accordingly designated in eAudIT. In order to discharge their responsibilities for audit and to meet the above requirements of the auditing standards, all ET members have read and write access to the engagement file

during the course of audit, including Audit File assembly period. The access right to close out the file is available to Engagement in-charge, Engagement manager and EP only. It is apparent that roles and responsibilities matrix for all ET members, including access and the level of access, is clearly defined within the audit tool, to the extent necessary, and in accordance with the requirements of SA 220.

The comment may be dropped in the AQR in view of the explanations.

2.15.8 It is, therefore, evident from the above that the eAudit 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 in Para 2.15.1. 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.

2.15.9 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 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.

Reply by the **Audit Firm:**

In their response to the **DAQRR** the **Audit Firm** submitted that:

The eAudIT system used by the Firm is an electronic workflow that facilitates audit documentation, a trail of review and repository of such work papers. This is in consonance with the requirements of the applicable audit framework and extent of controls specified by the existing Auditing Standards. The Firm has adequate system level or process level controls over access to and modification of an Audit File considering various stages of an audit process (during the audit; assemble period and close out period). The Firm has a process of security testing and an adequate process of patch management, updating changes and upgrades. End user or administrator activities and the roles and responsibilities matrix for all ET members are clearly defined, to the extent necessary and in accordance with the requirements of SA 220. We will also welcome suggestions from the NFRA to enhance the

functionality of the tool.

NFRA examined the reply. It is concluded that:

The IT tool used by the Auditor for audit documentation does not comply with certain fundamental security requirements of logs monitoring, authentication, and access control protocols. The platform does not fully meet the audit (inspection) requirements as well. The **Audit Firm** has compromised authenticity and reliability of the electronic Audit Documentation. The deficiencies are systemic and structural in nature and arise from compromise of basic principles of IT security, requirements of SQC-1, SA 220 and SA 230. This renders the audit documentation unreliable. There is no certainty that the Audit Documentation is completed in a time frame contemporaneous with the actual audit procedures performed, and without performing any further Audit Procedures or changes other than administrative changes, after the Audit Report date. In not rectifying these deficiencies, the **Audit Firm** is guilty of serious professional misconduct.

2.16 EQCR PROCESSES

2.16.1 In its communication dated 7th August, 2019, **NFRA** had conveyed its prime facie conclusions as follows:

a) All the WP documents forming part of the Audit File are not as per the SAs prescribed by Section 143(9) read with Section 2(7) and Section 143(10) of the Companies Act, 2013. The references to the Auditing Standards quoted therein appear to be references to International Auditing Standards/ PCAOB Standards/ other standards of unknown provenance. While these may have persuasive value, and may, in many cases, also be similar to, or even identical with, SAs in force in India under Section 143(10) of the Companies Act, 2013, the use of such other references, and the complete absence of reference to India's statutorily prescribed SAs indicate clearly a cut-and-paste approach to documentation. This shows that the documentation has only been prepared as a mere formality that does not comply with even the form, much less with the substance of the SAs. The EQCR Partner has failed to counter this, and on the contrary, has mentioned that, as per his knowledge, no matters have come to his attention that causes him to believe that the audit was not performed in accordance with the relevant auditing standards and KPMG requirements. This, in our view, is gross negligence not only on the part of Engagement Team led by the EP, but also the EQCR Partner.

b) As required by SQC 1 and SA 220, the ET's evaluation of the firm's independence in relation to the specific engagement has not been reviewed by the EQCR Partner. Further, it has been observed that the ET itself has not done any evaluation of the firm's independence as the evidence of the same is not available in the audit WPs.

c) In WP 2.5.3.70, the **Audit Firm** had noted that the EQCR Partner has reviewed the RBI Inspection Reports of the Auditee Company. However, what has been reviewed therein is not clear. Also, in the attached WP 4.6.2.0010 as referred by the **Audit Firm** in 2.14.1 under Going Concern, it has been noted that "Non-compliance with capital or other statutory requirements" is marked as "No such instance found" under 'Audit steps performed by us' column. This, in the context of RBI Inspection Reports, inter alia, proves that the EQCR Partner has not actually reviewed the audit WPs, but merely signed off the WPs as a formality.

d) In WP 2.14.2.10, there could not be found any risk assessment of issues as highlighted in the RBI Inspection reports. Further, the document is poorly drafted and appears to be a cut-paste job at multiple levels because of discontinuous numbering between the paragraphs written. Also, the risk of revenue recognition is very superficially touched upon, and matters such as ever-greening of loans, classification as NPA and recognition of attached interest income through such NPAs is not discussed. The review of this document by the EQCR Partner lacks seriousness and again seems a formality.

e) WP 2.15.1 and WP 2.15.1.10 – In its Inspection Report dated Nov 1, 2017, forming part of WP 2.5.3.70 and reviewed by Sh. Akeel Master, RBI has written to the company that "Engaging in such deliberate circuitous transactions to attempt to circumvent regulatory prescriptions does not reflect well on the Corporate Governance structure and practices of the company." Despite this statement, nothing about the same has been discussed between the EP and the EQCR Partner. None of these issues have been duly countered by the EQCR Partner.

f) In WP 4.7.2.50 and WP 4.7.3.10, it is noted that the EQCR Partner has reviewed the signed financial statements and signed audit reports respectively. However, based on the overall inadequacies in the audit done by the Engagement Team led by EP, it is apparent that the EQCR Partner has failed to bring to notice the key matters not appropriately dealt with during the audit.

g) There is no specific evidence of what discussion that the EQCR partner had with the EP as required by Para 64 of SQC 1. Also, WP 2.15.1.10 states that WP att. 2.15.1.10 is 'prepared by' "Ruchi Telang" on 24th January, 2018, and states within the document, "Agenda for EQCR call with Akeel Master to be held on 4th April, 2018, at 7 pm." It is, therefore, not clear whether the meeting actually happened, and if that happened, whether what is mentioned to be discussed has actually been discussed.

2.16.2 The **Audit Firm**, in its response dated 10th September, 2019, has stated as follows:

a) We deny your inference that the ET adopted a cut and paste approach to documentation and that the same has been prepared as a mere formality and does not comply with form/ substance of the SAs: The engagement team has considered compliance with the Standards of Auditing and documented the same as evidenced by a duly filled up checklist - refer WP

3.4.2.20 which has been signed off by the EQCR. Thus, compliance with all SAs in India has been evaluated.

As per the Preface to the Auditing Standards issued by the ICAI, Indian Standards have been harmonized with the International Standards.'

Our Firm's policy is to comply with SAs in India and if in any matter, the International Standards of Auditing (ISA) are more stringent, to comply with the same. In this process, the SAs in India get definitely complied with as per the provisions of section 143(9) and 143(10). The differences between the two sets of standards do not have an impact on the audit in the present case.

b) Engagement team's evaluation of firm's independence is documented as part of Engagement Acceptance process in attachment '1.1.1.50 Approved EAF' a copy of which is also sent to EQCR as stated therein. Further, both the Engagement Partner and EQCR have signed off the eAudit Screen 4.5.3 which evidences that there are no issues identified with respect to relevant independence and ethical requirements.

c) The WP referred contains the copies of the RBI Inspection Reports and related correspondence. The EQCR signoff of the screen clearly signifies having read the reports to develop an understanding.

The reference to RBI Inspection Reports here appears to be in the context of the NOF and CRAR issue reported therein. In this regard, it was noted that RBI had not levied any penalty or punitive action on the NOF and CRAR being assessed by RBI below the minimum requirement. Such a situation was prevalent in the earlier years also (the years in which we were not the auditors). The issues raised in the RBI's Inspection Report were under discussions between the Company and RBI. In 2018 the company had accepted the stipulations of RBI and agreed to reduce its group exposures by 31 March 2019, in order to be complaint with the minimum required NOF and CRAR. A plan to achieve this had also been drawn up and approved by the Board of Directors on 28 May 2018. Thus, the regulator itself had provided forbearance on this matter. In view of the fact that the Company had agreed to comply with the RBI stipulated requirements, a plan had been prepared and the regulator itself had shown forbearance to the company, the engagement team had considered that this was not an instance of non-compliance with capital or other

statutory requirements. The EQCR had also reviewed the same on that basis.

Based on our response as above, we submit that the EQCR Partner has signed off the work papers after performing necessary reviews of the same.

d) For the reasons stated below, we deny your inference that the document appears to be 'a cut paste job' and that the risk of revenue recognition is superficially touched upon:

The key issues highlighted in the RBI inspection reports relating to financial reporting are provisioning for Loans and Advances and Investments. Provisioning for loans and advances and investments was identified as 'Significant Risk' by the Engagement Team – refer page 2 and 3 of WP attachment 2.14.3.1.0010 which has also been reviewed by EQCR. Ever-greening of loans also translates into valuation of Loans and Advances or Investments which, as stated above and as documented in page 2 and 3 of WP attachment 2.14.3.1.0010, was identified as 'Significant Risk'.

In addition to the above, the RBI inspection reports also covered the matter relating to NOF/CRAR. Please refer to our responses to your comments in para 6 wherein this matter is extensively dealt with. All key work papers in this regard were reviewed by the EQCR – refer pages 6 to 9 WP 2.5.3.40.

As regards risk assessment for revenue covered in WP 2.14.2.10 under the heading 'Rationale for Rebutting Fraud Risk' it is documented that fraud risk is rebutted on interest income (that comprised 85% of total revenue of the Company for 2017- 18) since its initial measurement is in accordance with the sanction letter issued by the Company to the borrower and is directly in proportion to the loan sanctioned. By its very character, being contractually determined as a percentage of the loan given, existence/ entitlement to the interest income cannot be doubted once the loan is disbursed.

The ET had performed direct confirmation procedures for loan balances wherein confirmations were received for a substantial portion of the Company's loan portfolio and no significant differences were noticed on such confirmations. In substance, most of the revenues are derived from underlying assets by way of loans and investments and their computation is highly automated being driven by terms of contract. However, as regards recognition of interest income, the same is to be recognized on accrual basis for all accounts determined as 'Standard' under the RBI guidelines and on cash basis for all NPAs. Thus

income recognition for interest follows directly from the status of the loan account which involves evaluation. Further, analysis of the same against requirements of SA 315 is explained in response to your comments in the para after the next. It is for this reason that revenue recognition for interest was not identified with Fraud Risk as summarized in WP attachment 2.14.2.10.

On the basis of the above, we submit that the EQCR review covered all key matters and aspects and did not lack seriousness and the EQCR review was not performed as a mere formality as inferred.

e) The RBI matters covered in para 6 of your comments were also discussed with EQCR as evidenced by the meeting minutes in attachment 2.15.1.10, 4.2.1.10, 4.7.1.1.10 and Audit Committee Presentation. The matter was indeed covered with the EQCR with the inclusion of the disclosure in Note 2.6.4 of Annexure II to note no. 27 (b) of the financial statements as required under RBI guidelines for exceeding of limit as well as inclusion of the same in our presentation to the Audit Committee refer slide 14, both of which were reviewed by the EQCR as well.

f) As per SA 580, the auditor is required to seek and obtain written management representations, which was done in the instant case. Against various points raised by the Authority, we have provided our responses on each issue. The EQCR partner has reviewed all key matters and has followed the required procedures so that these are appropriately dealt with.

Based on our response as above, we submit that:

- there is no failure on the part of the EQCR Partner as alleged;

- the Engagement Team led by Engagement Manager and Engagement Partner have obtained independent/corroborative evidence as necessary;

- the Engagement Team led by Engagement Manager and Engagement Partner were skeptical wherever necessary;

g) there is no failure by the EQCR Partner to bring any notice to key matters not appropriately

dealt with during the audit. Refer WP 3.4.2.60 wherein EQCR has confirmed that he has discussed significant matters with the engagement partner. Also, in the same WP, EQCR has confirmed that he had reviewed the financial statements and the proposed auditors' report and has considered that the proposed auditors' report is appropriate. EQCR has also confirmed that he had reviewed the selected working papers, the same is evident from his sign offs on key work papers.

We confirm that the meeting on 4th April, 2018, with the EQCR did happen. A calendar invite for the same was circulated for that date which is attached herewith refer Annexure 4. Further, The EQCR and partner have signed off the work paper that captures the matters discussed evidencing the discussion."

2.16.3 NFRA had examined the above contentions of the **Audit Firm** and has concluded as follows in **DAQRR**:

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 Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA. While International Auditing Standards/ PCAOB Standards may have persuasive value, and may, in many cases, also be similar to, or even identical with, SAs in force in India under Section 143(10) of the Companies Act, 2013, the use of such other references, and the complete absence of reference to India's statutorily prescribed SAs indicate clearly a cut-and-paste approach to documentation. This shows that the documentation has only been prepared as a mere formality that does not comply with even the form, much less with the substance of the SAs. The EQCR Partner has failed to counter this, and on the contrary, has mentioned that, as per his knowledge, no matters have come to his attention that causes him to believe that the audit was not performed in accordance with the relevant auditing standards.

b) In Para 2.2 above, it has been conclusively shown that 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. This was compounded by further violations of Section 144 of the Act. The declaration of eligibility submitted by the **Audit Firm**, under Section 139 (1) of the Companies Act, 2013, is also fraudulent. Further, the **Audit Firm's**

compliance with the fundamental principles of independence was completely compromised by the self-interest threat which occurred due to the financial interest and dependence on fees from the client group. 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 EQCR Partner failed to evaluate the **Audit Firm's** independence in relation to the specific engagement. Thus, the Engagement Quality Control Review Partner was guilty of professional misconduct arising out of gross violations of the law and the applicable Accounting Standards.

c) As shown in Para 2.4 above, the **ET** knew that the disclosure made by the Management regarding NOF/CRAR was both inappropriate and insufficient. The **ET** failed to carry out the evaluation of Management bias as required by Para 12 of SA 700 (Revised) and Para A10 of SA 450. The **ET** also ignored the overwhelmingly clear legal position and chose to accept the stand taken by the Management without questioning it even once. Clearly, the preconditions for an EoM Para as laid down by Para 6 of SA 706, were not met. The EoM was inappropriate and soft reporting of a very serious matter. Further, the Financial Statements never disclosed the calculation of NOF/CRAR as per the RBI's method. As a result, the financial impact of the significant variation could not be ascertained. The **ET** failed to report material misstatement known to them to appear in the Financial Statements. The EQCR Partner actually failed to review the audit WPs in this regard, and merely signed off the WPs as a formality.

d) Para 2.6 above brings out that there had been a woeful lack of clarity, and utter confusion had prevailed in the ROMM assessment. Further, important aspects of the Auditee Company's situation, such as its SI-NBFC status, the very disturbing RBI Inspection Reports on the Company, the wide discrepancies in reporting of NPAs, etc., had not been given adequate importance in the ROMM assessment. The audit responses planned to reduce or mitigate the identified risks and the actions taken based on the audit responses to such identified risks were insufficient, improper and inadequately carried out. The Audit Procedures performed by the **ET** were completely insufficient in relation to the requirements laid down in Paras 5.25 and 5.26 of Chapter 5 "*Areas of Audit Concern*" of the Technical Guide on Audit of NBFCs issued by ICAI. The **ET** after having identified the significant risk of Rollover of loans, failed to design and implement any response to the identified risk, as required by SA 330. The EQCR failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET. Thus, the EQCR was guilty of professional misconduct arising out of gross violations of the law

and the applicable Accounting Standards.

e) The **ET** had not obtained the Management's assessment of the applicability of the going concern assumption (Para 2.9 above); consequently, no evaluation of such assessment has been made. The evidence indicated that there were serious doubts about the justification of the case of the Going Concern assumption in the present case. The **ET** has completely failed in displaying the required professional skepticism and obtaining sufficient appropriate evidence on this matter and has clearly not complied with SA 570. And the EQCR has completely failed to examine this issue.

f) The contention of the **Audit Firm** is that the involvement of EQCR can be proved from the signed working papers. However, 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 Working Paper. 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.

g) Even though the EQCR team has claimed to have reviewed multiple audit work papers, there is not a single paper in the Audit File where the EQCR has carried out independent analysis or review. Para 6 of SQC 1 defines "engagement quality control review" as *a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the ET made and the conclusions they reached in formulating the report*. Thus, the process required objective evaluation and separate working needs to be done for the purpose of evaluation of significant judgments and to verify the results. The same was not done by the reviewer.

h) The EQCR has also failed to document various requirements as required by Para 25 of SA 220. The review of multiple audit work papers and signatures on the same without any kind of independent analysis and work papers show that the evidence of EQCR involvement is false. EQCR should have documented its working properly and separately from the working of the Audit team.

2.16.4 Having examined the responses of the Audit Firm, NFRA concluded as follows in the DAQRR:

a) The documentation of the EQCR processes does not provide any evidence of the proper and complete performance of the EQCR work by the EQCR Team.

b) EQCR was not carried out in the manner stipulated by SQC 1 and other applicable SAs.

c) EQCR Partner has not exercised due diligence, and has been grossly negligent in the conduct of his professional duties.

d) EQCR Partner has failed to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

e) EQCR Partner has also failed to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

2.16.5 The **Audit Firm's** responses, in response to the observations of NFRA in the **DAQRR**, have been examined, and NFRA's conclusions thereon are as follows:

a) The Auditor has referred to Para 20 and Para 21 of SA 220, and has stated that the EQCR has fulfilled all of its roles and responsibilities, which is documented in eAudit screen 4.7.1.1 and WP attachment 3.4.2.60 of eAudit file. However, the documentation does not support this contention of the **Audit Firm** and does not bring out the work done by EQCR.

b) In response to Para 2.16.3 (a) of **DAQRR**, the **Audit Firm** has reiterated their earlier contentions about compliance with the Indian SAs. *As stated in **DAQRR***, the supposed equivalence of International Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA; While International Auditing Standards/ PCAOB Standards may have persuasive value, and may, in many cases, also be similar to, or even identical with, SAs in force in India under Section 143(10) of the Companies Act, 2013, the use of such other references, and the complete absence of reference to India's statutorily prescribed SAs indicate clearly a cut-and-paste approach to documentation. This shows that the documentation has only been prepared as a mere formality that does not comply with even the form, much less with the substance of the SAs. The EQCR Partner has failed to counter this, and on the contrary, has mentioned that,

as per his knowledge, no matters have come to his attention that causes him to believe that the audit was not performed in accordance with the relevant auditing standards. The above issue gets vindicated by the fact that in response to Para 2.4.3.d (RBI_NOF/CRAR Para), the **Audit Firm** has referred to Paragraph 96 of IAS 1, which is not part of Ind AS 1, the applicable law in India. Hence, it was concluded in Para 2.4 that the **Audit Firm** is trying to mislead NFRA by reiterating facts without any substantive evidence and quoting wrong provisions of Accounting Standards.

c) *In response to Para 2.16.3 (b) of **DAQRR**,* the **Audit Firm** referred to their response to Para 2.2. ET's evaluation of the firm's independence is documented as part of the Engagement Acceptance process in attachment '1.1.1.50 Approved EAF' a copy of which is also sent to EQCR as stated therein. Further, both the EP and EQCR have signed off the eAudit Screen 4.5.3_Independence and Ethical requirements. The EQCR made his own assessment of independence in eAudit screen 4.7.1.1.

The Auditor has not given any new reference that can prove their contention valid with regard to audit work and review by EQCR. Therefore, NFRA reiterates its conclusion that 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. This was compounded by further violations of Section 144 of the Act as explained above. The declaration of eligibility submitted by the **Audit Firm**, under Section 139 (1) of the Companies Act, 2013, was fraudulent. The EQCR Partner failed to evaluate the **Audit Firm's** independence in relation to the specific engagement.

d) In response to Para 2.16.3 (c) of **DAQRR**, the **Audit Firm** referred to the facts given in para 2.4, *RBI Inspection Matters: NOF/CRAR* wherein the basis of the ET's conclusion on the appropriateness and sufficiency of the disclosure related to significant matter were explained and the same were properly reviewed, assessed and documented by the EQCR in eAudit screen 4.7.1.1.

In para 2.4 of this report, NFRA has already explained all the facts and its observation regarding NOF/CRAR Para including management bias by referring to the relevant applicable laws and concluded that the procedure adopted by the Auditor or ET was not appropriate. Further, the eAudit screen 4.7.1.1 of eAudit file is a simple checklist which cannot be accepted as EQCR documentation for significant matters. The EoM was inappropriate and soft reporting of the serious matter of NOF/CRAR. Further, the Financial Statements did not disclose the numbers arising out of calculation of NOF/CRAR as per the

RBI's method. As a result, the financial impact of the significant variation could not be ascertained by any user. The **ET** failed to report material misstatement known to them to appear in the Financial Statements. The EQCR Partner actually failed to review the audit WPs in this regard, and merely signed off the WPs as a formality.

e) In response to Para 2.16.3 (d) of **DAQRR**, the **Audit Firm** has requested to consider the audit work explained by the auditor in Para 2.6 of their reply and also mentioned WP 2.14.1.20 (RAPD minutes of meeting) and WP 2.15.1 (topic- wise involvement of the EQCR in the risk assessment). Going through the response, it is observed that same points/facts and WPs which were considered at **DAQRR** stage have been reiterated by the Auditor. Therefore, NFRA reiterates its opinion regarding EQCR review related to ROMM because no new evidence is produced by the Auditor. The EQCR failed miserably in providing an objective evaluation of the significant judgements regarding ROMM made by the ET. Thus, the EQCR was guilty of professional misconduct arising out of gross violations of the law and the applicable Accounting Standards.

f) *In response to Para 2.16.3 (e) of **DAQRR**,* the **Audit Firm** has submitted that in addition to facts given in para 2.9, the ET and EQCR displayed the necessary professional skepticism, acted in good faith and obtained sufficient appropriate evidence on this matter and complied with requirements of SA 570. However, they also acknowledge the need for a better documentation of discussions and challenges from the EQCR.

It is appreciated that the **Audit Firm** has accepted that they need to improve with regard to their documentation. However, to document any conclusion, it is important to first perform necessary Audit procedures, which is not done in this case. The **ET** had failed to obtain the Management's Assessment of the applicability of the going concern assumption (Para 2.9 above); consequently, no evaluation of such assessment has been made by the EQCR team. This indicates that the EQCR has completely failed to examine the issue regarding Going Concern.

g) In response to Para 2.16.3 (f) of **DAQRR**, the **Audit Firm** has emphasized sign off of documents done by the EQCR. However, as already discussed in the foregoing paras of the report, WP 4.7.2.30-Audit Committee Presentation was a presentation prepared by both the Auditors. It does not mention/show/record "what matters were discussed and what conclusions were reached". Interestingly the Auditor did not prepare any internal minutes for the same also. Therefore, merely signing off a presentation would not prove that the EQCR has done any independent Analysis or questioned the ET on the reversal of ₹175

Crores from provision for general contingencies.

h) In response to Para 2.16.3 (g) of **DAQRR**, the **Audit Firm** has stated the assessment done by the EQCR is documented in eAudit screen 4.7.1.1 which includes overall assessment of the quality of the audit documentation, the communication to TCWG, etc. After examining eAudit screen 4.7.1.1, it is seen that this document does not have any independent analysis or review *to provide an objective evaluation, of the significant judgments the ET made and the conclusions reached in formulating the report*, as provided by Para 6 of SQC 1. Therefore, it is concluded that the EQCR process was not carried out in the manner stipulated by SQC 1 and other applicable SAs.

i) In response to Para 2.16.3 (h) of **DAQRR**, the **Audit Firm** has submitted that Para 25 of SA 220 does not require the EQCR to maintain separate documentation. However, it may be noted that Para 25 of SA 220 requires the EQCR to record his assessment that the significant judgments the ET made and the conclusions they reached were indeed appropriate. There is no working or documentation and minutes of discussion to show that the EQCR review had been completed on or before the date of the auditor's report; and no unresolved matters was pending before the reviewer to believe that the significant judgments the ET made and the conclusions, they reached were appropriate.

2.17 SQC 1 COMPLIANCE: POLICIES & PROCEDURES

2.17.1 In its communication dated 25th April, 2019, NFRA had asked following clarifications from the **Audit Firm**:

a) Why do you have two separate overlapping documents for complying with SQC 1?

b) Out of the two separate overlapping documents, which document should be considered?

c) What enquiries/steps were performed before acceptance of the audit engagement?

2.17.2 The **Audit Firm**, in its response dated 6th June, 2019, had stated as follows:

a) "The document titled, "Serving the Public Interest through Independence, Integrity, Ethics, Objectivity, and Quality Performance" lists down the policies and procedures of the firm with specific focus on Independence. The document titled, "Firm's policies and procedures with regard to compliance with SQC 1 including independence requirements" is an additional document, which provides mapping with various components laid down in SQC 1, for an easy cross-reference. Both the documents essentially cover the similar matters and consistent in terms of policies and procedures of the firm.

b) You may please consider the document with title "Serving the Public Interest through Independence, Integrity, Ethics, Objectivity, and Quality Performance" as primary document and may refer the other document for mapping perspective.

c) The client acceptance was carried out as per the laid down policies and processes of the firm. As a process, the ET carried out an evaluation of the client including:

i. its business, legal structure and nature of operations

ii. any adverse remark in the latest available audited Financial Statements/ review report and results

iii. background checks

iv. reasons for proposed appointment of the firm as a joint auditor

v. overall governance structure including the composition/profile of the BOD and audit committee members

vi. Any independence conflicts

vii. Communication with the predecessor auditor (which also continued as the joint auditor) for any reason, professional or otherwise, which we should be aware of, prior to our appointment as joint auditors of the Company.

viii. Overall reputation of the company including its credit ratings.

Besides the above, the firm also considered the overall composition of the ET and EQCR to ensure that their experience and specialization is commensurate with the industry and size of the client. The documentation of the various steps performed before acceptance of the audit engagement can be found in section 1.1.1 of our eAudit File."

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

a) The **Audit Firm** has referred to various International Standards in the policy documents, which is totally an extraneous material and which the majority of the workforce of the **Audit Firm** in India will have no occasion whatsoever to deal with in the course of their engagement. 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 Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA;

b) The section on Independence (Para 2.2 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.

c) Details of the written confirmation required to be obtained from the **Audit Firm** personnel are not available in the document referred by the **Audit Firm** and hence it is presumed that no such confirmations were in fact obtained.

d) No details were provided about the actions to be taken by the **Audit Firm** to mitigate and eliminate the familiarity and self-interest threat though the **Audit Firm's** compliance with the fundamental principles of the Code of Ethics was threatened by familiarity and self-interest threat.

e) 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 **DAQRR**. 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, and the evident confusion in assessing the ROMM and its impacts on the Audit responses and evidence obtained. Attention is also drawn towards failure of the **Audit Firm** to examine that internal controls pertaining to "Lending" and "Assets" in place were adequate and operating effectively, failure to obtain and evaluate the Management's assessment of the applicability of the going concern assumption, failure 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 communicate significant matters in a timely manner to appropriate persons or TCWG, soft reporting of a very serious matter of NOF/CRAR, and the sham character of the EQCR, as evidence of the need to revamp the QC policies and processes of the **Audit Firm**;

f) 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;

g) NFRA, therefore, is of the 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.

2.17.4 In response to the observations of NFRA in the **DAQRR**, the **Audit Firm's** responses have been examined and NFRA's conclusions thereon are as follows:

a) The **Audit Firm** has stated that *the matters included in **DAQRR** were not a part of prima-facie observations raised by the NFRA and are new matters included in the **DAQRR**. The responses referred in paragraph 2.17.2 were submitted by the Firm vide its letter dated 6 June 2019, not on 10 September 2019 as stated in the **DAQRR**.*

Even though all the above stated matters were not part of the prime-facie conclusions, the same were included in the **DAQRR**. The comment "Noted" (at PFC stage) was not a conclusion on the effectiveness of the design and implementation of the QC Policies. Further, NFRA accepts that the date stated in paragraph 2.17.2 should be 6th June, 2019 instead of 10th September, 2019 and the correction has now been made.

b) In response to Para 2.17.3.(i), the **Audit Firm** states that *the policy document is completely based on Indian Standards and other regulatory requirements including the Companies Act, Code of Ethics and RBI regulations. There is no reference in this policy document regarding compliance with International Standards.*

But this assertion is totally contrary to facts since the policy documents clearly indicate compliance with International requirements like Restricted Entity List (REL), Sentinel and many more. *Further, in response to Para 2.16.3 (a) of **DAQRR**, the **Audit Firm** itself has also stated that any enhanced framework, say International Standards, would not mean that the Firm doesn't comply with the applicable Indian Standards.* In response to Para 2.4.3.d (RBI_NOF/CRAR Para) also, the **Audit Firm** has referred to Paragraph 96 of IAS 1, which is not part of Ind AS 1, the applicable law in India. *As stated in the **DAQRR***, the supposed equivalence of International Standards to, or their even greater rigour in comparison with, Indian Standards is entirely irrelevant for the purposes of NFRA; The complete absence of reference to India's statutorily prescribed SAs in SQC indicate clearly a cut-and- paste approach to documentation.

c) In response to Para 2.17.3(j), the **Audit Firm** has referred to Section 2.2 of their reply. 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.

d) In response to Para 2.17.3(k), the **Audit Firm** states that *independence confirmations from professional staff are taken at the time of joining and annually thereafter, which are kept in the central database and will be provided to NFRA if the latter desires so. Moreover, engagement specific confirmations are preserved in the Audit File, obtained from key ET members involved in IFIN audit.*

NFRA observes that the most of the independence confirmations (including that of the signing partner) comprises the heading "*Annual Confirmation by members of IL& FS Financial services Limited"*, which altogether gives a false impression, that the concerned persons are members of IL& FS Financial Services Limited, and not the members of the audit team of IFIN. The work paper mentioned by the **Audit Firm** nowhere depicts that it belongs to BSR & Associates LLP, making it an unacceptable document. Hence, it is concluded that written confirmation required to be obtained from the **Audit Firm** personnel are not obtained or documented properly.

e) In response to Para 2.17.3(l), the **Audit Firm** has stated *that to mitigate the familiarity and self-interest threat, the Firm has established partner rotation policy in compliance with the requirements of Standard of Quality Controls, the ET members had no previous association with the client and were not involved in any other assignments in connection with IFIN. The Firm has comprehensive independence policies and controls over non-audit services to an audit client which has been detailed in Sec 2.2 'Compliance with Independence Requirements'.*

As shown in the Para on Independence, the **Audit Firm** is in breach of the independence in mind and independence in appearance required of the **Audit Firm**. As shown by Table 2.2 in the **DAQRR**, non-audit fee income over the five years ending with the audit period was many times higher than statutory audit fees and was significant enough to pose a major self-interest threat. Receipt of non-audit services fees amounting to ₹11.5 Crores in a period of 5 years, as opposed to Audit Fee revenue of ₹2 Crores, raises serious doubts over the Independence of the **Audit Firm**.

f) In response to Para 2.17.3(m), the **Audit Firm** has referred to *the responses stated in Section 2.7 – Internal Controls over Financial Reporting (ICFR), Section 2.9 – Evaluation of going concern, Section 2.11 – Investments, Section 2.14 – General contingency provision, Section 2.3 - Communication with TCWG, Section 2.4 -RBI Inspections Matters– NOF/CRAR and Section 2.16 - EQCR Processes.*

NFRA has already examined the responses of the **Audit Firm** in various Paras mentioned above. Hence, NFRA reiterates its observation from the **DAQRR** stage. "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, and the evident confusion in assessing the ROMM and its impacts on the Audit responses and evidence obtained. Attention is also drawn towards failure of the **Audit Firm** to examine that internal controls pertaining to "Lending" and "Assets" in place were adequate and operating effectively, failure to obtain and evaluate the Management's assessment of the applicability of the going concern assumption, failure 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 communicate significant matters in a timely manner to appropriate persons or TCWG, soft reporting of a very serious matter of NOF/CRAR, and the sham character of the EQCR, as evidence of the need to revamp the QC policies and processes of the **Audit Firm**."

g) In response to Para 2.17.3(n), the **Audit Firm** has stated that the issues highlighted by the NFRA in relation to the audit evidence are not reflective of a breakdown of the Firm's overall QC system and the NFRA's suspicion and allegation towards the Firm's alignment with the interests of the Management are denied. However, as shown in various Paras above, the collusion of the **Audit Firm** with the interest of the Management in the respective sections of the report clearly indicates the breakdown of the QC system.

h) NFRA, therefore, reiterates its opinion that the **Audit Firm** would be well advised to put in place mechanisms to comprehensively revise its policy documents to ensure that they conform to SQC 1, and to monitor compliance with such revised policy.

Approved by the Executive Body of NFRA for Issue

Vivek Narayan

(Vivek Narayan)

Secretary, NFRA

Annexure I

Chronology of Events

S. No.	Date	Event / Correspondence
1	07.02.2019	Formal letter of NFRA letter sent to BSR requesting for the IFIN 2017-18 Audit file.
2	24.04.2019	Submission of information by BSR regarding RBI related matters and SQC Policies
3	25.04.2019	NFRA's letter dated 25.04.2019 sent to CA N.Sampath Ganesh (Engagement Partner) seeking list of related parties and Audit/Non-Audit revenue in stipulated format under Affidavit.
4	10.05.2019	NFRA's letter dated 10.05.2019 containing Questionnaire, sent via email on 10.05.2019 to CA N.Sampath Ganesh seeking replies to the same.
5	15.05.2019	Reply of CA N.Sampath Ganesh to NFRA letter dated 25.04.2019 without affidavit and also sent via email by CA N.Sampath Ganesh.
6	17.05.2019	Reply of CA N.Sampath Ganesh to NFRA letter dated 25.04.2019 under affidavit and also sent via email by CA N.Sampath Ganesh.
7	24.05.2019	Email to CA N.Sampath Ganesh calling for meeting in NFRA Office on 28.05.2019
8	03.06.2019	Email to CA N.Sampath Ganesh sharing the minutes of meeting in NFRA office on 28.05.2019
9	06.06.2019	Email from CA N.Sampath Ganesh in response to NFRA Letter No. 11013/2/2018 dated 10.05.2019
10	17.07.2019	Submission of additional information via email from CA N.Sampath Ganesh in response to NFRA Letter No. 11013/2/2018 dated 10.05.2019
11	07.08.2019	NFRA's letter dated 07.08.2019 to CA N.Sampath Ganesh conveying its prima facie Observations / comments/ conclusions on the various issues in the questionnaire.
12	30.8.2019	Reply (1/2) of CA N.Sampath Ganesh dated 30.08.2019 to NFRA's letter dated 07.08.2019.
13	10.9.2019	Reply (2/2) of CA N.Sampath Ganesh dated 30.08.2019 to NFRA's letter dated 07.08.2019.
14	1.10.2019	Letter to CA N.Sampath Ganesh seeking copy of invoices and copy of engagement letter with reference to BSR's affidavit dated 17th May 2019

S. No.	Date	Event / Correspondence
15	14.10.2019	Letter to CA N.Sampath Ganesh regarding verification of dating of audit file and Procedures /IT safeguards pertaining to integrity of dating.
16	15.10.2019	Submission of Engagement Letters and Invoices by BSR in response to the NFRA's Letter dated 01.10.2019
17	23.10.2019	NFRA's letter dated 23.10.2019 containing Additional Questionnaire, sent via email on 23.10.2019 to CA N.Sampath Ganesh.
18	01.11.2019	Reply of CA N.Sampath Ganesh dated 01.11.2019 to NFRA's letter dated 14.10.2019 regarding verification of dating of audit file and procedures/IT safeguards pertaining to integrity of dating.
19	20.11.2019	Reply of CA N.Sampath Ganesh dated 20.11.2019 to NFRA's letter dated 23.10.2019 seeking responses to the additional questionnaire raised by NFRA
20	17.01.2020	Letter to CA N.Sampath Ganesh seeking additional information with reference to the various Engagement Letters and invoices raised on ILFS group companies by BSR.
21	25.01.2020	Reply of CA N.Sampath Ganesh dated 25.01.2020 to NFRA's letter dated 17.01.2020
22	30.03.2020	Issue of Draft AQR Report (DAQRR)
23	30.05.2020	Written replies furnished by CA N. Sampath Ganesh to NFRA's observations in the DAQRR
24	27.07.2020	Online Presentation to NFRA by CA N.Sampath Ganesh from BSR & Associates LLP (Auditor) and CA Kishore Kaushal and CA V. Venkataramanan from BSR & Co. LLP
25	08.08.20	Submission of Documents by BSR as asked for by NFRA on 27.07.2020.
26		Issuance of the final AQR Report by NFRA.

Annexure II

ICRA

IL&FS Financial Services Limited

March 28, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper programme	3,000.00	4,000.00	[ICRA]A1+; assigned
Total	**3,000.00**	**4,000.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 4,000 crore[1] (enhanced from Rs. 3,000 crore) commercial paper programme of IL&FS Financial Services Limited (IFIN)[2].

Rationale

The rating takes factors in IFINs strong parentage being a wholly owned subsidiary of Infrastructure Leasing and Financial Services Limited (IL&FS; rated [ICRA]AAA(stable)/[ICRA]A1+), its strategic importance to the IL&FS Group by virtue of being the key non-banking financial company (NBFC) for the group and the consequent expected operational and financial support from the parent. The rating also factors in the group's substantial experience and strong franchise in the execution and funding of infrastructure projects, company's diversified resource profile, adequate capitalization and liquidity position. The rating also takes into account the attendant the credit and concentration risks associated with the wholesale funding business model, deterioration in asset quality and consequently subdued profitability indicators. The company's conservative provisioning policy, however, provides some comfort. Going forward, the company's ability to ramp up and diversify its loan-book and improve its asset quality and profitability indicators would remain critical from a credit perspective.

Key rating drivers

Credit strengths

Strong parentage by virtue of being a subsidiary of IL&FS (rated [ICRA]AAA(Stable) / [ICRA]A1+) – IFIN, registered as a non-banking finance company (NBFC), is a wholly owned subsidiary of IL&FS which has diverse business interest in the infrastructure space. IFIN acts as the key financial service and infrastructure advisory company of the group and houses the asset and structured finance business, syndication business and corporate and project advisory business, in addition to its lending operations. The company draws significant support from the IL&FS group in terms of operational and managerial assistance.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications*

Group's strong franchise in infrastructure-related project development - The IL&FS group, which refers to IL&FS along with its subsidiaries, associates and joint ventures, is a diversified infrastructure developer with presence across sectors like surface transportation, urban infrastructure, energy (thermal and renewable), education, and maritime & ports. The group is engaged in all aspects of project development including project sponsorship, development and advisory services, investment banking, corporate advisory, asset management and advisory services in environmental and social management. The IL&FS group has a long history of business operations, spanning over three decades, and has been able to establish a strong brand name within this space supported by its demonstrated track record as well as domain expertise of its senior management. The company draws the advantage of being part of the IL&FS group by catering to the in-house demand for infrastructure advisory and resource syndication services, which has helped drive the company's fee based income which in-turn has supported its profitability levels in the past.

Adequate capitalisation and comfortable liquidity profile - IFIN's regulatory capital adequacy remains adequate at 18.52% as of September 30, 2017 (tier I of 11.56%), albeit lower than 21.08% (Tier 1 of 13.15%) as on March 31, 2017. ICRA however takes note of the increase in gearing levels to 7.95 times as of September 30, 2017, up from 7.56 times as on March 31, 2017 (from 6.18 times as on March 31, 2015). In ICRA's view however, given the importance of the entity to the parent coupled with IFIN's moderate growth targets, capital is not expected to be a constraint over near to medium term. IFIN maintains comfortable short-term liquidity profile with large part of the loan book with residual maturity of less than one year, adequate proportion of long term borrowings and unutilised bank lines. The liquidity profile is further enhanced with IFIN having access to the surplus liquidity at the group level as the treasury operations are integrated with IL&FS.

Strategic importance to the overall IL&FS portfolio - IL&FS considers the financial services operations crucial for their business and thus considers IFIN strategically important to the group. Given the group's presence in infrastructure segment, involving long-gestation capital-intensive projects, the IFIN's support to the group, in its capacity as a lender and advisor, remains critical. Additional, IFIN remains a major source of dividend income to IL&FS The presence of key senior executives and directors of IL&FS on the board of IFIN further underscores its relevance to the group.

Credit challenges

Relatively risky wholesale lending model with high concentration in loan-book - The company largely caters to corporates (including group companies) operating in the infrastructure and real estate space in its lending business. IFIN's loan-portfolio increased to Rs. 14,470 crore as of September 30, 2017, up from of Rs. 12,415 crore as of March 31, 2017, driven by disbursements in the infrastructure segment. Infrastructure, promoter funding, real-estate and other segments attributed to 39%, 20%, 17% and 23% of the loan-book respectively as on March 31, 2017. The client concentration in the loan-book remains high with the top ten group exposures (excluding related party lending) attributing to 28% of the loan-book as of March 31, 2017 (25% of loan book as of March 31, 2016).

Ability to manage asset quality of the portfolio - IFIN's asset quality moderated in FY2014, precipitated by the general economic stress. The trend continued in the following years, with a further deterioration in asset quality. The company's gross non-performing asset (NPA) increased to Rs. 410 crore as of March 31, 2017 from Rs. 350 crore as of March 31, 2016. NPAs in relation to the advances, as defined by gross NPA to gross advances increased to 3.30% from 2.80% in the same period, and further to 4.48% as of September 30, 2017. The company's conservative provisioning policy, however, provides some comfort. The company has created a provision for general contingency (Rs. 500 crore as on September 30, 2017) in addition to the specific provision and standard asset provisions as required under RBI regulations. Given the high risk profile of these segments, large ticket size nature of advances and the high concentration in the portfolio, more vulnerable to a lumpy deterioration in asset quality in case of any slippages.

Modest financial profile - The company reported a total revenue of Rs. 2,347 crore in FY2017 as against Rs. 1,922 crore in FY2016 registering a growth of 22% driven by healthy increase in interest income. Fee based income registered a growth in FY2017 of Rs. 185 crore as against Rs. 170 crore in FY2016). IFIN's net profitability continues to remain under pressure on the back of increase in credit costs and other provisions; the total provisions and write offs (including contingency provisioning) increased to 2.00% of ATA in FY2017 vis-à-vis 1.28% in FY2016. IFIN's profit after tax (PAT) dipped to 1.11% of ATA in FY2017 from 1.15% in FY2016. On an absolute basis, IFIN reported profit after tax of Rs. 208.8 crore in FY2017 (Return on equity or RoE of 9.91%) as against Rs. 192.8 crore in the previous fiscal (RoE of 9.43%). The company reported an operating income of Rs. 1,101 crore H1 FY2018 and the profitability continued to remain subdued with RoA of 0.92% and RoE of 8.51%. Going forward, the company's ability to maintain a high level of fee income would be instrumental in supporting the profitability levels.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

ICRA's Credit Rating Methodology for Non-Banking Finance Companies
ICRA's Approach for Rating Commercial Papers

About the company

IL&FS Financial Services Limited

IL&FS Financial Services Ltd. (IFIN) is a wholly owned subsidiary of Infrastructure Leasing and Financial Services Limited (IL&FS) (rated [ICRA]AAA (stable) and [ICRA]A1+). IFIN was initially incorporated as IL&FS Asset Management Company (AMC) in 1997. After IL&FS sold the AMC business to UTI in 2004, the company obtained a NBFC license in 2005 and was renamed as IL&FS Finvest Ltd. In line with the overall strategy of the group to create distinct verticals for each business, the banking team from IL&FS and the syndication team from IL&FS Investsmart Ltd. were integrated under IL&FS Finvest Limited and subsequently the name of the integrated entity was changed to IL&FS Financial Services Ltd. IFIN commenced its new business activities in October 2006, in the various business lines like asset and structured finance business, syndication business, and corporate and project advisory business.

During FY2017, IFIN reported a net profit after tax of Rs. 209 crore on a total income base of Rs 2,346 crore as compared to a net profit of Rs. 193 crore on a total income base of Rs 1,921 crore in FY2016. During H1 FY2018, IFIN reported a net profit of Rs. 92 crore on a total income of Rs. 1,101 crore.

Infrastructure Leasing and Financial Services Limited

IL&FS Limited was incorporated in 1987 with the objective of promoting infrastructure projects in the country. IL&FS was promoted by the Central Bank of India (CBI), Housing Development Finance Corporation Limited (HDFC) and Unit Trust of India (now, Specified Undertaking of Unit Trust of India - SUUTI). While SUUTI has largely exited (stake of 0.82% as on December 31, 2016), the shareholding has broadened over the years with the participation of many institutional shareholders. As on March 31, 2017, Life Insurance Corporation of India (LIC) and ORIX Corporation Japan were the largest shareholders in IL&FS with their stake holding at 25.34% and 23.54% respectively, while Abu Dhabi Investment Authority (ADIA), HDFC, CBI and SBI stake holding are at 12.56%, 9.02%, 7.67% and 6.42% respectively.

Over the years IL&FS' focus has steadily shifted from project sponsorship to that of project advisory and project facilitator for development and implementation of projects. IL&FS acts as the main holding company of the IL&FS Group with most business operations domiciled in separate companies. IL&FS's group companies are currently involved in infrastructure related project sponsorship, development & advisory, investment banking, corporate advisory, asset management and advisory services in environmental and social management, with presence across sectors like surface

transportation, urban infrastructure, energy (thermal and renewable), education, maritime & ports etc. The group has a long history of business operations, spanning over three decades, in the infrastructure domain and has been able to establish a strong brand name within this space supported by its demonstrated track-record as well as domain expertise of its senior management.

During FY2017, on a standalone basis, IL&FS reported a net profit of Rs. 383 crore on a total income of Rs. 1,787 crore.

Key financial indicators (audited)

	FY2016	FY2017	H1 FY2018 (limited review)
Total Income	1,921	2,346	1,101
Profit after tax (PAT)	193	208	92
Net Worth^	2,057	2,157	2,169
Total managed portfolio	12,523	12,415	14,470
Total managed assets	17,956	19,563	20,722
Return on managed assets (PAT/AMA)	1.15%	1.11%	0.92%
Return on average net worth (PAT/Avg. net worth)	9.43%	9.91%	8.51%
Gearing (times)	7.23	7.56	7.95
Gross NPA%	2.80%	3.30%	4.48%
Net NPA%	2.20%	2.36%	3.13%
Net NPA/Net worth	13%	13%	21%

^Net worth does not include preference share capital with premium; Total Debt = Borrowings + preference share capital + Interest accrued on borrowings
#AMA – average managed asset
Amounts in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Current Rating (FY2018) Rated amount (Rs. crore)	Amount Outstanding (Rs Crore)	Mar-18	Chronology of Rating History for the past 3 years FY2018 Feb-18	Nov-17	FY2017 Mar-17	FY2016 Mar-16	Dec-15
1.	Commercial Paper Programme	Short Term	4,000	NA	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

ICRA

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Commercial Paper	NA	NA	7-365 days	4,000.00	[ICRA]A1+

Source: IL&FS Financial Services Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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ANNEXURE III

Details of sample documents in Audit file where there is mismatch in dates

Name of Auditor **BSR & Associates LLP** Name of Entity **IL&FS Financial Services Limited (IFIN)**

Date of signing of Engagement Letter – **01 February 2018** FY **2017-18**

Date of signing of Audit Report – **28 May 2018** Last date for closing the Audit File - **27th July, 2018**

S.N.	Document No in Audit File	Name of Document	Type of Document Word / Excel / PDF. Etc.	Name of each person who has completed / reviewed the document as per the signoffs	Dates of sign offs in respect of each person as in Col E.	Dates as documented in the contents of the document	Dates as per the properties of the document
1.	3.4.2.60	EQCR Checklist	Word	Prepared – Pratik Krishnani Reviewed – G N Sampath Reviewed – Akeel Master	22-May-2018 24-May-2018 24-May-2018	 24 May 2018 24 May 2018	Created – 04-07-2018 17:26 Last Modified – 04-07-2018 17:42
2.	2.3.1.10	Significant Account-Scoping	Word	Prepared – Ruchi Telang Reviewed – G N Sampath Reviewed – Akeel Master	23-Jan-2018 24-Jan-2018 03-May-2018	Prepared – Tarika Sampat Reviewed – Ritesh Sheth (Not-dated)	Created – 12-07-2018 17:36 Last Modified – 24-07-2018 15:49
3.	2.5.1.10	Meeting Minutes	Excel	Prepared – Ruchi Telang	23-Jan-2018	None	Created – 12-12-2017 12:32

S.N.	Document No in Audit File	Name of Document	Type of Document Word / Excel / PDF. Etc.	Name of each person who has completed / reviewed the document as per the signoffs	Dates of sign offs in respect of each person as in Col E.	Dates as documented in the contents of the document	Dates as per the properties of the document
				Reviewed – Ritesh Sheth Reviewed – G N Sampath Reviewed – Amod Sagvekar Reviewed – Akeel Master	23-Jan-2018 24-Jan-2018 24-Jan-2018 03-May-2018		Last Modified – 24-07-2018 18:22
4.	2.14.2.10	Fraud Risk assessment	Word	Prepared – Ruchi Telang Reviewed – Anuj Rawat Reviewed – G N Sampath Reviewed – Akeel Master	24-Jan-2018 19-Apr-2018 26-Apr-2018 03-May-2018	Prepared – Tarika Sampat (Not-dated)	Created – 23-07-2018 18:52 Last Modified – 26-07-2018 23:01
5.	4.7.2.30	AC Presentation	PPT	Prepared – Tarika Sampat Reviewed – Anuj Rawat	28-May-2018 28-May-2018 28-May-2018	28 May 2018	Created – 19-12-2014 15:02 Last Modified – 26-07-2018 17:28 Author – Kalpesh Mehta (DHS)

S.N.	Document No in Audit File	Name of Document	Type of Document Word / Excel / PDF. Etc.	Name of each person who has completed / reviewed the document as per the signoffs	Dates of sign offs in respect of each person as in Col E.	Dates as documented in the contents of the document	Dates as per the properties of the document
				Reviewed – G N Sampath Reviewed – Akeel Master	28-May-2018		

Annexure IV

Queries Put-up with Audit Firm during IT Systems & Procedures Review

S.No.	Queries Put-up with Audit Firm
1.	Copy of Release note for eAudit version is in use?
2.	Required Application Architecture? Integration if any?
3.	11 Roles and responsibility matrix for all roles under the drop down available at the time of creation of engagement – Access and Privilege?
4.	0365 server locations? DC and DR site?
5.	eAudit Server administrator level of access – Application, DB and Storage (Archival).
6.	Sentinel Number – when it gets expired? where it gets generated etc. – who all approves it, Roles and name? Risk formalities.
7.	Proof that every year we do sentinel for same engagement/ sharing of sentinel information happens within the firm or just one entity (BSR). What all information or resources are shared with other division or Global division?
8.	Review notes process – purged at time of sign off process.
9.	Is there log for any change made in document or the document has been replaced?
10.	Screen shot – ACL – For Drop box (Storage) + System Time stamp.
11.	Closed file - PDF – how and who generated and share with NFRA?
12.	Network architecture in place for Audit with controls are place + security.
13.	SIEM tool (Security Incident Event Management Tool) If Yes then what rules are configured for alerts/monitoring when are these rules configured?
14.	DB, Archival and Application access – ACL and screen shot.
15.	Reopen Workbook? in a closed out file - who all have the access and process around? If you open locked engagement reopen workbook there should be some alert and logs.
16.	How many times RET and PDF are generated for IFIN?
17.	Log for Archival and Retrieval process for Eng. and RET file.
18.	Change management process in Audit? Post closeout.
19.	Hard delete of engagement process who has the authority to delete and approve.

20.	Document on support matrix and model. Global team handles v/s Local team.
21.	Does system throw an alert if same user logged in from more than two system.
22.	Patch Management - Screen shot for Server - OS, Application and process for patch management and frequency.
23.	SQL Server - Reopening of closed file is the earlier data updated or appended. (Ref#15)
24.	SDLC - eAudit Application – Global.
25.	Application security testing report, configuration review report, integrated services and VAPT of eAudit. Write up on Global security practices? (Summary)
26.	why P1 generate two separate files after you reopen workbook where in PII is shows only 1 file?
27.	For listed client in last 3 years - List of Opinion date, last date of archival as per firm policy and actual archival date Do you maintain for all the above listed clients - any document report - document properties of created and last modified dates mapped to their prepared and reviewed sign off dates? if Yes provide if No then how do you monitor.